

IHT: BPR – Company issues in practice (Lecture P1303 – 10.22 minutes)

Background

Business property relief (BPR) offers inheritance tax (IHT) relief at rates of 100% or 50% to the extent that a transfer of value is attributable to relevant business property.

AIM listed shares

'Relevant business property' includes an interest in an unincorporated business and unquoted shares in a company, broadly where the unincorporated business or company's business does not consist wholly or mainly of dealing in securities, stocks or shares, land or buildings or making or holding investments (IHTA 1984, s 105(3)).

'Unquoted shares' are defined as shares not listed on a recognised stock exchange. However, shares that are listed, but only on the Alternative Investment Market (or AIM, for short) are regarded as unquoted for BPR purposes.

It is important that individuals investing in AIM shares for BPR purposes recognise that some AIM listed companies have secondary listings on other stock exchanges, which may be recognised stock exchanges, thus depriving the shares of BPR status. Good practice would therefore involve monitoring the company and its activities.

Single company or company with subsidiary?

Another potential BPR pitfall for company shareholders concerns an anomaly in the way that the legislation treats single companies compared to companies with subsidiaries.

Broadly speaking, shares in a group holding company are eligible for BPR if the company's business consists wholly or mainly of holding shares in one or more companies carrying on a business activity that is not wholly or mainly investment (IHTA 1984, s 105(4)(b)).

Even if the shares in the holding company qualify for BPR, there is a restriction in relief if the business of any subsidiaries is wholly or mainly investment. In those circumstances, BPR is only available based on what the value of the holding company shares would have been if the non-qualifying subsidiary or subsidiaries were excluded from the group (IHTA 1984, s 111).

The anomaly in the BPR rules is that shares in a company with no subsidiaries, which is mainly trading but carries on a minor investment business qualifies for BPR in full, whereas if the investment business was carried on by a subsidiary of a trading company and the investment business was the subsidiary's principal activity, BPR would be restricted. HMRC is aware of this anomaly (see HMRC's Shares and Assets Valuation manual, at SVM111190), but seems to consider that Parliament intended the relief to operate in this way. Nevertheless, it is a point worth bearing in mind when considering a group structure.

Ending or reorganising the company

If a company is no longer required, its owners may decide to liquidate or voluntarily wind up the company. As a general rule, the company's shares are excluded from BPR if there is a transfer of value of the shares, and at the time of the transfer of value a winding-up order has been made, or a

voluntary winding-up resolution has been passed, or the company is otherwise in the process of liquidation.

However, there is an exception to this general rule if the company's business is going to continue after a reconstruction or amalgamation. This applies if the reconstruction or amalgamation is either the purpose of the winding-up or liquidation, or if it takes place no later than one year after the transfer of value of the shares (IHTA 1984, s 105(5)).

The key requirement for this exception is the continuation of the company's business. If the company has ceased trading and is then being wound up, it is likely that BPR would cease to be available simply because the company is no longer carrying on a business (IHTA 1984, s 103(3)).

Gift followed by a share sale

Another point to watch out for is a gift of shares followed shortly afterwards by a sale of the company.

An anti-avoidance provision that sometimes gets overlooked concerns 'binding contracts. As a general rule, BPR is denied on a transfer of value of the shares if a binding contract for their sale has been entered into at the time of the transfer. However, there are certain exceptions to this general rule. One such exception relates to transfers of shares or securities where the later sale is made for the purpose of a company reconstruction or amalgamation (IHTA 1984, s 113(b)).

Care is needed on a straightforward sale of the shares. For example, if a chargeable lifetime gift of shares (e.g., a gift of shares into a family discretionary trust) is made on which BPR is claimed and this is followed shortly afterwards by a sale of the company, HMRC might check the position carefully to establish whether there was a binding contract for the sale when the gift was made. HMRC's inheritance tax manual (at IHTM25291) advises its officers to investigate such circumstances to ensure that BPR is properly due.

Surplus cash

Another BPR anti-avoidance rule concerns 'excepted assets' (IHTA 1984, s 112). An asset is 'excepted' broadly if it was neither used wholly or mainly for the purposes of the business in question throughout the two years (or any shorter period the company owned the asset) immediately preceding the transfer of value, nor required at the time of the transfer of value for future use for the purposes of the business. Note that both incorporated and unincorporated businesses are potentially affected.

If 'caught' by the excepted asset rule, BPR is broadly restricted by the value attributable to the excepted asset. Only that part of a transfer of value which relates to 'relevant business property' is reduced by BPR; the other part relating to the excepted asset is not reduced by BPR and is chargeable to IHT as normal.

Surplus cash which is excessive for the present and future needs of a trading company will normally be regarded as an 'excepted asset'. In those circumstances, steps should be considered to mitigate the effect of any BPR restriction. For example, the cash might be used to pay business creditors. Another possibility might be to invest the surplus cash to acquire assets that will constitute a business activity, such as a portfolio of shares or investment properties, provided (most importantly) that the company's trading activity remains the dominant activity of the company. BPR should be available on both the trading and investment business activities in those circumstances.

Control of the company

Transfers of shares in unquoted trading companies can generally obtain 100% relief, regardless of the size of the donor's shareholding.

By contrast, if an individual holds shares in a company which constitute relevant business property, and also owns land or buildings, machinery and plant used wholly or mainly by the company, a gift of that asset can obtain BPR at the 50% rate, but only if the shareholder then had control of the company (IHTA 1984, s 105(1)(d)).

A person has 'control' of a company for these purposes broadly if they have voting control on all matters affecting the company as a whole, which if exercised would yield a majority of the votes capable of being exercised.

Helpfully, in determining whether a person is deemed to control a company, any shares that are 'related property' are taken into account (IHTA 1984, s 269(2)). 'Related property' includes property comprised in the estate of a spouse (or civil partner).

On some occasions, the order of gifts may be very important. For example, a gift of shares that reduces the donor's shareholding to less than 50% may result in the loss of BPR on a subsequent gift of the business premises, unless control is retained for BPR purposes taking into account a spouse's shareholding.

However, even if BPR is lost due to making gifts in the 'wrong' order, it is not necessarily a disaster for IHT purposes if the qualifying asset was gifted to another individual, because the gift is a potentially exempt transfer which becomes exempt after seven years in any event. Consideration could be given to taking out insurance against the risk of the transferor's death within that period.

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