How business assets can reduce inheritance tax on a company

Understanding the role of business assets in inheritance tax

When you own a company or a share in one, those assets form part of your estate for inheritance tax purposes. Without careful planning, the tax due on passing them on can be substantial. However, certain types of business assets qualify for a relief that can reduce or even eliminate the inheritance tax charge. The key is knowing which assets qualify and how to structure ownership so the relief applies.

This article walks through the practical steps to assess and apply that relief, with attention to the conditions that must be met and the common pitfalls that can cause a claim to fail.



Step 1: Identify the business assets in your estate

The first step is to take a clear inventory of what you own. Business assets can include:

- A sole trader business or partnership interest
- Shares in a trading company that is not listed on a recognised stock exchange
- Shares in a company that is listed but where you hold a controlling interest (usually more than 50 percent)
- Assets used in a business that you run yourself, such as land, buildings or equipment

Not everything that looks like a business asset qualifies. For example, a portfolio of investment properties held through a company is unlikely to count. The critical factor is whether the business carries on a commercial trading activity rather than investment or speculation.

Step 2: Understand the qualifying period

To be eligible for relief, you must have owned the business assets for at least two years. This is known as the qualifying period. If you acquired the assets within the past two years, you cannot yet claim the relief. The clock starts from the date you became the beneficial owner, not from the date the company was formed or the shares were issued on paper.

There is an exception: if you inherited the assets from someone who had already owned them for at least two years, you may be treated as having met the qualifying period yourself. This can be useful in succession planning, but it requires careful documentation of the previous owner's period of ownership.

What to watch: If you transfer the assets to someone else before the two years are up, the qualifying period resets. Do not assume that a short-term restructuring will preserve the relief.

Step 3: Check the nature of the business activity

The relief is available only for businesses that are wholly or mainly trading. A trading business is one that buys and sells goods or services with a view to profit, as opposed to one that holds investments. HM Revenue and Customs looks at the overall character of the business. If more than half of its activity is investment rather than trading, the relief may be denied.

This is a common area of dispute. A company that owns a single rental property is almost certainly an investment business. A company that runs a hotel, by contrast, is trading because it provides services and actively manages the property. The line can be blurry for businesses that hold a mix of trading and investment assets, such as a farm that also rents out cottages.

What to watch: If you plan to sell the business or wind it down, the relief can be lost for assets held in the final stages. Once a business ceases to trade, it becomes an investment company and the relief no longer applies.

Step 4: Determine the level of relief available

Once the business qualifies, the relief reduces the value of the assets chargeable to inheritance tax. The rate of relief depends on the type of asset:

- For a sole trader business or a partnership interest, the relief is usually 100 percent, meaning the entire value passes tax-free.
- For shares in a trading company that you control, the relief is also 100 percent.
- For shares in a company that you do not control but that is not listed, the rate is 50 percent.
- For land or buildings used in a business that you own, the rate is 50 percent.

These percentages apply to the net value after deducting any liabilities. If the business has debts, those reduce the value before relief is calculated. The relief cannot create a loss or a refund; it only reduces the value that is otherwise chargeable.

What to watch: If the business assets are held jointly with someone else, the relief applies only to your share. A partnership interest, for example, is valued based on your share of the partnership assets, not the whole business.

Step 5: Plan the ownership structure carefully

How you hold the business assets matters. If you own them directly as an individual, the relief is simpler to claim. If you hold them through a trust or another company, the conditions become more complicated. Trusts have their own inheritance tax rules, and business relief may still apply, but the trust must be structured so that the qualifying conditions are met.

Another consideration is the transfer of the business during your lifetime. If you give away the business assets but continue to benefit from them - for example, by remaining as a director and drawing a salary - the gift may be treated as a gift with reservation. In that case, the assets stay in your estate for inheritance tax purposes, and the relief may be lost.

What to watch: A lifetime gift of business assets may qualify for immediate relief if the donee (the person receiving the gift) continues to run the business. But if the donee sells the assets within two years, the relief is clawed back. This can create unexpected tax bills.

Step 6: Coordinate with your succession plan

Business relief is most valuable when combined with a clear succession plan. If you intend to pass the business to a family member who will continue to run it, the relief can ensure that the transfer does not trigger a large inheritance tax bill that forces a sale. Without a plan, the family may have to sell the business purely to pay the tax.

A succession plan should address who will take over, how the shares or partnership interest will be transferred, and whether there are other assets in the estate that can be used to cover any remaining tax. It is also worth considering whether the business can be restructured to improve the relief position - for example, by separating trading and investment activities into different companies.

What to watch: Do not assume that all shares in a trading company automatically qualify. If the company has a large cash reserve or investment portfolio, those assets may not be considered trading assets, and the relief may be reduced proportionally.

Putting it all together

Business relief can be a powerful tool for reducing inheritance tax on a company, but it requires careful planning and attention to detail. The relief is not automatic. You need to identify the qualifying assets, hold them for the required period, ensure the business is genuinely trading, and keep the ownership structure clean. Mistakes in any of these areas can result in a reduced relief or no relief at all.

The most common errors include failing to document the two-year ownership period, assuming that any business activity qualifies, and overlooking the impact of non-trading assets. A periodic review of the business and its assets can catch these issues early.

Because the rules are detailed and the consequences of getting them wrong can be significant, it is sensible to seek professional advice tailored to your specific situation. A personalised inheritance tax plan can help assess your estate exposure, identify where business relief may apply, and ensure that the steps you take are aligned with your wider objectives for passing on wealth.