

A merry dance

JAMES KESSLER and **OLIVER MARRE** contend that shares in a trading company that are held by way of a partnership are still eligible for business property relief.

It is often the case that shares in a trading company are held through an investment partnership, as indicated by *Partnership Holdings*. Typically, this is a limited liability partnership (LLP), but the type of partnership does not usually matter, because *IHTA 1984, s 267A* directs that an LLP is to be treated in the same way as other partnerships for inheritance tax purposes.

HMRC contend that business property relief is not available for inheritance tax purposes, for example on the death of a partner or on a gift of a partnership share, even though the relief would have been available if the same shares had been held directly by the individual, instead of through the partnership.

The department's view was recently restated in the ICAEW's *Taxguide 1/14: IHT Business Property Relief – Interests in Partnerships/LLPs and Surplus Cash Holdings* (www.lexisurl.com/bv5tr). This is an unfair view so it is pleasing to find that, on analysis, it is not correct.

The opposite view

Business property relief applies to "relevant business property". *IHTA 1984, s 105(1)* sets out six categories of such property.

We are considering a case where the partnership carries on the business of making or holding investments. That precludes relief under the first category, *s 105(1)(a)*. An interest in a partnership is relevant business property under *s 105(1)(a)*, but not in the case of a partnership carrying on an investment business. This is because *IHTA 1984, s 105(3)* states:



"A business or interest in a business, or shares in or securities of a company, are not relevant business property if the business or, as the case may be, the business carried on by the company consists wholly or mainly of one or more of the following, that is to say, dealing in securities, stocks or shares, land or buildings or making or holding investments."

What about the third category, *s 105(1)(bb)*? This provides that unquoted shares in trading companies are relevant business property and so qualify for business property relief.

The response of HMRC is that partnerships are "opaque" for inheritance tax purposes and that it is not possible to "look through" the partnership down to the underlying shares.

However, the department's approach overlooks the relevant statutory provision. Business property relief is conferred by *IHTA 1984, s 104(1)*, which provides:

"Where the whole or part of the value transferred by a transfer of value is attributable to the value of any relevant business property, the whole or that part of the value transferred shall be treated as reduced..."

KEY POINTS

- Unquoted shares in trading companies are relevant business property.
- Limited liability partnerships are treated as other partnerships.
- HMRC consider that relief is not available where unquoted shares are not held directly.
- The impact of the case of *RCC v Nelson Dance*.
- Over-reliance on the concepts of "transparent" and "obscure" does not help.

PARTNERSHIP HOLDINGS



IHTA 1984, S 105(1)*Relevant business property*

Subject to the following provisions of this section and to s 106, s 108, s 112(3) and s 113 below, in this Chapter “relevant business property” means, in relation to any transfer of value:

- (a) property consisting of a business or interest in a business;
- (b) securities of a company which are unquoted and which (either by themselves or together with other such securities owned by the transferor and any unquoted shares so owned) gave the transferor control of the company immediately before the transfer;
- (bb) any unquoted shares in a company;
- (cc) shares in or securities of a company which are quoted and which (either by themselves or together with other such shares or securities owned by the transferor) gave the transferor control of the company immediately before the transfer;
- (d) any land or building, machinery or plant which, immediately before the transfer, was used wholly or mainly for the purposes of a business carried on by a company of which the transferor then had control or by a partnership of which he then was a partner; and
- (e) any land or building, machinery or plant which, immediately before the transfer, was used wholly or mainly for the purposes of a business carried on by the transferor and was settled property in which he was then beneficially entitled to an interest in possession.

Consequently, the question that must be asked is not whether a partnership is transparent, but whether the value transferred by a transfer of value is *attributable to the value* of any relevant business property.

A transfer of value

If a partner makes a gift of the partnership interest, or dies when the partnership interest is part of their estate, they make a transfer of value. This is attributable to the value of the partnership interest. It is also attributable to the value of the underlying assets of the partnership. It is relevant to note that a partner has an interest in partnership assets as a matter of partnership law. Because the assets are relevant business property, ie shares in a trading company, business property relief applies.

This is confirmed by *HMRC v Nelson Dance Family Settlement Trustees* [2009] STC 802. In that case a farmer, who carried on business as a sole trader, transferred farmland to a trust. The value transferred by the transfer of value was attributable to the value of the land, but the land was not relevant business property. However, the value transferred was also attributable to the value of the farming business, which was. That was sufficient and business property relief applied.

The error in HMRC’s view arises from casual use of the labels “transparent” and “opaque”. The principal use of these terms is in an income tax context. HMRC’s *International Manual* at IM180020 explains the position as follows.

IHTA 1984, S 267A*Limited liability partnerships*

For the purposes of this Act and any other enactments relating to inheritance tax:

- (a) property to which a limited liability partnership is entitled, or which it occupies or uses, shall be treated as property to which its members are entitled, or which they occupy or use, as partners;
- (b) any business carried on by a limited liability partnership shall be treated as carried on in partnership by its members;
- (c) incorporation, change in membership or dissolution of a limited liability partnership shall be treated as formation, alteration or dissolution of a partnership; and
- (d) any transfer of value made by or to a limited liability partnership shall be treated as made by or to its members in partnership (and not by or to the limited liability partnership as such).

“Entities are described as either fiscally ‘transparent’ or ‘opaque’ solely for the purposes of deciding how a member is to be taxed on the income they derive from their interest in the entity. In the case of a ‘transparent’ entity the member is regarded as being entitled to a share in the underlying income of the entity as it arises ... In the case of an ‘opaque’ entity the member generally is taxed only on the distributions made by the entity.”

Useful shorthand only

Outside that income tax context, the terms “transparent” and “opaque” may be a useful shorthand, but it is necessary to focus on the words of the statute; if that is not done, the terms may mislead. They are best used to represent a conclusion rather than a reason for reaching that conclusion. For instance, the situs of a partnership interest for inheritance tax is where the partnership business is carried on, not the situs of the underlying partnership assets, which one may summarise by saying that partnerships are not transparent for inheritance tax situs.

The First-tier Tribunal made this point in *Swift v HMRC* [2010] UKFTT 88 at paragraph 18.

“The issue is whether the UK tax is ‘computed by reference to the same profits or income’ or whether he is taxable on the equivalent of a dividend. Asking whether SP LLC is transparent or opaque may be another way of asking the same question but we consider that it is preferable to apply the words of the treaty.”

Quite so. ■

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