

Related property planning

(Lecture P1214 – 26.57 minutes)

The related property provisions in S161 IHTA 1984 are there to prevent an individual deliberately fragmenting a shareholding in a private company (or indeed any property which is more valuable as a whole than the sum of its parts) by means of an exempt transfer to a spouse, civil partner, charity or other exempt body. The most important application of this rule arises in connection with the transfer of unquoted shares. This is because of its effect when considered alongside two important factors:

1. the principle that the loss to the donor is the measure of the value transferred; and
2. the fact that the value of different shares in the same company can vary considerably depending on the size of the holding to be valued.

Where a husband and wife each own shares in a company and their combined holdings carry control, the IHT valuation rules ensure that there can be significant benefits in arranging for the spouse with the smaller holding to make the transfer which reduces their combined holdings to below the level of control.

Illustration

Jeremy has a 49% shareholding in a family business and his wife owns a 2% shareholding in the same company. There are 100 ordinary shares of £1 each in issue. Prospective share values are as follows:

51% holding	£10,000 per share
49% holding	£5,800 per share
2% holding	£1,200 per share

If Jeremy and his wife have decided to give away their shares, the position where Jeremy makes the first gift is:

		£
Jeremy	49 shares @ £10,000 per share	490,000
Wife	2 shares @ £1,200 per share	<u>2,400</u>
		<u>£492,400</u>

On the other hand, if Jeremy's wife makes the first gift, the position is:

Wife	2 shares @ £10,000 per share	20,000
Jeremy	49 shares @ £5,800 per share	<u>284,200</u>
		<u>£304,200</u>

Jeremy's wife should therefore make the first gift. This effect is a standard phenomenon within the context of IHT and should always be borne in mind. However, the position is complicated by the rates of business relief. If the company which Jeremy and his wife control is a trading concern, a 100% relief would be available in either case to cancel out the transfer of value. This planning point is therefore most useful where the transfer involves shares in investment companies or in trading companies with significant excepted assets.

A problem faced by parents holding in excess of 50% of the voting shares of a large family company is that their children are usually unable to afford to purchase their parents' shares in one go. If, instead, the parents make piecemeal gifts or sales of their shares to the children, they may still be vulnerable to a disproportionately large tax charge in connection with the transfer which reduces their related holdings to below the level of control.

Illustration

Sam's Business Ltd is a family company with an issued share capital of 10,000 ordinary shares of £1 each. Shareholdings of various sizes are valued as follows:

60%	£170 per share
45%	£80 per share
15%	£25 per share

Sam owns 4,000 shares, while his wife holds 2,000. A 15% holding can be disposed of by either Sam or his wife in a number of different ways:

First possibility - Sam's wife gives 1,500 shares to their son.

Thus:

Before	2,000 shares @ £170 per share	340,000
After	500 shares @ £80 per share	<u>40,000</u>
		<u>£300,000</u>

Shares worth £37,500 (1,500 shares @ £25 per share) have been passed to the son, but the chargeable value of this gift for IHT purposes (before reliefs) is £300,000. Note that the CGT disposal value is £37,500.

Second possibility - Sam's wife sells 1,500 of her shares to the son for £37,500. It is important to appreciate that this will still be a transfer of value, unless the wife can show that the (see S10 IHTA 1984):

- transaction was not intended to confer any gratuitous benefit on any person;
- disposition was such as might be expected to be made in a transaction at arm's length between persons not connected with each other; and
- deal was done at a price which was freely negotiated at the time of the sale (or at a price such as might be expected to have been freely negotiated at that time).

If the son was threatening to leave the company unless he was allowed to acquire some shares (and where his services were valuable to the business), it is thought that S10 IHTA 1984 would be in point – but otherwise, probably not.

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