OLD SQUARE
TAX CHAMBERS

Business Property Relief & Employee Trusts

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WHAT IS COVERED IN THIS TALK

- What are the key inheritance tax concerns of individuals returning to the UK?
- How can Business Property Relief help them?
- How can Employee Trusts help them?

Key concerns

- Inheritance tax
  - How does inheritance tax apply?
  - Current Nil Rate Band: £325,000 (residence NRB £175,000 by 2020/2021)
  - Rate: 40% / 20%
  - Exempt Transfers, Chargeable Transfers, Potentially Exempt Transfers

KEY EXEMPTIONS / RELIEFS

- Transfers between spouses (bear in mind domicile of the spouses)
- Gifts to certain favoured bodies
- Gifts of certain type of property
- Annual exempt amount of £3,000
- Gifts of up to £250
- Payments for family maintenance
- Normal expenditure out of income
- *Employee Trusts

- Business Property Relief
- Agricultural Property Relief
- Woodlands Relief
- Transfers within 7 years of death

Example

John has an investment company which he has been operating in Dubai.

He returns to the UK tomorrow to remain for the rest of his life without putting any planning into place. He sells 20% of the shares in his company for a gain of £400,000.

He will be upset because:

1. He will have had to pay capital gains tax on the gain as soon as it arises.
2. The remaining shares will form part of his estate when he dies.

IHT on Trusts

Distinguish between:

- Qualifying Interests in Possession
- Relevant Property Regime
    - Entry Charge
    - 10 yearly charge
    - Exit charge

Business Property Relief: Overview

- Statutory Relief from Inheritance Tax
- Part V, Chapter I IHTA 1984
- Has increased over the years from 30% to 50%/100%
- Must:
    - Be relevant business property;
    - Meet the ownership requirement;
    - Not be in one of the excluded categories; and
    - Not include value that is excepted.

Business Property Relief: Questions to ask

- To apply the relief, you have to ask:
  - Has there been a transfer of value?
  - What value was transferred by the transfer of value?
  - Did the transfers involve Relevant Business Property and, if so, what is the applicable rate of Business Property Relief?
  - What was the value of the Relevant Business Property?
  - How much of the value transferred by the transfer of value was attributable to the value of the Relevant Business Property?

Business Property Relief: Summary of Planning Option

- Trading Company owned for 2 years
- Transfer the trading company into a trust structure
- HMRC Claim necessary?
- Why do it?
  - IHT
  - CGT

Relevant Business Property

100% relief for:

- A business or an interest in a business
- Unquoted Company Shares
- Unquoted Company Securities that give control of more than 50% of the votes

Relevant Business Property

50% relief for:

- Quoted company shares or securities (must give control of more than 50% of votes);
- Land, buildings, machinery or plant owned by the transferor directly and used wholly or mainly for the purposes of a business carried on by a company or partnership that he controlled where that interest in the company or partnership interest also qualified as relevant business property; and
- Land, buildings, machinery or plant owned by a trust used by a life tenant wholly or mainly for the purposes of a business carried on by him that also qualified as relevant business property.

Meaning of “Business”

- Not Defined
- Includes: “a business carried on in the exercise of a profession or vocation, but does not include a business carried on otherwise than for gain”
- Business does not need to be in the UK

Meaning of Control

- Important in relation to shares and securities
- Meaning as provided in section 269 IHTA 1984: means control of powers of voting on all questions affecting the company as a whole which if exercised would yield a majority of the votes capable of being exercised on them.

Exceptions to Relevant Business Property

- Businesses which consist wholly or mainly of dealing in securities, stocks or shares, land or buildings or making and holding investments;
- Shares or securities if at the time of transfer, the company has passed a resolution for winding up; and
- Property which is subject to a binding contract for its sale.

Investment or Trading Business

- No clear cut line on investment or trading business
- No definition of wholly or mainly
- Look to the main activities of the business, its assets and sources of income and gains over a reasonable period preceding the transfer
- Take care where there has been a change in the nature of the business
- HMRC usually deny BPR where the business involves letting property on the grounds that it is one of making or holding investments

Other Exceptions

- Liquidation

  Shares in or securities of a company are not relevant business property in relation to a transfer of value if at the time of the transfer a winding-up order has been made in respect of the company or the company has passed a resolution for voluntary winding-up or is otherwise in process of liquidation …

- Properties subject to a contract for sale:

  If at the time of the transfer a binding contract for sale has been entered into, the property will not qualify as relevant business property unless:

  (i) it is a business or an interest in a business and the sale is to a company which is to carry on the business and is in consideration wholly or mainly for shares or securities in the company; or

  (ii) it is shares or securities in a company and the sale is for the purpose of reconstruction or amalgamation.

Minimum Ownership Requirement

- Must have been owned by the transferor throughout the two-year period leading up to the transfer
- Beneficial ownership
- Ownership by a trust?
- Relaxation for:
  - Transfers between spouses
  - Quick succession
  - Replacement Property

Valuation and Excepted Assets

- Valuation of a business or interest in a business is its net value (section 110 IHTA)
- Value of any relevant business property attributable to excepted assets does not qualify for relief.
- Excepted assets are those neither:

  (i) used wholly or mainly for the purposes of the business concerned throughout the last two years before the transfer (or since acquisition if more recent) – Be careful of personal use!; nor

  (ii) required at the time of the transfer for the future use of the business.

CLEARANCES / CLAWBACK

- Where property benefiting from Business Property Relief is transferred during the person's lifetime, the relief is clawed back if the transferor dies within seven years of the transfer unless both of the following exists:
  - The transferee still owns the property or replacement property
  - The property still qualifies as Relevant Business Property (ignoring the minimum ownership requirement).
- Gifts With Reservation concerns?
- Non-statutory clearance?

Capital Gains Tax

- Capital Gains Tax advantage by holding through a non-resident trust
- Not immediately chargeable where gains made to non-resident trustees

Employee Trusts: Overview

- Helpful where client owns primarily an investment business
- Employee trusts are trusts (usually discretionary) created for the benefit of employees
- Overseas company could set up the Employee Benefit Trust
- Client then transfers at least 51% of his share to the Employee Benefit Trust
- Can keep shares outside of relevant property regime

Section 28 IHTA

(1) A transfer of value made by an individual who is beneficially entitled to shares in a company is an exempt transfer to the extent that the value transferred is attributable to shares in or securities of the company which become comprised in a settlement if—

(a) the trusts of the settlement are of the description specified in section 86(1) below, and

(b) the persons for whose benefit the trusts permit the settled property to be applied include all or most of the persons employed by or holding office with the company.

(2) Subsection (1) above shall not apply unless at the date of the transfer, or at a subsequent date not more than one year thereafter, both the following conditions are satisfied, that is to say—

(a) the trustees—

(i) hold more than one half of the ordinary shares in the company, and

(ii) have powers of voting on all questions affecting the company as a whole which if exercised would yield a majority of the votes capable of being exercised on them; and

(b) there are no provisions in any agreement or instrument affecting the company's constitution or management or its shares or securities whereby the condition in paragraph (a) above can cease to be satisfied without the consent of the trustees.

Section 86(1) requirements

(1) Where settled property is held on trusts which, either indefinitely or until the end of a period (whether defined by a date or in some other way) do not permit any of the settled property to be applied otherwise than for the benefit of—

(a) persons of a class defined by reference to employment in a particular trade or profession, or employment by, or office with, a body carrying on a trade, profession or undertaking, or

(b) persons of a class defined by reference to marriage to or civil partnership with, or relationship to, or dependence on, persons of a class defined as mentioned in paragraph (a) above,

then, subject to subsection (3) below, this section applies to that settled property or, as the case may be, applies to it during that period.

Required Shareholding

(2) Subsection (1) above shall not apply unless at the date of the transfer, or at a subsequent date not more than one year thereafter, both the following conditions are satisfied, that is to say—

(a) the trustees—

(i) hold more than one half of the ordinary shares in the company, and

(ii) have powers of voting on all questions affecting the company as a whole which if exercised would yield a majority of the votes capable of being exercised on them; and

(b) there are no provisions in any agreement or instrument affecting the company's constitution or management or its shares or securities whereby the condition in paragraph (a) above can cease to be satisfied without the consent of the trustees.

Participator Restriction

- The trust cannot permit any of the settled property to be applied for the benefit of (section 28(4) IHTA 1984):
  - a participator in the company;
  - any other person who is a participator in any close company that has made a disposition whereby property became comprised in the settlement which but for the provision related to close companies and employee trusts would be a transfer of value;
  - any other person who has been a participator in the company at any time after or during the ten years before the transfer of value mentioned in subsection (1);
  - any person connected with the aforementioned participators.

WHO IS A PARTICIPATOR FOR THESE PURPOSES?

- A participator is any person who is or would be if the company were resident in the UK) a participator in relation to that company within the meaning given by section 454 Corporation Tax Act 2010, other than a person who would be such a participator by reason only of being a loan creditor.
- However, the definition of participator is limited by section 28(5) IHTA in that it does not include any participator who:
  - Is not beneficially entitled to, or to right entitling him to acquire, 5 per cent of more of, or of any class of the shares comprised in, its issued share capital, and
  - On a winding-up would not be entitled to 5 per cent. or more of its assets.

Drafting Points

- Trustees' discretion cannot be fettered in certain ways
- Do not include Personal Representatives of a deceased employee as a beneficiary (IHTM 42922)
- Take care with trustee remuneration (IHTM 42926)
- Trustees can have the power to alter trusts to add beneficiaries. The problem only arises if it is exercised in a way that means the trust is no longer within section 86(1)

Property Leaving the EBT

- If the EBT ceases to qualify under IHTA section 86, then an exit charge can arise.
- Additionally, an exit charge is also levied if the trustees make a distribution to persons listed in section 72(3):

  (a) he has directly or indirectly provided any of the settled property otherwise than by additions not exceeding in value £1,000 in any one year; or

  (b) in a case where the employment in question is employment by a close company, he is a participator in relation to that company and either—

  (i) is beneficially entitled to, or to rights entitling him to acquire, not less than 5 per cent. of, or of any class of the shares comprised in, its issued share capital, or

  (ii) would, on a winding-up of the company, be entitled to not less than 5 per cent. of its assets; or

  (c) he has acquired an interest in the settled property for a consideration in money or money's worth.

* Exception where income payment

Additional Considerations

- Capital Gains Tax (off-shore trustees / UK domiciled individuals)
- Interaction with BPR
- Consider whether any reporting obligation exists under section 218 IHTA