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Tax

Excerpt from Rayney's Tax Planning for Family and Owner-Managed Companies 2019/20 – Chapter 17 - Business property relief (BPR) for the family or owner-managed company

Rationale for BPR

17.19
Business Property Relief (BPR) (sometimes now also referred to as Business relief) was introduced by the *FA 1976*. At that time, the primary aim of the relief was to ensure that, on the death of the owner-manager, the business could continue within the family without having to be sold or broken-up to fund the IHT liability. Since then, there is general acceptance that BPR encourages investment in risky trading businesses.

Over time, BPR has extended to a wider range of business assets, including minority shareholdings in trading companies.

However, there is a growing feeling that the generous BPR is being exploited, perhaps as a result of its relatively generous qualifying rules.

HMRC has recently conducted research into 'The influences of inheritance tax reliefs and exemptions on estate planning and inheritances'. This survey showed that most BPR claims appeared to be 'genuine and in keeping with policy objectives'.

100% relief for qualifying shareholdings

17.19A
100% BPR applies to most unquoted shareholdings (including non-voting ordinary or preference shares) in trading companies. (Shares in AIM companies are 'unquoted' for this purpose and hence qualify for 100% BPR). Qualifying shareholdings are completely exempt from IHT, both on a lifetime transfer and on death. BPR operates by reducing the value transferred – in this case to nil (*IHTA 1984, s 104(1)*).

The relevant shareholding must be held for at least two years prior to the transfer/death to qualify for the relief (*IHTA 1984, ss 106, 107*). Where shares are acquired on the death of a spouse, their period of ownership also counts towards the two-year minimum ownership period (which is not the case in

respect of a lifetime transfer) (*IHTA 1984, s 108(b)*).

Where the two-year period is not satisfied, relief may still be available under the special rules for replacement business property (*IHTA 1984, s 107*), or successive transfers made within two years (*IHTA 1984, s 109*).

BPR is available to both working and passive shareholders – it is not necessary for the shareholder to be a director or work full time in the business (for further potential restrictions, see **17.25**–**17.34**).

Securities in unquoted trading companies may also qualify for 100% relief, provided the special 'control' conditions in (*IHTA 1994, s 105(1)(b)*) are satisfied.

It may be possible to defer any IHT liability on shares that do not qualify for 100% BPR (for example, shares in a family investment company) and certain other assets by electing to pay it over ten years in equal instalments. The IHT can be deferred on an interest-free basis for most business assets (see *IHTA 1984, ss 227, 228, 233* and *234* for detailed conditions).

50% relief for business property owned by a controlling shareholder

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Where the owner-manager personally holds property or plant and machinery outside the company which are used in the company's trade, then BPR of 50% should be available on these assets on a chargeable lifetime transfer or on death (see also **17.111**). However, the shareholder only qualifies for this relief if they control the company. For these purposes, related property, such as shares held by a spouse (see **17.8**), is also considered in determining whether the transferor has the necessary control.

The Special Commissioners' decision in *Walkers Executors v CIR* [2001] STC (SCD) 86 may be helpful in cases where only 50% of the shares are held. In this case, the shareholder was chairman of the board of directors and beneficially owned only 50% of the company's ordinary shares. Under the company's Articles of Association, the chairman was entitled to a casting vote at a general meeting of the shareholders. The combination of the 50% shareholding and the casting vote was held to be sufficient to secure control and thus 50% BPR was given on property owned by the (deceased) shareholder which had been used in the company's business.

The *Companies (Model Articles) Regulations 2008* (which apply to private and public companies incorporated on or after 1 October 2009) are likely to provide for a chairman to be appointed and for them to have a casting vote. However, relief may not be secured in those cases which provide for a 'rotation' of the casting vote, as the chairman may die at the 'wrong' time!

Loan accounts

17.21

Family and owner-managed companies are often financed by loans from shareholders (which can be repaid more readily). However, loans, debts, directors' current account balances, etc do not qualify for BPR.

In appropriate circumstances, it may therefore be beneficial to 'capitalise' such loans as preference or ordinary shares, taking care that the rights, etc attaching to the new shares do not create any unintended shift in the balance between the company's existing shareholdings (see **11.23**–**11.24B**).

Planning with rights issues of shares

17.22
In appropriate cases, a rights issue of shares can be used to access BPR where an owner manager personally holds substantial cash but is unlikely to meet the two-year BPR ownership period before death – ie they are in 'poor health' and unlikely to live very long.

Such planning relies on the special rules in *IHTA 1984, s 107(4)*, which provide that unlisted shares which are 'acquired' under a CGT reorganisation within *TCGA 1992, ss 126–136* (such as on a rights issue) are identified with shares already held by the owner manager. Thus, a right issue of shares would be treated as held for the same period as the owner-manager's existing shares. These 'new' shares would therefore invariably qualify for BPR immediately after they were issued (since they would be deemed to have satisfied the 'two-year ownership' test).

An attempt to use this type of planning failed in *The Executors of Mrs Mary Dugan-Chapman & Anor v HMRC* [2008] SpC 666. However, this was only because of a failure to implement the rights issue correctly, which requires an offer to all the company's shareholders in proportion to their existing shareholdings.

In this case, Mrs Chapman, who was recently widowed and had failing health, was advised by Counsel to capitalise her £300,000 loan account by subscribing for further shares under a rights issue in the family trading company. HMRC accepted that BPR was available on these 300,000 £1 shares. However, documentation was prepared for a further share subscription of £1,000,000 by Mrs Chapman. She subscribed for the shares (through an attorney) but died two days later. However, because there was no offer to the other shareholders at the time of this subscription, it was *not* a rights issue. Consequently, since the shares did not fall within the special provisions in *IHTA 1984, s 107(4)*, the Special Commissioner held that BPR was not available on Mrs Chapman's subsequent £1,000,000 share subscription. Following this decision, the 'Chapman family' took a successful negligence claim against the lawyers on the grounds that, had the planning been executed properly, BPR would have been available (see *Vinton v Fladgate Fielder* [2010] EWHC 904 (Ch)).

BPR on a PET of shares becoming chargeable

17.23
Where a PET of shares (see **17.10**) becomes chargeable on the donor's death (within seven years of the gift), BPR will only be available on the 'failed PET' if the *donee* has retained the shares until the donor's death and the shares still qualify for relief at that point (*IHTA 1984, s 113A*).

Binding contract for sale of shares

17.24
No BPR is available if a binding contract for the sale of the relevant business property has been entered into at the date of transfer (*IHTA 1984, s 113*). From an IHT perspective, the relevant shares are effectively treated as no longer held by the deceased shareholder. This means that the value of the right to receive the sale proceeds must be included in their taxable estate for IHT (since the right is not relevant business property).

The question of whether a 'binding contract for sale' exists at the date of the relevant transfer is a question of fact, which will be determined by the precise circumstances of each case. Private company shareholders should therefore be aware of agreements which require their executors to sell their shares to the remaining shareholders if they die before retirement. This is fatal as HMRC regard this as a binding contract for sale and therefore deny BPR (SP12/80).

The basic rationale behind this rule is to prevent the transferor from obtaining BPR where they enter into a binding agreement to sell their relevant business property and then make an immediate transfer of it. In effect, the transfer becomes one of all or part of the proceeds of sale.

HMRC will look very carefully at the availability of BPR in cases where an actual sale or flotation of a company takes place shortly after a transfer of the shares.

No BPR restriction applies where the business (or interest in a business) is sold to a company wholly or mainly in exchange for shares *or* the sale is part of a reconstruction or amalgamation transaction.

The 'binding contract for sale' restriction may (exceptionally) catch certain buy and sell agreements which are sometimes entered into by shareholder-directors of owner managed companies. Typically, these agreements are triggered where one of the shareholders dies before retirement and gives the surviving shareholders the right to purchase the deceased shareholder's shares (from funds provided by life assurance policies).

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In most cases, if the company's articles simply require the personal representatives of the deceased shareholder to *offer* to sell the shares back to the company or other shareholders (without any legal

obligation by them to purchase the shares), this will not constitute a binding contract for sale. On the other hand, such agreements will cause BPR to be denied where the deceased's shares pass to their personal representatives and

- the personal representatives are *required* to sell the shares to the other shareholders; and
- the other shareholders must buy them (SP12/80).

In practice, the potential denial of BPR is normally avoided by using 'put and call' options (see **17.37** and **17.51**) which give the deceased's personal representatives an *option* to sell the deceased's shares and the remaining shareholders (or the company) the *optio*n to buy the same shares (out of the proceeds of an appropriate life insurance policy – see **17.37**). Either party can, therefore, ensure that the shares are transferred without the risk of losing BPR (as there is no binding contract for sale). From a CGT perspective, it is desirable to have successive (and different) exercise periods for the put and the call option.

Prohibition on liabilities used to finance share acquisitions

17.25A

Loans and debts owing by the deceased are normally deductible against their taxable estate for IHT purposes. However, since 6 April 2013, loans taken out to finance the purchase of BPR-eligible shares cannot be deducted against the deceased's estate for IHT purposes (see **17.14A**)

For more information about Rayney's Tax Planning for Family and Owner-Managed Companies 2019/20: