

Recycling business relief (Lecture P1378 – 16.30 minutes)

FA 1996 widened the scope of the 100% business relief. In his Budget speech on 28 November 1995, the Chancellor (Ken Clarke) had this to say about the IHT relief for relevant business property:

‘IHT can . . . have a direct effect on enterprise. A family company may have to be broken up when the owner dies. We already recognise this problem through the existence of business property relief for qualifying unquoted companies. I now propose to remove the burden altogether by extending 100% relief to unquoted shareholdings whatever their size.’

This change took effect for transfers of value and other chargeable events occurring on or after 6 April 1996. Previously, small minority holdings of unquoted shares (i.e. those carrying 25% or less of the votes) only attracted a 50% relief.

It was at this time that the idea of recycling the benefit of full relief (i.e. effectively a complete IHT exemption) was born. The arrangement is described in the example below.

Example 1

Patrick died on 1 May 2023, leaving the following assets:

	£
Freehold house	500,000
Shares in family trading company (held since 1980)	900,000
Portfolio of quoted shares	800,000
Cash	<u>.....600,000</u>
	<u>£2,800,000</u>

In his will, Patrick leaves his family company shares to his daughter, along with cash of £120,000. The residue of Patrick’s estate is bequeathed to his widow absolutely.

The residue comprises:

	£
Freehold house	500,000
Quoted shares	800,000
Cash (600,000 – 120,000)	<u>.....480,000</u>
	<u>£1,780,000</u>

On the assumption that Patrick had made no chargeable lifetime gifts within the seven years before his death, the IHT liability on his estate is nil:

	£
Shares in family company	900,000
Less: Business relief (100%)	<u>900,000</u>
	—
Other assets (500,000 + 800,000 + 600,000)	<u>1,900,000</u>
	1,900,000
Less: Spouse exemption	<u>1,780,000</u>
Chargeable estate	<u>£120,000</u>

Patrick's chargeable estate falls comfortably within the IHT nil rate band.

However, in order to implement the recycling arrangement, the daughter's next step is to sell the family company shares to her mother for £900,000. This purchase will be financed out of the mother's cash legacy and the sale of some of the quoted shares (but do not overlook the fact that there is also a 0.5% stamp duty cost). Provided that the mother survives this transaction by two years (which will ensure that, on her death, the shares are eligible for business relief) and amend her will so that they are left to the daughter, the end result is that the daughter has cash of = £1,020,000 (£120,000 + £900,000) and the mother has family company shares worth £900,000, a freehold house worth £500,000 and quoted shares worth £380,000. Assuming that the mother leaves her entire estate to the daughter, the IHT liability on her death should be nil (although this depends on what other assets the mother owned). As you can see, the family company shares will have attracted business relief of 100% twice over.

There are two final points to make about this recycling arrangement:

1. In the past, it was customary where the mother had insufficient assets to afford the acquisition of the shares from the daughter, for her to give the daughter an IOU for the sum owed. This technique will no longer work because of the legislative change in FA 2013. The mother is borrowing to buy favoured property, i.e. the family company shareholding.
2. Following the introduction of the Inheritance Tax Avoidance Schemes (Prescribed Descriptions Of Arrangements) Regulations 2017 (SI 2017/1172), which took effect on 1 April 2018, it has to be asked whether this form of planning falls foul of the latest IHT hallmarks. It would certainly seem that the ploy is caught by the first of the two required conditions (Condition 1), namely that there is a reduction in the value of a person's estate without giving rise to a chargeable transfer or a PET. However, in order to be subject to the Disclosure Of Tax Avoidance Schemes (DOTAS) legislation, the arrangements must also involve one or more contrived or abnormal steps without which a tax advantage could not be obtained (Condition 2). It is difficult to see how the market value sale of an asset to a family member could be classified as 'contrived or abnormal' and so hopefully this is not a problem, but the speaker is unaware of any official DOTAS pronouncements – one way or another – from HMRC on planning of this sort.

Contributed by Robert Jamieson