Earl of Balfour v Revenue & Customs [2009] UKFTT 101 (TC) (14 May 2009)
INHERITANCE TAX
Business/agricultural reliefs

[2009] UKFTT 101 (TC)

TC00069

Appeal number SC/3212/2007

Inheritance Tax; business property relief; liferent; partnership; replacement property; Inheritance Tax Act 1984 sections 49, 105, 106, 107, 110

FIRST-TIER TRIBUNAL
TAX

ANDREW MICHAEL BRANDER, Representative of the late
Rt. HON. GERALD ARTHUR JAMES, Fourth Earl of Balfour

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

(Inheritance Tax) Respondents

TRIBUNAL: J GORDON REID QC, F.C.I.Arb

Sitting in public in Edinburgh on 9-11 December 2008

Julian Ghosh, Advocate (QC of the English Bar), instructed by Turcan Connell, Solicitors, Edinburgh for the Appellant

Roderick N Thomson QC, instructed by HMRC Solicitors' Office, for the Respondents

DECISION

Introduction

1. The executor of the Right Honourable the Fourth Earl of Balfour "Lord Balfour"), who died on 27/6/03, appeals against a Notice of Determination dated 4/9/08 by which business property relief, in respect of Lord Balfour's interest in Whittingehame Farming Company, a partnership formed in 2002, was denied for Inheritance Tax purposes. The broad issue in the appeal is the applicability of the replacement property provisions contained in section 107 of the Inheritance Tax Act 1984. In the year before his death Lord Balfour, having been declared by the House of Lords, pursuant to the Entail Amendment (Scotland) Act 1847, to be the fee simple proprietor of Whittingehame Estate, by Haddington, East Lothian, entered into a partnership (the Whittingehame Farming Company) with his intended successor, Michael Brander. The appeal involves a consideration of how the various activities on the estate were carried on between about 1999 and 2002, and the consequences in law on the business property relief regime in the 1984 Act. One particular issue, which featured prominently in the evidence, was whether the Estate was run during that period as a single unified business or whether there were separate businesses run by Lord Balfour on the one hand, who then enjoyed a liferent over the whole Estate, and the Estate Trustees on the other hand.

2. The appeal was heard at Edinburgh on 9th 10th and 11th December 2008. The Appellants were represented by Julian Ghosh, advocate, (Q.C. of the English Bar). He led the evidence of Nicholas Barrett, BSc (Hons) MRICS, FAAV, ACIArb, a senior lecturer in Rural Estate Management, in the School of Rural Economy and Land Management at the Royal Agricultural

College, Cirencester, Robert Balfour, James Donald, chartered surveyor and senior land agent with Bidwells Property Consultants, Perth, and Andrew Michael Brander, Lord Balfour's successor and the present proprietor of the Estate. Roderick N Thomson Q.C. appeared on behalf of the Respondents ("HMRC"). He led no evidence. Joint Bundles of productions were lodged by the parties. There was no dispute as to the authenticity, and where appropriate, the transmission and receipt of these documents. A Joint Statement of Agreed Facts was produced. Both counsel also produced Notes of Argument.

Legislation

3. Chapter 1 of Part V of the 1984 Act deals with business property relief. Section 103(3) provides that *business* does not include a business carried on otherwise than for *gain.* Section 104 provides that relevant business property falling within section 105(1)(a), (b) or (bb) attracts 100 per cent relief.

4. Section 105 provides *inter alia* as follows:–

(1) Subject to the following provisions of this section and to sections 106, 108, 112(3) and 113 below, in this Chapter "relevant business property" means, in relation to any transfer of value,–

(a) property consisting of a business or interest in a business:

(b) securities of a company …

(bb) any unquoted shares in a company

…

(d) any land or building, machinery or plant which, immediately before the transfer, was used wholly or mainly for the purposes of a business carried on by a … partnership of which he then was a partner: and

(e) any land or building, machinery or plant which, immediately before the transfer, was used wholly or mainly for the purposes of a business carried on by the transferor and was settled property in which he was beneficially entitled to an interest in possession.

…

(3) A business or interest in a business, …, are not relevant business property if the business … consists wholly or mainly of one or more of the following, that is to say, dealing in securities, stocks and shares, land or buildings or making or holding investments.

5. Section 106 provides that:–

Property is not relevant business property in relation to a transfer of value unless it was owned by the transferor throughout the two years immediately preceding the transfer.

6. Section 107 provides that:–

(1) Property shall be treated as satisfying the condition in section 106 above if–

(a) it replaced other property and it, that other property and any property directly or indirectly replaced by that other property were owned by the transferor for periods which together comprised at least two years falling within the five years immediately preceding the transfer of value, and

(b) any other property concerned was such that, had the transfer of value been made immediately before it was replaced, it would (apart from section 106) have been relevant business property in relation to the transfer.

(2) In a case falling within subsection (1) above relief under this Chapter shall not exceed what it would have been had the replacement or any one or more of the replacements not been made.

(3) For the purposes of subsection (2) above changes resulting from the formation, alteration or dissolution of a partnership … shall be disregarded.

…

7. Section 110 provides:–

For the purposes of this Chapter–

(a) the value of a business or of an interest in a business shall be taken to be its net value;

(b) the net value of a business is the value of the assets used in the business (including goodwill) reduced be the aggregate amount of any liabilities incurred for the purposes of the business:

(c) in ascertaining the net value of an interest in a business, no regard shall be had to assets or liabilities other than those by reference to which the net value of the entire business would fall to be ascertained.

8. Section 49(1) of the 1984 Act provides:–

A person beneficially entitled to an interest in possession in settled property shall be treated for the purposes of this Act as beneficially entitled to the property in which the interest subsists.

9. Sections 1 and 2 describe chargeable transfers and transfer of value. Section 5 provides that a person's estate is the aggregate of all the property to which he is beneficially entitled. Subject to exceptions not material here this includes an interest in possession in settled property in which the person is beneficially entitled to the interest in possession.

Notice of Determination

10. On 4th September 2008, HMRC issued a Notice of Determination (which superseded an earlier Notice dated 24/7/07 which has been withdrawn). The later notice reflects more accurately the issues between the parties and was issued by arrangement with Appellants and the Office of the Special Commissioners. In effect the current Notice determines that–

A Lord Balfour's interest in Whittingehame Farm Co (the partnership formed with Andrew Brander and commencing on 10/11/02) was not relevant business property for the purposes of section 104 having regard to the provisions of section 105(3) of the 1984 Act.

B In the alternative, Lord Balfour's interest in that partnership was not relevant business property for the purposes of section 104 having regard to the provisions of section 106.

C In the alternative–

(1) the estate management and farming activities were managed by Lord Balfour as his single composite estate management business immediately prior to the formation of the partnership,

(2) that business was not relevant business property immediately prior to the partnership having regard to the provisions of section 105(3) of the 1984 Act.

(3) the partnership replaced that business,

(4) as none of the property replaced by the partnership was relevant business property immediately before it was replaced Lord Balfour's interest in the partnership was not relevant business property for the purposes of section 104 having regard to the provisions of section 107.

D In the alternative–

(1) the estate management and farming activities were not managed by Lord Balfour as his single composite estate management business immediately prior to the formation of the partnership,

(2) the estate management activities were not relevant business property immediately prior to the formation of the partnership as it was not property falling within any of the meanings in section 105(1); or was property consisting of a business but was a business carried on otherwise than for gain or was property consisting of a business but was a business consisting wholly or mainly of making or holding investments,

(3) the partnership replaced the estate management and farming activities

(4) having regard to the sections 106 and 107(1), (2) and (3), at his death Lord Balfour's interest in the partnership was relevant business property for the purposes of section 104 to the extent only that his interest replaced property which immediately before the establishment of the partnership would have been relevant business property.

Facts

11. The parties produced a Joint Statement of Agreed Facts which is in the following terms:–

1. In terms of the Trust established by the 1st Earl of Balfour's will dated 1 January 1923 and relative codicils registered in the Books of Council and Session on 24 March 1930 ("the Trust"), The Right Honourable Gerald Arthur James, 4th Earl of Balfour and Viscount Traprain ("Lord Balfour" or "the deceased") had been a liferenter of Whittingehame Estate, East Lothian ("the Estate"), a traditional Scottish landed estate.

2. Lord Balfour acquired his liferent interest in the Estate on his father's death on 27 December 1968.

3. From 27 December 1968 until 6 November 2002 the deceased enjoyed a liferent over the whole of the Trust Estate, heritable and moveable.

4. From 27 December 1968 until his death the deceased enjoyed a liferent over the whole moveable Trust Estate.

5. The moveable Trust Estate included corporeal moveable property comprising (i) a valuable Burne-Jones panel, (ii) furniture valued at £147,870 at the date of Lord Balfour's death, and (iii) part of the Balfour Archive, a valuable collection of personal and political papers. Additionally, there was incorporeal moveable property including cash, debtors and pre-payments with a total value at the date of Lord Balfour's death of £80,352.

6. Lord Balfour died on 27 June 2003.

7. Subject to the declarator hereinafter described and until its date on 6 November 2002, the Trust Estate included the whole heritable property of the landed estate, including Whittingehame Tower Farmhouse, Whittingehame Mains and Eastfield Farms, Luggate, Papple and Overfield Farms, together with buildings associated therewith and certain further grazings and woodlands. In addition there were a number of let houses and cottages.

8. For a number of years prior to 10 November 2002 the deceased had operated in hand farming at Whittingehame Mains and Eastfield Farms under the name of Whittingehame Farming Company. From time to time the deceased had operated these farms in partnership with another. In particular, during the period prior to 28 September 1999 Whittingehame Farming Company operated as a partnership between the deceased and George Thomson. The partnership terminated with Mr Thomson's death on 28 September 1999. Thereafter, until 10 November 2002 the deceased operated these farms without a partner, continuing to operate Whittingehame Farming Company for the purpose.

9. The trustees of Whittingehame Estate Trust have had prepared on their behalf periodic accounts during the subsistence of Lord Balfour's liferent interest.

10 The agricultural lettings of Luggate, Papple, and Overfield Farms commenced on 28 November 1952, 28 November 1954, and 28 November 1953, respectively. The table on page 6 of the report and valuation by Messrs Bidwells pertaining to Whittingehame Estate dated November 2003 is true and accurate as to the matters it describes.

11. Prior to November 2002, separate bank accounts were maintained for Whittingehame Farming Company and the Whittingehame Estate Trust.

12. The operations of the Estate Trust and of Whittingehame Farming Company were separately registered for VAT purposes.

13. Whittingehame Estate Trust was first registered for VAT in March 1976 (VAT registration number 271 9545 36). It was and remained registered as a non-profit making body. This registration was in the name of the Trustees of the Whittingehame Estate Trust.

14. Whittingehame Farming Company (VAT registration number 269 8479 84) was registered for VAT purposes in the name of Lord Balfour during the period from 28 September 1999 to 10 November 2002, and Lord Balfour and Andrew Michael Brander (as partners of the partnership referred to at paragraph 20 below) until Lord Balfour's death on 27 June 2003.

15. There was a composite insurance policy covering the whole of the Estate. The insurance premium was apportioned between Whittingehame Farming Company and the Whittingehame Estate Trust prior to 10 November 2002.

16. In December 1999 Bidwells, Property Consultants, 5 Atholl Place, Perth, were appointed by Lord Balfour to take over the factoring/management of Whittingehame Estate.

17. Bidwells invoiced Whittingehame Farming Company and Whittingehame Estate Trust separately.

18. In November 2003 Messrs Bidwells produced a report and valuation in respect of Whittingehame Estate. Appendix 4 thereof provided a schedule of cottages and other premises on the Estate, 28 in number. The first 26 correspond to those cottages identified in a schedule produced by the District Valuer, elsewhere herein described. In respect of those 26 cottages and other premises the Bidwells' schedule is true and accurate as to the property identified, the commencement of letting, the type of letting, the rent per annum as at the date stated, the review date and the tenant.

19. On 6 November 2002 the House of Lords declared the deceased to be the fee simple proprietor of the heritable estate hitherto treated as Trust heritage, pursuant to section 47 of the Entail Amendment (Scotland) Act 1848.

20. On 16 February 2003 by written agreement the deceased entered into a partnership with Andrew Michael Brander. The effective date of commencement of that partnership was backdated to 10 November 2002. The agreement is produced.

21. The partnership agreement of 16 February 2003 was to the effect that the partnership name would be Whittingehame Farming Company.

22. The partnership agreement provided for the introduction of initial capital into the business on the basis that (a) the heritable property comprising the whole of Whittingehame Estate belonging to the deceased was contributed and credited to Partnership Capital Account A, and belonged to the deceased; and (b) the capital of the operation previously known as Whittingehame Farming Company, one half having been gifted to the said Andrew Michael Brander by the deceased, was contributed equally by the two and credited to Partnership Capital Account B, and belonged to them equally.

23. With effect from 10 November 2002 the capital value of the whole heritable estate of Whittingehame Estate was treated as a fixed asset of Whittingehame Farming Company in the partnership accounts, its initially stated value being £3 million.

24. With effect from 10 November 2002 the capital introduced to Partnership Capital Account B was £198,117, this being the closing net assets balance represented by the capital and current accounts in the Whittingehame Farming Company accounts for the period to 10 November 2002.

25. After 10 November 2002 all non-heritable property of the Estate Trust remained in the Trust

26. The list of properties owned by Whittingehame Farming Company, being for the avoidance of doubt the partnership between the deceased and Mr Brander, as at the date of death is described in the valuation report by Bidwells that is produced. A return was made to the Inland Revenue Capital Taxes Office in respect of certain property and it is produced. The said return gave suggested valuations for the various properties comprising the Estate on an open market value basis.

27. By letter of 12 July 2005 the District Valuer intimated agreement in respect of the various properties. In relation to items a-f parties are agreed on the basis set out in the said letter, but those matters form no part of the subject matter of the present appeal. Items h and i do not form part of the subject matter of the present appeal.

28. In the said letter of 12 July 2005 the District Valuer confirmed agreement of an open market value for item g, being 26 houses and cottages, 23 of which were let at the date of the deceased's death, in the sum of £2,818,000. He provided a schedule to the letter which, inter alia identified the 26 houses and cottages comprising item g. The schedule is accurate as to the identification of those properties. Parties are agreed as to that open market value for item g. The treatment of this property for inheritance tax purposes is at the heart of the present appeal.

12. In the light of the oral and documentary evidence, I make the following additional findings-in-fact:–

29. Whittingehame Estate, which extends to about 771.85 hectares (1907.25 acres), is a low ground agricultural estate in East Lothian, with a historic Tower House dating from the late fifteenth century. It was acquired by the Balfour family in about 1817 and then extended to some 10,000 acres. Large parts of the estate had to be sold in the 1930s and the 1960s to pay estate duty. Before Lord Balfour's death there were two in-hand farms (Whittingehame Mains Farm and Eastfield Farm), three let farms (on secure agricultural tenancies), some 26 let houses and cottages (mainly let on short assured tenancies), and two sets of business premises. The in-hand farms at Whittingehame Mains and Eastfied extend to about 269 hectares. The three let farms at

Papple, Overfield and Luggate extend to about 371 hectares. There are also policy parks (let on a seasonal basis) and valuable sporting rights attached to the Estate.

30. The in-hand farms the policy parks, and the woodlands extend to about 393.6 hectares while the let farms extend to about 371 hectares.

31. The first Earl of Balfour's Trust Disposition and Settlement provided *inter alia* as follows:–

"IN THE SEVENTH PLACE, With regard to the whole rest and residue of my means and estate heritable and moveable, real and personal, wherever the same may be situated, I direct my Trustees to … pay or apply the whole nett revenue or income thereof for behoof of the following series of heirs … each for his or her liferent use allenarly videlicet:– My brother … whom failing … in fee, and that in the manner for the purposes, with the faculties and subject to the powers conferred by me and after expressed: (First) I hereby declare that all of the liferents successively before provided shall be for alimentary use only, and the respective rights and interests shall not be assignable nor affectable by the debts or deeds of the liferenters or the diligence of creditors: (Second) It is my wish and intention and I direct my Trustees that my said brother Gerald … shall be entitled to the whole past due and current rents feuduties and other profits of my landed estates without reference to the crops or years for which they may be payable as if such liferenter were absolute proprietor …

(Third) I desire and direct my Trustees to put my said brother Gerald … into the personal occupancy and liferent use and possession, not only of my landed estates of Whittingehame and others in Scotland ... And I desire and direct my Trustees as far as possible consistently with the terms of this Trust to confer upon my said brother Gerald … all the rights, powers and privileges that are conferred by law upon liferenters my wish and intention being that the successive liferenters should have the same rights, powers and privileges and that under the same obligations as if I had conveyed the said lands and estates in Scotland … directly to them in liferent in their order successively: and without prejudice to the foresaid rights, powers and privileges but in addition thereto I authorise my Trustees to confer upon each of the successive liferenters power to open up and work minerals and to let the subjects liferented including such minerals and that on lease at a fair rent, but without grassum or other consideration for granting such lease other than the rent or royalties and not exceeding the periods following videlicet:– In the case of (One) Agricultural subjects, nineteen years: (Two) Minerals … (Three) the Mansion House … and all other house property furnished or unfurnished … Ten years: and (Four) Shootings and fishings, Ten years: Declaring that it shall be the duty of my Trustees to see that the buildings, fences, and others on the said estates … are kept by the successive liferenters in proper repair and the whole buildings … duly and fully insured in the name of my Trustees …

(Fourth) Whereas I have at present on hand and in my own occupancy the Home Farm of Whittingehame (which includes Overfield Farm) it is my wish and desire that means should be provided to permit of the same being carried on as I have been in use to do, therefore I hereby confer upon my Trustees full power and authority with the consent of the liferenter for the time to carry on the Home Farm (including Overfield Farm) or to let the same or any part thereof for such term or terms as they think fit, in which latter case the whole stock, crop and implements of husbandry on said farm including as aforesaid, or such part thereof as may be necessary shall be realised and disposed of and the nett proceeds shall fall into the residue of my means and estate and be invested and managed by my Trustees as part thereof, and any loss incurred in the course of carrying on or managing the said farm shall be borne by the liferenter for the time, and all profit shall belong to him or her as his or her own property …"

Lord Balfour

32. Lord Balfour in his daily business activities made no demarcation between the Whittingehame Farming Company ("WFC") and the Estate. Lord Balfour held keys for all properties on the Estate. Much of Lord Balfour's correspondence was written on notepaper

simply headed Whittingehame Estate Office. That correspondence also shows that Lord Balfour met the costs of running the Estate with, generally, no particular distinction being drawn between capital improvements and repairs After George Thomson's death, Lord Balfour ran the in-hand farms on a *contract farming* basis; the contract farming agreement was between Lord Balfour and the contractor. Lord Balfour's own view appears to have been that before the Trust came to an end in 2002 everything was run as one business.

33. There was no strong demarcation for staff either. Lord Balfour handled all matters relating to staff. Lord Balfour's secretary dealt with all aspects of the Estate and the WFC. Another illustration of this lack of any clear line of division is the employment of David Young who was a general worker on the Estate from at least 1968 until his death in 1997. PAYE records reveal that his employer was Lord Balfour but his wages were paid from the trust funds of the Estate and not WFC. There was no apportionment of his salary. The gamekeeper was employed by Lord Balfour. His responsibilities must have ranged across the whole estate and certainly beyond the in-hand farms.

34. WFC was concerned solely with in-hand farming which included rent from cottages on the two in-hand farms, until 2001 when the income from the cottage rents began to be remitted to the Estate.

The Trustees

35. Robert Balfour is a chartered surveyor and second cousin of Lord Balfour. Mr Balfour was a trustee under the 1923 Trust Deed from the mid 1980's. Mr Balfour's father had been a Trustee from the outset. The Trustees had no active role to play as Lord Balfour occupied and ran the whole Estate as if he were the owner; in particular, Lord Balfour dealt with the letting of residential properties on the Estate through Anderson Strathern, solicitors, and before them, Strathern and Blair; Mr Balfour as trustee, was never called upon to sign any lease; the Trustees were not authorised signatories on any bank account; the income and expenditure of the Estate were dealt with by Lord Balfour; Lord Balfour dealt with all forestry work; property disposals were instigated by Lord Balfour; Lord Balfour's wishes on estate matters, which Lord Balfour regarded as his own business, were invariably acceded to by the Trustees. Very few meetings of the Trustees took place. Trust Accounts were issued to the Trustees once they had been approved by Lord Balfour; these accounts did not include the in-hand farming operations; The correspondence produced also shows that the Trust solicitors in effect took instructions from Lord Balfour rather than the Trustees. The Trustees became involved in formal or administrative matters only.

Bidwells

36. Bidwells were appointed in 1999. They provided *inter alia* a book keeping service, preparing annual accounts and VAT returns; they prepared separate annual accounts for the Estate and the WFC; there were separate cheque books and thus accounts for WFC and the Estate; Lord Balfour was an authorised signatory on both accounts. Mr Donald produced an analysis of annual accounts which showed that income from crop and cattle sales, subsidies, grazing and potato lets, cottage and some let farms and some wayleaves was received by WFC; and income from some let farms, some cottages, woodlands and some wayleaves was paid to the Estate; there was a composite insurance policy for the whole Estate; the premium was apportioned between the WFC and the Estate. Bidwells carried out the day to day management and reported to Lord Balfour on all matters (letter of appointment dated 22/12/99); they managed the woodlands, the let housing stock and the agricultural tenancies although Lord Balfour was still involved in various aspects of these activities; and instructed various property repairs and maintenance on the Estate.

37. Income from the in-hand farming operations exceeded the income generated by the letting of property (cottages etc). The majority of cottage lets were on short assured tenancies, as already noted. Mr Donald spent the bulk of his time on the farming operations rather than on the letting

side. He understood the whole operation on the Estate to be Lord Balfour's business. The balance of labour expended by employees on the Estate related to farming operations rather than the lettings. If one took into account management time, the balance was the other way round. However, in 2001 and 2002 Bidwells spent a little over three quarters of their time on farming and forestry matters and a little less than one quarter on property letting and maintenance matters. They rendered separate fee notes to the WFC and to the Estate

38. WFC was concerned solely with in-hand farming which included rent from cottages on the two in-hand farms, until 2001 when the income from those cottage rents went to the Estate. The following Table summarise trading and letting income between 2000 and 2002.

Year	Total Trading Turnover	Letting Turnover
2000[1]	£121.566 of which £304 was attributed to Woodlands Income and treated as Trust Income payable to the Trustees	£67,009 of which £64,026 was attributed to cottage, farm and other rents and wayleaves and treated as trust income payable to the Trustees; the balance being grazing income cottage and farm rents and wayleaves paid to the WFC
2001[2]	£119,804 of which £3,585 was treated as such Trust income	£82,027 of which £76,520 was treated as Trust income
2002[3]	£101,966 of which £1,187 was treated as such Trust Income	£95,266 of which £78.722 was treated as Trust Income
Nov 2002[4]	£119,364 of which £196 was treated as such Trust Income	£96,248 of which £75,448 was treated as Trust Income

General

39. The nature and scope of the business activities being carried out at Whittingehame Estate and the manner in which they were being conducted were essentially the same before 2002 as they were after 2002 until Lord Balfour's death. After Bidwells were appointed, Lord Balfour continued to be involved in the running of the Estate, and the Trustees' role did not change. Bidwells reported to and took their instructions from him.

40. Lord Balfour used trust assets, namely the heritable property, and in particular the let property, in a single composite business carried on by him at Whittingehame. The overall intention was always to make a profit.

Discussion of the Evidence

Mr Barrett

13. Mr Barrett's view was that the Estate was managed by Lord Balfour as a single unified business. He described a unified rural estate as an entity incorporating agriculture, forestry, other land based businesses, dwellings and commercial premises, and community and public facilities including conservation and historical and cultural features. He visited Whittingehame Estate in October 2008 accompanied by Mr Brander. He examined various documents and was privy to Mr

Brander's witness statement in this appeal. He considered that Lord Balfour had managed the Estate in a way that was characteristic of his generation; that is to say without a specific management plan but on the basis that the estate was managed as a unified business with each part contributing to and supporting the whole. However, it became apparent, after an effective cross-examination, that the basis upon which he held these views was somewhat shaky. He had not seen any trust accounts; nor was he informed of the terms of the Trust Disposition and Settlement. He gave no consideration to the existence of the Whittingehame Farming Company, its function or effect on the question of whether the Estate embraced one business or more than one. He was unaware of the staffing arrangements. Nevertheless, his conclusion is consistent with the thrust of most of the evidence I heard. Moreover, his undoubted experience entitled him to make the reasonable comment that Lord Balfour appeared to manage the Estate in a way that was characteristic of his generation.

Robert Balfour

14. Robert Balfour's evidence was to the effect that the Trustees had no active role to play as Lord Balfour occupied and ran the whole Estate as if he were the owner; very few meetings of the Trustees took place; he could only remember attending two; Trust Accounts were issued to the Trustees once they had been approved by Lord Balfour; these accounts did not include the in-hand farming operations;. He did not know that the in hand farms were run by WFC. He did not believe that Lord Balfour acted as factor for the estate, Rather he thought George Thomson was the factor. This was how Lord Balfour described him. He never saw any partnership accounts between Lord Balfour and Thomson.

15. Overall, Mr Balfour did not add much to an appreciation of how the many facets of the Estate were run or why the WFC was set up or its status and position in the grand scheme of things at the Estate. What is clear from his evidence is that Lord Balfour dominated and in practice controlled the running of the Estate.

James Donald

16. James Donald is a very experienced land agent. He was involved from the outset of Bidwell's appointment in 1999. The thrust of his evidence was that Bidwells carried out day to day management and reported to Lord Balfour. Bidwells managed the woodlands, the let housing stock and the agricultural tenancies although Lord Balfour was still involved in various aspects of these activities; and instructed various property repairs and maintenance on the Estate. The lettings of dwellings were generally to someone Lord Balfour knew or someone who would contribute to an aspect of the various activities on the Estate.

17. Mr Donald, like Robert Balfour, was clear that the Trustees had no significant involvement in the running of the Estate. After November 2002, when the Trust came to an end, Bidwell's role and involvement did not change; the only difference was that a single set of accounts was prepared.

18. His view, which was supported by the accounts, was that income from the in-hand farming operations exceeded the income generated by the letting of property (cottages etc). He spent the bulk of his time on the farming operations rather than on the letting side. He understood the whole operation on the Estate to be Lord Balfour's business. The balance of labour expended by employees on the Estate related to farming operations rather than the lettings. If one took into account management time, the balance was the other way round.

19. Bidwells held various leases; although they were not produced Mr Donald's evidence was that some ran in the name of Lord Balfour, some in the name of WFC and some ran in the name of the Trustees.

20. Mr Donald's impression, disclosed in cross examination, was that Lord Balfour acted as factor for the Estate. His understanding was that when George Thomson was alive, he was Lord

Balfour's assistant factor. In re-examination he stated that Lord Balfour treated the business of running the Estate as his own Estate.

Michael Brander

21. Michael Brander is a nephew of the late Lord Balfour. He was brought up on the Estate. His parents resided and still reside at Whittingehame Mains Farmhouse. He became a partner of Lord Balfour as his intended heir. The partnership capital included the assets of Lord Balfour's business which traded as the WFC and the heritable estate which vested in him in 2002.

22. He described what he referred to as the Estate business as the management of a typical Scottish landed estate, the core elements being farming, forestry, shooting, let properties and a private water supply, which served about forty houses.

23. He said that the Trustees left Lord Balfour to run the whole estate. The Trustees played a passive administrative role. When Lord Balfour's health began to decline, Bidwells were appointed as factors. They were to report to Lord Balfour on all matters. He referred to a variety of correspondence showing Lord Balfour's involvement in all areas of management of the Estate including woodlands, shooting, the appointment of staff, the in-hand farms, the tenanted farms, game control issues, the water supply, residential tenants, the engagement of employees, and the repair, improvement and sale of parts of the Estate. Lord Balfour, he said, was also involved in the preparation of the Trust Accounts. According to Mr Brander Lord Balfour managed the Estate as a whole and as he thought best.

General Assessment of the Evidence

24. I found the witnesses to be credible and generally reliable. Mr Thomson criticised the selective nature of the documents produced. However, so far as I am aware, no steps were taken by HMRC to recover all the relevant files or additional links in the chain of correspondence referred to in the evidence. While there are inevitably gaps in the documentation, it is often difficult to know how much to produce. Not all the documents produced were referred to in evidence or submissions. I am not therefore prepared to criticise the Appellants.

25. The general uncontradicted burden of the evidence, which I accept, is reasonably clear. Lord Balfour ran the Estate as a single composite business deploying such of the assets of the Estate as he thought fit from time to time. The additional findings-in-fact reflect that view.

Issues

26. The principal issue is whether Lord Balfour's interest in the partnership (Whittingehame Farming Company) which subsisted immediately before his death), replaced the previous business carried on by Lord Balfour. If so, the question arises as to the nature of these businesses.

Conclusions

Business activity on Whittingehame Estate

27. Lord Balfour ran the Estate for his own benefit for the preservation of the Estate and for his future heirs. Just what he meant when he wrote, at one stage in the early nineties, that he was the estate factor is not entirely clear. That period is outwith the period which has to be considered. However, it does point unequivocally towards the view that he regarded his efforts as being for the benefit of one overall enterprise, which would be entirely consistent with the view that Whittingehame Estate was a traditional Scottish landed estate. The administrative reasons for setting up Whittingehame Farm Company and the separate VAT registration of the partnership and the Trustees were not explored in detail in evidence. Between 1999 and 2002 there was no partnership. Lord Balfour carried on business at the Estate as sole trader. He was a liferenter and

entitled to enjoy the fruits of the Estate and the activities carried on there. The Trustees, on the evidence I heard, carried on no business activity whatsoever. All business activity was generated by or through the efforts of Lord Balfour. This is consistent with the terms of the first Earl's Trust Disposition and Settlement. Lord Balfour's detailed knowledge of the Estate infrastructure seems to have been unrivalled and without it the Estate probably would not have fared as well as it did over the last four decades. It made sense for him to be involved in and take overall charge of the running of the Estate.

28. Whatever the formal administrative and accounting arrangements, my conclusion on the facts is that the activities which were carried on at Whittingehame Estate throughout the period between 1999 and 2002 were managed by Lord Balfour as his single business. To that end, he used assets of the trust estate in the business activities being carried on at Whittingehame. He took *de facto* responsibility for running all aspects of the Estate. He either made the business decisions himself or made recommendations to the Trustees which he expected them to approve and they invariably did so. The Trustees rarely met and appeared to be entirely passive. The Trust solicitors appear to have dealt mainly with Lord Balfour on estate matters. This is all consistent with Lord Balfour running the Estate as a whole. The burden of the evidence I heard was all to that effect and is reflected in the factual findings I have made. That is consistent with what one would generally expect as explained by Mr Barrett.

29. The reason for establishing the partnership with Mr Thomson was also not explained in evidence. HMRC made much of this in submissions. The reason may have had something to do with the provisions in the Trust Disposition and Settlement which singled out for special treatment the arrangements relating to the in-hand farms. The partnership was a limited partnership under the Limited Partnership Act 1907 and Lord Balfour and Mr Thomson were the general partners (see the terms of the Standard Security at file 2/238). However, throughout the period with which this appeal needs to be concerned, Lord Balfour was either liferenter carrying on business on the estate as a sole trader (and it therefore does not matter at all under what name he trades) or in partnership in which the estate vested in him (in November 2002), formed part of the capital of the partnership. Such business use as there was of the heritable property at Whittingehame Estate, was exactly the same the day before the 2002 partnership began as it was the day after it had begun.

30. The business was the traditional mix of a traditional Scottish landed estate and consisted of a blend of agriculture (in-hand and let farms), woodland and forestry management and related sporting interests, and the letting of cottages and other properties within the estate either to estate workers or to others. The letting of some of the cottages provides a good illustration of the fact that the management of the various activities on the Estate was integrated and strategically prudent, e.g. the provision of accommodation at reasonable or low rents to attract good workers or occupants who had skills which might one day be deployed on the Estate. The Estate work force was not rigidly divided so that each member worked exclusively on only one particular estate activity although it is likely that some carried out much the same activity all the time. They did not report to the Trustees but to Lord Balfour. Lord Balfour's secretary was involved in administrative aspects of all activities of the estate which required secretarial services. As with Lord Balfour himself, there were no demarcation lines except for administrative purposes to reflect the fact that Lord Balfour's interest until November 2002 was as liferenter and not as owner of the Estate. Thus, Trust accounts were kept. The Trust was separately registered for VAT. Whatever the accountancy treatment, Lord Balfour was entitled to the fruits or profits of the Estate's business activities.

31. It seems to me plain on the evidence that Lord Balfour used the trust assets as part of the overall business enterprise carried on by him for gain at Whittingehame Estate. Indeed, given the nature of a traditional Scottish landed estate, it would be difficult to do otherwise. Sections 49 and 110 of the 1984 Act are applicable, as is the reasoning in *Fetherstonaugh & Ors(Finch) v IRC 1984 STC 261 at 269j-270h, and 274g-h*. In his capacity as liferenter (until November 2002) Lord Balfour has to be treated as beneficially entitled to the property in which the liferent interest then

subsisted. That was, essentially, the whole Estate. The fact that the trust was a separate entity from Lord Balfour does not mean that there had to be two separate businesses. The existence of these two entities required certain administrative accounting procedures but such procedures do not of themselves create two separate businesses.

32. In reaching these conclusions on the facts, I have taken into account *Scales v George Thompson & Co Ltd 1927 13 TC 83* cited by the Appellants, where the issue was, for the purposes of Income Tax liability, whether the underwriting activities carried on by the taxpayer company, was a separate trade, profession or vocation to that of ship owning. The detailed facts do not matter. However, the approach of Rowlatt J, which is instructive, was to consider whether the conduct of the two businesses were interlaced or dovetailed into each other. Here, it can readily be concluded that various activities on the Estate are interlaced or dovetailed. The letting of farm cottages to employees or to persons who could otherwise be of benefit to the Estate is but one example.

33. This is entirely consistent with the nature of Lord Balfour's interest as liferenter. He was given, by virtue of the terms of the First Earl of Balfour's Trust Disposition and Settlement the privileges and powers of a proper liferenter as that phrase is understood in the law of Scotland. That includes as the Trust Disposition and Settlement envisages, occupying and having complete freedom as to the management of the property liferented such as carrying on business and thus using for business purposes the liferent subjects (*Miller v CIR 1928-31 15 TC 25 at 55-58* [these *dicta* are not affected by the successful appeal to the House of Lords]*; Dobie Manual of Liferent and Fee in Scotland page 64*). Power to let is expressly given in detail to the liferenter by Clause (Third) of the Trust Disposition and Settlement. This is consistent with the powers of a proper liferenter (see *Lady Miller* per Lord Sands at 55) No one has suggested that the terms of the Trust Deed establishing the liferent were infringed.

34. The fact that the liferent was alimentary is of no moment. The effect of that stipulation was that the liferent was unassignable and the rights of creditors were restricted. Mr Thomson suggested that an alimentary liferent afforded protection against the foolishness of the liferenter. So be it, but that has no relevance whatsoever to the present proceedings. For the avoidance of any doubt, no one has suggested that Lord Balfour acted foolishly in the management of the Estate. The evidence led shows that he was highly competent in his management of the Estate.

35. Mr Thomson also made a number of submissions based on the law of liferent and fee under reference to the *Stair Memorial Encyclopaedia of the Laws of Scotland volume 13 paragraphs 1607*; *Wilson & Duncan on Trusts Trustees and Executors 2nd edition paragraph 8-26 and 24-32 et seq.* and to *M'Callum v M'Culloch's Trs 1904 7F 337 at 345.* I regret that I did not fully follow the purpose of these submissions. However, for what it may be worth, I observe that in *Stair* at paragraph 1638, it is noted that a proper liferenter may grant leases to third parties and is virtually in the position of an ordinary proprietor. It is also there noted that a liferenter has no right to cut timber subject to the exception of ordinary windfalls and thinnings. At paragraph 1634 it is noted that where there is a trust liferent, the liferenter's rights are dependent on the conditions laid down by the trust deed. Here, the first Earl of Balfour's Trust Disposition and Settlement provided that his Trustees were to confer upon the liferenter all the rights, powers and privileges that are conferred by law upon liferents as if they lands had been conveyed to them in liferent (see finding-in-fact 29 above). The intention must be that the liferenter is to be viewed as a liferenter under a proper liferent subject to any qualifications in the trust deed. For example, the trust deed qualifies the power to let by stipulating the longest duration of particular types of leases. Mr Thomson pointed to the fact that actual leases had not been produced and there was little evidence of Lord Balfour being authorised to grant leases. Standing these provisions in the Trust Disposition and Settlement and the background of law to which he drew my attention, I do not see how the absence of evidence of the terms of or parties to the various leases or such express authority matters at all to the issues I have to decide.

36. Mr Thomson for HMRC argued that the evidence led and documents produced were highly selective. However, it seemed to me to be amply sufficient to justify the additional findings of fact which I have made and the conclusions I have reached. HMRC did not lead any evidence and it must therefore be reasonable to draw favourable inferences from uncontradicted evidence where that evidence has not been destroyed, weakened or prejudiced by cross examination.

37. It cannot be disputed, subject to any argument based on section 105(3), that if Lord Balfour had survived for two years following the creation of the partnership in about November 2002, business property relief would (on his subsequent death) have been available in relation to the whole value of his share in the partnership. This follows because of the provisions of sections 107(1) and (3).

38. In the foregoing circumstances, section 105(1)(a) is applicable subject to the provisions of section 105(3).

Wholly or mainly making or holding investments?

39. The carrying on of a business which consists wholly of making or holding investments might suggest a relatively passive activity which is designed to achieve investment or capital gain and/or receive what may be described as passive income or return on capital. Once the investment is made the return, if any, will follow generally because of the soundness of the investment and the state of the market in which the particular investment is made rather than the continuing efforts of the owner of the funds or property invested. A trading activity usually involves the buying and/or selling of goods or the provision of services or a mixture of both. The extent of profit from the activity directly depends on the effort, and the efficiency and quality of effort put into the business by its owner and employees. There are no doubt grey areas where the business of making or holding investments and trading activities meet or overlap. Be that as it may, a different view has been expressed in *Martin v IRC 1995 STC (SCD) 5,* and *Burkinyoung v IRC 1995 STC (SCD) 29.* The reasoning in that case is cogent. However, a broader approach was taken by the Court of Appeal in *IRC v George 2003 STC 147 at paragraph 60 and 61*

40. In the circumstances as I have found them to be in the present proceedings, to suggest that the activities carried on at Whittingehame Estate comprised wholly or mainly the making or holding of investments is to belittle the efforts required properly and profitably to manage the various components of an estate of this nature. Even the residential letting aspect of the activities required Lord Balfour's experience, business acumen and careful planning. They are an important component in the overall business; the cottages were historically part of the overall farming enterprises or housed full time estate workers. On the evidence, it is apparent that Lord Balfour took particular care to endeavour to secure a benefit for the estate as a whole when letting out property on the estate. He appears to have preferred to let, where at all possible, to estate employees or to individuals who possessed a skill or talent which might be of benefit to the estate whether on a formal or an informal footing. Other facets of the business activities carried on at the Estate are plainly positive and active trading activities as opposed to the more passive notion of holding investments. I therefore have no difficulty in rejecting the argument that the business carried on at the Estate (at any time after 1999-it being unnecessary to consider the position before then) was wholly or mainly making or holding investments. In these circumstances, it is unnecessary to make any kind of quantitative analysis of the various activities.

41. Even if one assumes that the letting of the 26 houses and cottages (identified at paragraph 28 of the Joint Statement of Agreed Facts; and which unlike the let farms do not attract agricultural property relief) constitutes making or holding investments, I am not satisfied that the estate management and farming activities managed by Lord Balfour as his single composite estate management business immediately prior to the formation of the November 2002 partnership (to use the language of the HMRC Notice of Determination) was a business which consisted wholly or mainly of making or holding investments. The estate management business did not, on any view, consist *wholly* of making or holding investments.

42. As for whether such business consisted *mainly* of holding or making investments, I consider that it is necessary to establish what the preponderance of business activity is. This can be looked at from the point of view of a variety of relevant factors in an attempt to create an overall picture, to see whether that picture shows that the business activities on the Estate consisted mainly of making or holding investments. These factors include turnover, profit, expenditure and time spent by everyone involved in the carrying on of the various business activities. Unless every hour of every employee, every item of income and expenditure is identified and analysed and overlapping activities taken into account, no precise quantitative assessment can be made. Such an assessment over any reasonable period is probably impossible to achieve and ultimately the matter must be assessed on the basis of such evidence as the parties have been able to lead or point to. With incomplete evidence as we have here, and probably in most cases, it is a matter of more general assessment and impression as to where the preponderance of business activity lies. This means looking at the activities being carried on at the estate in the round (an approach emphasised by the Court of Appeal in *IRC v George 2003 at 152c*). My impression is that the management of a landed estate such as Whittingehame Estate even where a significant amount of the income is derived from letting income is, overall, mainly a trading activity. That is where the preponderance of activity and effort lies. Bidwells were engaged as estate managers; most estates of the type under discussion are heavily based on farming and to some extent on forestry and woodland management and related shooting interests. The letting side was ancillary to the farming, forestry, woodland and sporting activities. The farming activities, albeit they include agricultural tenancies, occupied by far the greater area of the Estate. (see for example *Farmer v IRC 1999 STC (SCD) 321,* especially at paragraphs 6, 22 40, 41, 43, 47, 52-54).

43. In these circumstances, I consider that the business activities carried on at Whittingehame Estate do not consist wholly or mainly of making or holding investments. Section 105(3) is not engaged.

Entail Amendment (Scotland) Act 1848

44. Mr Thomson submitted that the Judgment of the House of Lords dated 10/11/02 (a copy of the Extract Decree has been lodged as a production) in the appeal to the House of Lords (see *Earl of Balfour Ptr 2002 SLT* 1385) was not retrospective. I do not recollect suggesting that it was. In these circumstances, I have proceeded, in HMRC’s favour, on the basis that the Interlocutor does not have retrospective without actually deciding the point.

Summary

45. From at least about 1999 until November 2002 the estate management and farming activities carried on at Whittingehame Estate were managed as a single composite business. The 2002 partnership replaced these estate management and farming activities. The assets of the Estate in issue in these proceedings were used in that business. All the property replaced by the capital of the 2002 partnership was relevant business property immediately before (and for a period of more than two years before Lord Balfour’s death) it was so replaced. Lord Balfour’s interest in that partnership is relevant business property within section 105(1)(a), and attracts the relief set forth in section 104(1)(a).

Disposal

46. The Notice of Determination dated 4th September 2008 is quashed in terms of section 224(5) of the 1984 Act.

J GORDON REID QC, F.C.I.Arb

TRIBUNAL JUDGE

RELEASE DATE: 14 May 2009

[1] Year ended 31/3/00 for WFC and the Trust

[2] Nine months to 31/12/00 for WFC and year to 31/3/01 for the Trust

[3] Year ended 31/12/01 for WFC and year to 31/3/02 for the Trust

[4] ? Period from 1//02 to 10/11/02 for WFC and 1/4/02 to 10/11/02 for the Trust