



**James Hervey-Bathurst
Consultant**

James Hervey-Bathurst is a consultant to Christie's Heritage and Taxation Advisory Service. After qualifying as a solicitor, he worked in banking and recruitment and has also managed his family's historic house, art collection and estate over the last twenty years. He was Chairman of the Historic Houses Association Tax Committee for nine years and HHA President from 2004-08. He also acts as an independent consultant, focusing on historic houses, estate management and capital taxation.

MANAGING HERITAGE ASSETS: AN OWNER'S EXPERIENCE AND CONCLUSIONS

It may be of interest to professionals to hear from an owner who has been on the receiving end of their advice for the last twenty years and who has been aware of the advice given to other owners of heritage assets from time to time. I will reflect on the process of receiving and implementing the advice and where we are now in terms of achieving a robust structure which should not be too vulnerable to capital taxation, at least under current rules.

BACKGROUND

My family collection is at Eastnor Castle (www.eastnorcastle.com). The house, contents and estate company passed largely outright to my mother on my grandfather's death in 1944 at the age of 57. A large amount of Estate Duty was payable at the time (£5 million in today's money); furthermore, his will was not in an ideal condition as he had died while a new version was in preparation. Investments, land and works of art were sold to pay the tax. No exemptions were claimed. From birth, therefore, I was brought up in the shadow cast by this financial disaster and have been determined since to take action to protect my inheritance from further damage.

Our house is divided into two parts: the public side seen by visitors and not used by the family, except very occasionally, and the private side where we live. In 1974 our solicitor, taking the initiative, advised my mother that she should hand on any chattels on the public side valued at less than £1,000, the then CGT exemption limit, to avoid the consequences of the imminent introduction of Capital Transfer Tax. She gave the contents of the rooms downstairs on the public visiting route to me and those in store upstairs to my younger brother, thinking that re-using the abandoned bedrooms was unlikely to happen, and I would not need them myself.

In 1982, we were advised to review our tax situation, particularly as regards a Discretionary Trust holding shares in the estate company. This led to some transfers out of that trust into an Accumulation and Maintenance Trust, with some CTT becoming due and paid for partly by the sale, privately, of our best painting. As it ended up in the National Gallery, we would have done better to have taken advice, negotiated a sale direct and claimed the benefit of the *douceur*.

On my mother's death in 1986, just after the introduction of IHT most of her estate passed to my father. When he moved out of the house two years later, he handed the rest of the chattels on to me, and I insured his life under a Gift Protection Policy. He survived the seven-year period and so, in 1995, I had full ownership, without conditional exemption or the immediate threat of another tax charge.

NEXT STEPS

By then, the public side, where the bulk of the collection is displayed, had been restored and was open, downstairs as well as upstairs, to the public and for business use. I saw that eventually the collection would have to be conditionally exempted on my death or there could be a charge to CGT if I handed on the collection as a PET.

Although there was no immediate need to act, I was also concerned that there could be some unhelpful change in the law in the future, so we went back to Counsel who concluded:

1. I could transfer the public side chattels into an Accumulation and Maintenance Trust for the benefit of my children without paying CGT as the chattels (then) qualified as plant used in the house-showing business.
2. I would be reserving a benefit because I was a director of the estate company using my gifted chattels in its business, unless a rental agreement was put in place.
3. I would need to meet the costs of using the public side of the house for private purposes also to avoid reserving a benefit and breaking the benefit rules applying to company directors, an income tax point.

However, the possibility of doing nothing and using Business Property Relief or conditional exemption at a later stage was not considered. As I regarded the chattels almost as fixtures in the house and unlikely to be of use to me anywhere else I might live, I was happy to go ahead with the transfer.

I agreed to rent the chattels back from the trustees and then rent them on to the company. The rents were negotiated at arm's length by our advisers: I paid slightly more to the trustees than I received from the company. The rates worked out at figures just below 1%, based on the great number of items involved. The rent was reviewed every three years and increased in line with the value of the collection. I was warned that the rental agreement would need to continue until I ceased to be a director of and shareholder in the company, but I decided to go ahead anyway.

RECENT DEVELOPMENTS

The pre-owned assets tax rules introduced in Finance Act 2004 were obviously a cause for some concern. However, careful interpretation of the rules revealed that our arrangements were acceptable as long as we kept the rent levels under review and at open market levels.

The introduction of the new tax on trusts in Finance Act 2006, however, was more of an issue as the chattels would become "relevant property" from April 2008. The trustees could have appointed the chattels to my eldest daughter at age 25, before the incidence of the ten year charge, but they took the view that it would be wiser to wait until she was older and also, incidentally, until she might be able to protect them on marriage within an enforceable pre-nuptial settlement.

So, with the threat of a large decennial charge hanging over the trustees in 2012, we went back to leading counsel to seek an alternative route. He advised that:

1. The trustees, the company, my brother and I should set up a house-showing/house-business partnership to run the house and park. My brother and I were included as my brother had left most of his chattels in the house, and they had come back into regular use, and I had added some of my personal chattels to the business after the original transfer to the trust.
2. The chattels should be transferred into the partnership and the rental agreement would cease. The partners' profit shares were negotiated at arm's length.
3. The partnership should be set up as an independent trading activity, with its own accounts, VAT number and tax code, as well as annual partners' meetings.
4. If the partnership were correctly set up and managed, ideally making a profit from time to time, then the partners' interests (including the assets within the partnership) would qualify for Business Property Relief after two years.
5. As partner in a trading activity, the company would maintain its level of trading activity, a key consideration as far as the capital tax treatment of the shares was concerned.

We accepted the advice, made the transfers and the partnership started trading in October 2009. Inevitably, the process took much longer than expected, but the management structure in the estate company, with a separate office already running the house and park, made it a relatively simple change from a business point of view. There were no objections from the bank, our suppliers or clients. The process will have cost just less than 10% of the decennial charge that would otherwise be payable in 2012 by the trustees of the chattels settlement.

The benefits of all these arrangements are obvious from an IHT point of view. Our next move, on a voluntary basis, will be to introduce a Collections Management Plan for the chattels, which will take English Heritage guidelines into account, but not necessarily follow them in every respect as we are not obliged to do so. Using an electronic database, such as ARTfoleo offered by Christie's, will be an essential element in the process.

This will be a self-imposed burden, but we accept that a systematic approach to care and repair of the collection will be more beneficial than the current ad hoc one, and we will save money in the long run. Although Christie's encourage eventual buyers with the ambiguous term "country house condition" to describe items for sale, we feel "good condition" would be more helpful if the time comes.



LESSONS FOR PROFESSIONAL ADVISERS?

Much of this will be familiar ground, but what can be learnt for advisers? I suggest the following:

1. As far as chattels are concerned, keeping an up-to-date inventory, with details of ownership, tax status, location, condition, value etc., is essential when clients have to respond to changing rules and need to know accurately what they own. Adding images to such an inventory will be helpful too. The values of works of art are subject to varying market conditions, as we see in the current surge in value of Chinese porcelain, for example.
2. Clients should be encouraged to keep their tax affairs and wills under regular review. There is an annual Budget, and tax cases are reported all the time. Of course, many developments are not relevant, but having an annual or biannual review means there will at least be a process in place which should enable an early response.
3. The review should also include consideration of insurance cover, both for the collection and the historic building in which it is contained. Listed Buildings may require a full rebuild after a fire, and owners must take the huge costs of doing so into account when arranging cover.
4. Advisers should keep clients informed of developments as they happen, not just by sending the firm's newsletter and hoping the client will read the relevant article, but by writing or calling and specifically drawing a report to the client's attention. Clients receive a mass of newsletters every year, and many will not read them. Advisers should be aware of this and make sure that key articles are studied. The coverage of tax matters in the Historic Houses Association members' magazine is highly focused and may be a good starting point.
5. Most clients will be well aware of the benefits of using at least some of their chattels in a business so advisers may well want to encourage their clients to explore the possibilities for their own collections, especially where unexempted items are concerned.
6. Involving the next generation at a reasonably early stage is important. Advisers will want to keep their relationship with the family over the long term, and although the intended successor may have to take independent advice at some stage, he or she thereafter should be encouraged to stick with the family firm. Tell clients that it is a good idea, as they often hesitate to bring a successor along.



In practice, many clients are reluctant to follow the regular review route as they are concerned about costs. They think the money will have been wasted unless the review leads to action. Some, unfortunately, will also feel that they get all they need from their neighbours at shooting lunches, when it is free. So, professionals need to find a way of keeping clients' affairs under regular review without putting the clients off and incurring chargeable time without reward. Perhaps an informal review over a sandwich lunch could be offered when clients are in London for other reasons such as the Chelsea Flower Show, HHA AGM or January sales?

CONCLUSION

A sceptical reader may observe that my own position would have been almost no worse today if the action we had taken over the last twenty-five years had been limited to the setting up of a partnership for the chattels. But it is easy to say this with the benefit of hindsight, and impossible to predict what may change by the time the next IHT event occurs. I feel the advice and action taken has so far proved worthwhile.

Christie's can be a useful catalyst in the process of keeping clients up-to-date and is happy to collaborate with professional advisers in any way we can.

