

Avoiding IHT on family company shareholdings

Business property qualifies for 100% relief from inheritance tax, subject to many detailed conditions and exclusions. It is becoming evident that HM Revenue & Customs are endeavoring to restrict the boundaries of what qualifies for the relief and generally it will be found that claims are given intense scrutiny by the Revenue.

Shares in an unquoted company may qualify for the relief, but two exclusions can apply. The first is where the business carried on by the company is wholly or mainly one of dealing in securities, stocks or shares, land or buildings or making or holding investments; in that case, no relief at all will be given in respect of the shares in the company as it will be totally excluded from any relief. The second exclusion is for excepted assets held within the company; these are assets which are not wholly or mainly used for the purposes of a business and those particular assets will cause a limitation on the relief available for the shares in the company, albeit not destroying the claim to relief entirely as is the case with companies conducting wholly or mainly an investment business.

It is by no means unusual for a trading company to change its nature over a period of years so that the trading activity declines and an investment activity commences as an addition to the trading activity. In these cases, inheritance tax business property relief may still be available for the shares in the company, so long as the investment activity does not cause the company to be wholly or mainly an investment company. How this is to be tested is not necessarily a straightforward matter. But if the time engaged by the directors in the trading activity exceeds the time engaged in the investment activity that will be one helpful factor. One will also need to review the income streams produced by the two different activities as well as the capital assets held for each of them. In this way, it should be possible to build up the overall picture in order to decide whether the company is still wholly or mainly trading, and thus eligible for relief, or whether it has become mainly an investment company, qualifying for no relief at all.

So long as the investment activity is not the main one, the remaining issue will then be whether the investments held constitute excepted assets, thus causing a limitation on business property relief for the company shareholders. In this regard, there are a number of decisions of both the courts and the special commissioners in the context of corporation tax which give helpful guidance. The main one is the Korean Syndicate case 12TC181 in which it was held that a company which received only bank interest and some royalties was still carrying on a business for tax purposes. A useful decision of the special commissioners is in the case of Land Management v Fox in which a company held a tenanted residential property producing rents of £1,000 a year and it received some small amounts of interest. It also had one or two shares in quoted companies. It was

held that the company was carrying on a business, this being a business of holding and making investments.

On the basis of these decisions there is a strong argument to the effect that a company which is mainly a trading company, but which additionally has an investment activity, perhaps with let properties or with holdings of quoted shares, has no excepted assets at all for business property relief purposes. The investment holdings are held for the purposes of an investment business whose extent is still overshadowed by the main trading business.

HM Revenue & Customs will commonly argue that an investment activity conducted by a company is only a business if the directors are actively involved in it. This contention should not be accepted. In the special commissioners case of Salaried Persons Postal Loans Limited, a company held a let property producing a small rental stream and this was entirely based under the control of an outside agent. However the special commissioner noted that the use of an agent was irrelevant, since the activity of the agent was to be attributed to the company. The fact that the company was paying someone else to do what it would otherwise have had to do itself was neither here nor there. A similar point was made in the American Leaf Blending case [1978] STC561 in which it was held that "the carrying on of business no doubt usually calls for some activity on the part of whoever carries it on, though, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence". Thus even though there may be investment managers or property agents employed by a company, the central decision making process by the company in relation to its investment business will still be made by the Board on a periodic basis and the American Leaf Blending case justifies the conclusion that the activity remains an investment business of the company.

This may appear to indicate, therefore, that any company which is mainly trading can never have excepted assets because any investment assets will be held for the purposes of an investment business. Whilst there are some who subscribe to this view, leading counsel has advised that the simple holding of one or two investments by a trading company will probably not amount to an investment business being conducted by the company, so that the investments concerned will be excepted assets. This view point is however not universally accepted and no doubt it will one day be tested at the special commissioners.

In the case of a trading group, one important point to note is that if one of the subsidiary companies is wholly or mainly an investment company, that will restrict the inheritance tax business property relief in relation to the shares in the parent company. If however the investments are spread around a group companies which are all mainly trading companies, there should be no restriction on the inheritance tax relief for the reasons given above.

Companies which have acquired investment businesses alongside trading activities are well advised to have the whole position reviewed from an inheritance tax prospective to ensure that business property relief will not be lost for the shareholders. We can undertake such a review and can advise on the steps which may be taken to improve the prospects of a successful claim to the relief.

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