INHERITANCE TAX - BUSINESS PROPERTY RELIEF

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Introduction

After being stalled by the General Election last April, the Finance (No 2) Act 1992 (in section 73 and Schedule 14) has now implemented the significant changes to the inheritance tax relief for business property which were foreshadowed in the Chancellor of the Exchequer's Budget on 10th March 1992.

In place of the previous régime with its rates of relief at 50% and 30% there is now relief at either 100% (equivalent in effect to a complete exemption from tax) and 50%. Further, there have been important changes made to the types of asset qualifying for business property relief, in particular the new definition of a quoted company for the purposes of the relief has been designed to specifically exclude USM companies from being quoted companies.

The new rates of relief now apply to the following categories of relevant business property (the old rates of relief are referred to in square brackets):

100% relief will apply to:

(a) gifts of interests in unincorporated businesses (whether the business is carried on as sole trader or as a partner) [50%];

(b) gifts out of controlling shareholdings in unquoted companies [50%] (which now includes USM companies [50%]);

(c) gifts out of non-controlling shareholdings above 25% in unquoted companies [50%] (which again now includes USM companies [0%]).

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50% relief will apply to:

(a) gifts out of controlling holdings in fully listed companies [50%];

(b) gifts out of holdings of 25% or less in unquoted companies [30%] (now including USM companies [0%]);

(c) assets (comprising land or buildings, plant or machinery) owned by a partner and used wholly or mainly for the purposes of the partnership business or owned by a controlling shareholder and used wholly or mainly for the purpose of the business of the company [30%];

(d) Assets as in (c) above held in an interest in possession settlement and used wholly or mainly for the purposes of a business carried on by the beneficiary with an interest in possession [30%].

The new rates of relief apply for any transfer of value (e.g., a lifetime gift or on death) occurring after 9th March 1992. They will also apply where tax becomes payable as a result of a person's death in respect of a previous potentially exempt transfer or chargeable transfer made prior to 10th March 1992 which becomes a chargeable transfer or gives rise to additional tax respectively on or after that date.

As a result of the above changes, there are many new planning considerations for practitioners and their business clients.

Future Strategy - Give Now or Wait Until Death?

Where the new 100% relief is available there may now be considerable reluctance to make lifetime gifts where any capital gain is not fully exempted by retirement relief and/or the annual capital gains tax exemption. Even if capital gains tax hold-over relief were available to avoid an immediate capital gains tax charge there is still the risk of an "emigration" charge if the donee subsequently emigrates from the UK (s.168 TCGA 1992). Further, business property relief on a lifetime gift may be lost if the donee no longer owns the assets gifted at the date of the donor's death (see "Loss of Business Property Relief" below).

On the other hand there may be a desire to make the best use of the current favourable regime in case it is altered again following a change of government before the donor's death. With family companies there may well be a greater inclination to "generation skip" in making lifetime gifts or gifts on death in case the new reliefs are reversed before the shares get into the "grandchild" generation's hands.

These new tendencies may prove frustrating for aspiring "next generation" children working in the family business and may also result in a delay in their being able to build up their own 100% business property relief two year qualifying period and also their full ten year capital gains tax "retirement relief" qualifying period (for which, in the case of company shareholdings, they will require either at least a 25% interest in voting rights in their own name or at least 5% with members of their family (including themselves) having a 51% interest in voting rights).

The "Two" 2 Year Requirements

Two Years Ownership

For property to qualify as relevant business property the donor/deceased must have owned it for at least two years prior to the lifetime gift or death (as the case may be) (s.106 IHTA 1984).

There are rules, however, governing replacement business property which has not been owned for the required two year period. Broadly, section 107 Inheritance Tax Act 1984 allows such replacement property to qualify as long as the original property and the replacement property were owned for at least two years out of the five years immediately prior to the lifetime gift or death. However, the replacement property rules do not normally apply to replacements of unquoted minority holdings (whether above or below 25%), except in the case of certain reorganisations of share capital (see below) s.107(4).

It should be noted that the above replacement property rules are different from those dealing with replacement property in connection with the possible loss of business property relief after a lifetime gift (see "Loss of Business Property Relief" below).

Two Years Voting Control for Minority Holdings Above 25%

Previously, the 50% business property relief for gifts out of unquoted non-controlling minority shareholdings above 25% required the transferor to have, for at least two years prior to a lifetime gift/death, control of powers of voting (save for some limited exceptions) on all questions affecting the company as a whole which, if exercised, would have yielded more than 25% of the votes capable of being exercised on them. This rule continues for the new 100% relief now available for such holdings (s.109A IHTA 1984).

This two year requirement is not imposed, however, in the case of relief for gifts out of controlling shareholdings whether unquoted (where 100% relief is available) or quoted (where 50% relief is available).

The purpose of the rule is to prevent manipulation by "death-bed" arrangements although these are still possible for gifts out of controlling holdings.

Example 1

Arthur acquired 49% of Amethyst Ltd in September 1989. Arthur becomes seriously ill in June 1992 and in July 1992 his son gifts him a further 2%. Arthur dies in August 1992. 49/51ths of his holdings should be eligible for 100% business property relief.

Example 2

Using the same facts as in Example 1, save that Arthur only acquired 24% of Amethyst Ltd in September 1989. On his death in August 1992 none of his 26% holding would be eligible for 100% relief (but 24/26ths would be eligible for 50% relief).

In the light of the two year voting control requirement unquoted company proprietors should ensure that a holding giving voting control above 25% is maintained for at least two years prior to a lifetime gift or death and this can either be by the taxpayer alone or between himself and his wife as "related property" or between himself and a trust giving him or his spouse an interest in possession.

It will also be necessary to give careful consideration, for example, to "weighted voting rights" arrangements in the Articles of Association or shareholder agreements governing the operation of the company which might deprive the taxpayer of the necessary "25% plus" voting control on all matters affecting the company.

In the case of unquoted companies it should also be remembered that the "replacement property" rules available in connection with the two year ownership requirement do not apply to minority holdings in unquoted shares except where there is a reorganisation of share capital to which the capital gains tax reorganisation provisions in Chapter II of Part IV of the Taxation of Chargeable Gains Act 1992 apply (s.107(4) IHTA 1984). Further, where there is such a reorganisation the "new holding" acquired in the reorganisation will be treated as one with the "old holding" for the purposes of the two year voting control requirement. Thus when considering certain company restructurings it may be vital to secure clearance from the Inland Revenue under s.138 TCGA 1992 that the above capital gains tax reorganisation provisions apply so as to preserve business property relief.

Excepted Assets and Ineligible Assets

The changes made by the Finance (No.2) Act 1992 have not affected the existing restrictions on business property relief where a company has "excepted assets". In this situation that part of the value transferred by a transfer of value which is attributable to excepted assets is excluded from the relief. An asset is an "excepted asset" if it was neither (a) used wholly or mainly for the purposes of the business concerned throughout the whole of the last two years of the period immediately prior to the gift during which the asset was owned by the donor, nor (b) required at the time of the transfer for future use for those purposes (s.112 IHTA 1984).

It should also be remembered that certain businesses (or an interest therein) and certain shareholdings may be ineligible for relief, viz. where the business in question or the business carried on by the company (in the case of shares) consists wholly or mainly of dealing in securities, stocks or shares, land or buildings or making or holding investments (although relief will not be denied for gifts of shares in a company whose business consists wholly or mainly of being a holding company of companies who do not carry on such disqualified activities (e.g., where the company is a holding company of a trading group)); s.105(3),(4) IHTA 1984.

Death Planning

Some new strategies may now need to be applied when planning the distribution of a taxpayer's estate on death where it consists of assets qualifying for 100% business property relief. To date, a common strategy has been to maximise business property relief by making a specific gift on death of property qualifying for the relief to non-exempt beneficiaries (often including a gift up to the nil-rate band - after taking account of the relief - to a will discretionary trust).

Certainly this approach should be continued for such taxpayers dying after 10th March 1992. However, where the testator has a will which currently provides for such assets to pass to a nil-rate band discretionary trust, the terms of the will need to be carefully reviewed to ensure that excessive assets are not now to be contributed to the trust because of the availability of 100% relief (note that this may also have implications for any inheritance tax payable in the event of a gift out of such a trust between two and ten years after a gift on death (see "Planning for Lifetime Gifts and Using Trusts" below).

Where a taxpayer has died before 10th March 1992 with an estate which includes assets qualifying for the new 100% relief which will pass by will or intestacy to non-exempt beneficiaries, to take advantage of the new 100% relief (as opposed to 50% applying at the date of death) it may be worth considering executing a deed of variation to direct the assets to the deceased's spouse. The spouse may then choose to gift the assets to the beneficiaries free of immediate inheritance tax and also capital gains tax (on the assumption, for example, that an election under s.62(6) TCGA 1992 is made and that any gains arising between the deceased's death and the date of the spouse's lifetime gift either fall within the spouse's annual capital gains tax exemption or may be held over under s.165 TCGA 1992).

In connection with the above arrangement it should be noted that under s.108 IHTA 1984 property to which a surviving spouse becomes entitled on the death of his/her spouse is treated as owned by the survivor during any period of ownership by the deceased for the purposes of the general two year ownership requirement in s.106 IHTA 1984. Further, where there is such a succession, it also appears that the two year "25% plus" voting control requirement for 100% relief is not required by the survivor (as long as he/she has such voting control during his/her period of ownership) - s.109A(b) IHTA 1984.

Planning for Lifetime Gifts and Using Trusts

If clients are minded to make lifetime gifts of business property, e.g., because retirement relief will fully exempt any gain that would otherwise have to be held over or because of a fear of a change of government at the next Election, then the amount and timing of any gift needs careful consideration.

For example, if a lifetime gift is contemplated from a holding of shares which the donor has owned for at least two years and which gives more than 25% of the voting rights, then ideally the gift should be made as one gift.

Example 3

Cedric owns 40 of the 100 ordinary shares of Cynthia Ltd. If Cedric gifts his whole holding of 40 shares by one gift, then 100% relief will be available. If, however, he gifts the shares in two equal stages, while 100% relief will be available for the first gift of 20 shares, only 50% relief will be available for the second gift.

As mentioned earlier, for the purposes of the restructured relief USM companies are to be treated like unquoted companies so that 50% business property relief will be available for minority holdings of 25% or below, with 100% relief available for shareholdings above 25%. Thus a possible strategy now is to convert a non-exempt estate into an estate qualifying for, say, 50% relief, by purchasing small minority holdings in USM companies. If such a strategy does catch on then the USM may make something of a comeback with some companies preferring USM rather than fully listed status.

The strategy does, however, carry a considerable degree of risk. First, USM shares are clearly a high risk investment so a carefully selected portfolio will be required and only a small part of the taxpayer's estate should be converted in this manner.

Secondly, the taxpayer would have to own the shares for at least two years and continue to own them right up until death (if this was part of a death planning strategy).

Thirdly, if the USM shares were gifted by way of a lifetime gift (the donor having first achieved the relevant two year ownership period) the donee may, in some cases, have to continue to hold the shares for up to seven years for relief not to be forfeited (see "Loss of Business Property Relief" below).

As already mentioned, the new régime for business property relief applies where tax becomes payable as a result of a person's death after 9th March 1992 in respect of a previous potentially exempt transfer or chargeable transfer made prior to 10th March 1992 which becomes a chargeable transfer or gives rise to additional tax (as the case may be) on or after that date. Where, following an earlier gift, appropriate term assurance arrangements have been effected on the basis of lower rates of business property relief being available and 100% relief is now potentially available such insurance arrangements may need to be reconsidered (particularly if the seven year period from the date of the previous gift would expire before the prospective date of the next General Election). In considering this matter, however, it will be necessary to be aware of the rules whereby business property relief on a lifetime gift may be forfeited (see "Loss of Business Property Relief" below).

Lifetime gifts of business assets into suitable trusts have been and should continue to be a useful strategy in appropriate circumstances. As a chargeable transfer with 100% business property relief is as effective as a potentially exempt transfer in avoiding an immediate inheritance tax charge, it may well be that gifts of business assets into discretionary trusts will become more favoured than gifts into accumulation and maintenance trusts. This will, of course, depend on a number of factors, in particular:

(a) Although accumulation and maintenance trusts can be drafted with considerable flexibility they are not as versatile as discretionary trusts.

(b) There will be no difference in income tax or capital gains tax rates between the two types of trusts while all beneficiaries do not have interests in possession.

(c) Unrestricted capital gains tax hold-over relief is currently available for gifts into and out of discretionary trusts under s.260 TCGA 1992. This is in contrast to gifts into and out of accumulation and maintenance trusts where hold-over relief for gifts of business assets would quite often only be available under s.165 TCGA 1992 (where hold-over relief can, in fact, be restricted where a company (or group) has non-business assets and at any time within the twelve months prior to disposal either

   (i) where the donor is an individual - the company is his "family company"; or

   (ii) at least 25% of the voting rights are exercisable by the donor).

   However, it should be noted that the easy availability of hold-over relief for gifts into and out of discretionary trusts under s.260 TCGA 1992 may change in the future if the Inland Revenue's Consultative Document on Trusts (published in March 1991) is implemented since it is suggested (in paragraph 6.37) that in future section 260 hold-over relief may be denied except to the extent that immediate inheritance tax is actually paid in respect of the gift.

(d) Were business property relief subsequently to be lost following a lifetime gift, an original gift into a discretionary trust (being a chargeable transfer) may sometimes be preferable to a gift into an accumulation and maintenance trust (being a potentially exempt transfer) - see "Loss of Business Property Relief" below.

(e) Where a discretionary trust is set up, business property relief may be available for calculating the value of the fund for the tenth anniversary charges and also to any "loss to the estate" on distributions from the trust. Thus, provided the discretionary trust continues to hold the assets qualifying for 100% relief for the foreseeable future, it will be an "inheritance tax-free vehicle" as much as an accumulation and maintenance trust. However, it needs to be remembered that for distributions made prior to the first ten year anniversary, the effective rate of tax is calculated without reference to the availability of business property relief (s.68(5) IHTA 1984). In some cases, therefore, it may be worth postponing any distribution until just after the first tenth anniversary of the trust.

(f) Finally, a word of warning, in that a future change of government (or any subsequent reduction in the new rates of business property relief) is more likely to affect discretionary trusts than accumulation and maintenance trusts (whose special status was introduced by the Labour government in 1976 and which have been "politically" stable since that date). As a precaution it is sensible, therefore, to continue with the common strategy of establishing a "series" of "nil-rate band" discretionary trusts on separate days (thus avoiding the trusts being "related settlements") to be followed by the appropriate gifts of business assets all on the same day (to minimise the impact of the "added property" rules for discretionary trusts). This strategy will also assist with the problem of distributions before the first ten year anniversary referred to in (e) above.

Loss of Business Property Relief

Sections 113A and 113B of the Inheritance Tax Act 1984 which may forfeit retrospectively business property relief applying to a lifetime gift were introduced with the régime for potentially exempt transfers in the Finance Act 1986.

These rules are now even more important than before where a lifetime gift of shares is made which qualifies for the new 100% business property relief.

Where a donor dies within seven years of a potentially exempt transfer or a chargeable transfer comprising relevant business property, business property relief will only be available if:

(a) the original property gifted is owned by the donee throughout the period from the date of the gift to the earlier of the date of the donor's or donee's death (although there are provisions dealing with the situation where the original property is replaced - see "Replacement Property" below); and

(b) the property would be relevant business property in relation to a notional transfer of value by the donee at the earlier of the date of his or the donor's death (ignoring the two year ownership condition); s.113A(3)(b) IHTA 1984.

The rule in (b) above does not apply to a gift of shares made after 16th March 1987 which were either quoted at the date of the original gift, or made out of a controlling holding provided the shares gifted remain unquoted throughout the period referred to in (a) above (s.113A(3A) IHTA 1984).

For the purposes of the above provisions and those relating to replacement property ("see Replacement Property" below) the Finance (No.2) Act 1992 amendments are assumed to have been in force at the time of a previous lifetime gift made before 10th March 1992. However, where such a gift was made out of a controlling holding the amendments made are to be ignored altogether for the purposes of determining whether s.113A(3A) above applies (paragraph 9(3) Schedule 14 Finance (No.2) Act 1992).

Thus, for example, if, before 10th March 1992, a gift of a minority holding of unquoted shares is made out of a controlling holding and, after that date, the shares become dealt in on the USM it appears to be intended that relief is to be lost if the donor dies within seven years. This is because, under the previous rules (assumed to be unamended), a minority holding of USM shares would not have been relevant business property in the hands of the donee and condition (b) above would not be satisfied. It may well be, however, that this intention is not satisfied since, by virtue of paragraph 9(2)(a) Schedule 14 Finance (No.2) Act 1992 such a holding would now qualify as relevant business property for the donee, so that condition (b) above is, in fact, satisfied.

There are many examples, however, of where, following a lifetime gift, there would be a failure to satisfy the conditions in (a) and (b) above:

(i) A gift by a donee of the business property in question including its transfer into a settlement established by the donee.

(ii) A sale of the gifted property by a donee unless all the proceeds are used to acquire replacement property (see "Replacement Property" below).

(iii) Where the original gift is into, say, a discretionary or accumulation and maintenance trust, the trustees appointing the property to a beneficiary absolutely or subject to an interest in possession.

This is particularly relevant for gifts into accumulation and maintenance trusts where gifts of shares to children under 25 can be made as potentially exempt transfers via such a trust. However, where the beneficiary of such a trust is aged 18 or over when the trust is established, since he must attain at least an interest in possession within the next seven years business property relief may be lost on the original gift into trust if the donor dies after the beneficiary has attained the interest in possession (or an absolute interest) and within seven years after the gift. In these circumstances an alternative for such beneficiaries would be to gift the shares into an interest in possession trust, giving the beneficiary(ies) a life interest and providing the trustees with a power to revoke all or part of such life interest.

Where the beneficiaries are under 18 then the trustees should be aware that an advance of capital or the giving of interests in possession to such beneficiaries within seven years of the gift into trust could lead to a loss of business property relief on the original gift into trust if the donor dies thereafter and within seven years of that gift.

(iv) A gift of shares to a donee followed by the liquidation of the company unless for purposes of reconstruction (see "Replacement Property" below).

(v) A gift of land or buildings, machinery or plant where the donee cannot satisfy the "control" condition (e.g., because he is a minority shareholder).

(vi) A gift out of a minority holding of shares in an unquoted company which subsequently becomes fully listed on the Stock Exchange (relief would not now be lost, however, if a private company's shares subsequently became dealt in on the USM as opposed to becoming fully listed).

Replacement Property

Section 113B Inheritance Tax Act 1984 contains rules for identifying replacement property with the original property gifted (so that business property relief on the original gift is not lost). However, the rules are extremely strict and the following conditions must be satisfied, viz:

(a) the donee must have disposed of the original property before the death of the donor;

(b) the whole of consideration received by the donee for the disposal must be applied in acquiring other property;

(c) the replacement property must be acquired or a binding contract entered into within twelve months after the disposal of the original property gifted (the date of disposal here being the date of a binding contract of sale of the original property);

(d) the disposals and acquisitions must be on arm's length terms; and

(e) the replacement property must be relevant business property at the date of the donor's death (ignoring the two year ownership requirement).

A number of important consequences of these requirements should be noted:

(i) Only one replacement is possible under these rules.

(ii) The whole of the disposal consideration may be difficult to apply in the purchase of the replacement property unless one assumes that the legislation refers to the consideration net of capital gains tax and incidental costs of disposal (compare here the wording in s.113B IHTA 1984 with, for example, s.219(1)(b) ICTA 1988 (dealing with purchases of own shares)).

(iii) There is no provision for the replacement property to be acquired *before* the disposal of the original property gifted (contrast, for example, the capital gains tax roll-over relief provisions in sections 152-158 TCGA 1992).

(iv) If the donor dies before the donee but after the disposal of the original property by the donee but before he acquires the replacement property, then business property relief on the original gift may be lost, but not if the donee still acquires the replacement property within twelve months of the disposal of original property and the replacement property is relevant business property.

Finally, it should be noted that there are provisions dealing with share reorganisations - broadly, if the original shares gifted are replaced with other shares through a share reorganisation under which capital gains tax roll-over relief under Chapter II of Part IV of the Taxation of Chargeable Gains Act 1992 would be available, then the "new holding" is identified with the original shares (s.113A(6) IHTA 1984). There must, of course, be no tax avoidance motive involved in the reorganisation which might preclude the capital gains tax roll-over relief being available, and a clearance from the Inland Revenue should be applied for where appropriate.

There are also similar provisions identifying with the original property gifted (where this consists of a business or an interest in a business) any shares issued by a company in consideration of the transfer of that business (or interest) to the company.

Thus a donee who subsequently incorporates a business gifted to him, will not, per se, forfeit business property relief.

Effect of Loss of Business Property Relief

If business property relief on a lifetime gift is subsequently "lost" and the donor dies within seven years then the consequences may be different depending on whether the original gift was a potentially exempt transfer or a chargeable transfer.

Where a potentially exempt transfer is made (e.g., a gift into an accumulation and maintenance trust), the relief is "lost" both for calculating any inheritance tax payable by the donee in respect of the potentially exempt transfer and for cumulation of the gift with the donor's death estate or other lifetime gifts.

However, where a chargeable transfer is made (e.g., a gift into a discretionary trust), although the relief is "lost" for calculating any additional inheritance tax payable by the donee, it remains intact for cumulation purposes (see s.113A(1) and (2) IHTA 1984).

In cases, therefore, where 100% relief is available (and in some cases where 50% relief is available), it may be better for the original gift to be a chargeable transfer rather than a potentially exempt transfer.

Example 4

A settlor, Dennis, who has a 30% minority holding of shares in Dennis Ltd wishes to settle the shares which qualify for business property relief (at 100%) on accumulation and maintenance trusts. The value of the shares is £200,000 and the rest of Dennis' estate is worth £400,000 (the effect of the annual £3,000 exemption is ignored).

A. **Using a PET** (i.e., accumulation and maintenance trust established at the outset)

April 1992: Dennis gifts the shares to the trustees

Value of shares	200,000	
Less 100% relief		200,000
Value of PET		Nil

No tax is payable at the time of the gift and there is nothing to cumulate.

April 1994: Dennis Ltd obtains a full listing on the Stock Exchange - business property relief is thus lost.

February 1995: Dennis dies.

Because Dennis has died within seven years the potentially exempt transfer loses its exempt status and becomes a chargeable transfer, and without the benefit of business property relief. The full value of the PET is thus cumulated with the estate on death:

Value of PET (now chargeable)		200,000
Tax payable on PET (by trustees) (assume 1992/93 rates apply)		20,000
Value of Estate (as the top slice of cumulative total of £600,000)	400,000	
Tax payable on Estate (1992/93 rates)		160,000
Total tax (PET and Estate)		180,000

B. **Using a chargeable transfer** (e.g., a gift into a discretionary trust with appointments out after two months into an accumulation and maintenance trust).

Value of Shares	200,000
Less 100% relief	200,000
Value of Chargeable Transfer	Nil

No tax is payable on making the gift.

When Dennis dies the additional tax payable on the lifetime chargeable transfer is calculated on the full value of the shares at the date of gift without business property relief. However, the estate on death is cumulated with the value of the gift as reduced by the business property relief.

Thus additional tax payable on the gift is 20,000 (same as in A). Tax on the Estate is, however, as follows:

Value of Estate (as top slice of cumulative total of £400,000)	400,000	
Tax payable on Estate		100,000
Total Tax (PET and Estate)		120,000
Tax saved in B compared with A -		60,000

Value of Business

For the purposes of business property relief the value of a business (and thus any interest therein) is taken to be its net value, i.e., the value of the assets used in the business (including goodwill) reduced by the aggregate amount of any liability incurred for the purposes of the business (s.110 IHTA 1984). Thus it may be advisable where liabilities are to be incurred for these possibly to be structured as personal liabilities rather than liabilities of the business.

Share Valuations

For company shareholdings the previous rates of business property relief of 50% and 30% produced an equivalence where a 28.58% discount on the valuation of a minority holding (of 25% or less) was achieved.

Example 5

A holding of more than 25% is worth, say, £100 per share. The inheritance tax value (after 50% business property relief) = £50.

A holding of 25% or less is worth, say, £71.42 per share (i.e., a 28.58% discount). The inheritance tax value (after 30% business property relief) = £50.

With the new rates of relief being 100% and 50% there is no such "equivalence" between the two rates. Thus, the less the discount achieved on an inheritance tax valuation of a minority holding of 25% or less, the greater will be the difference in the post-tax effect of the 100% and 50% reliefs.

In practice, however, where a lifetime gift is made and (because 100% relief is available) no immediate inheritance tax liability arises (and none is considered likely in the future were the donor to die within seven years) and nor is any capital gains tax payable (for example, because of retirement relief being available to the donor) there will be the problem of deciding whether costs should be incurred (which a client may not be very happy with) in agreeing a value with the Shares Valuation Division for the shares gifted. Failure to do so could, however, pose substantial difficulties (in the absence of proper records and information being retained) should a future valuation be required (e.g., were the donor to die just before seven years after the gift with business property relief having previously been forfeited under the rules described earlier).

In the case of death valuations of minority shareholdings an interesting problem has been identified by Bernard Rose in *Taxation* of 25th June 1992 ("the Sting in the Tail"). The problem arises where it is evident that no inheritance tax is payable on an estate consisting of a shareholding qualifying for relief and which is left either to the deceased's spouse (as an exempt gift) or to his children (with 100% business property relief being available). In such circumstances there may be no "ascertainment" (by the Inland Revenue via the Shares Valuation Division) of the value of the shares gifted on death for inheritance tax purposes so that there is no inheritance tax value so agreed which would then form the base cost of the shares for capital gains tax purposes in the hands of the legatee (s.274 TCGA 1992).

This causes a particular problem where the deceased and his/her spouse both owned shares in the same unquoted company and, because their holdings are "related property" for inheritance tax purposes, an inheritance tax valuation of the holding of the first to die would produce a higher valuation than a capital gains tax valuation of the holding under s.62(1) and (4) TCGA 1992.

Thus, for example, where the deceased had only a minority holding of unquoted shares but together he and his spouse had control of the company, his minority holding (assuming it is left to his spouse or, if left to a non-exempt beneficiary, it qualifies for 100% relief) will be valued for capital gains tax purposes as an isolated holding and not on a "related property" basis. This would often have the effect of considerably reducing the base cost of the shares in the hands of the legatee.

The suggested (and innovative) solution is for the company to acquire a suitable amount of "excepted assets" prior to the deceased shareholder's death with a view to crystallising a small inheritance tax liability on the death, thus requiring the shares in question to be valued (on a "related property" basis) for inheritance tax purposes leading to an uplifted base cost for the legatee.

Company or Partnership?

The introduction of the new 100% business property relief may now make partnerships considerably more attractive than companies from an inheritance tax point of view. As a result of the changes, where there are more than three equal "partners" in a company, only 50% relief will be available to each. In the case of a partnership, however, all partners, whatever their interest, will be eligible for 100% relief. Further, on the incorporation of a partnership a "partner" in the company who receives a non-controlling interest (even if above 25%) will have to wait until he has owned his shares for at least two years after the incorporation before that holding is eligible for any business property relief (whether at 100% or 50%) - s.107(4) IHTA 1984.

Where land or buildings, plant or machinery are owned outside the business but used for the purposes of it, 50% relief is available to the owning partner(s) whatever his/her interest in the partnership. However, 50% relief is only available to a shareholder owning such property which is used for his company's business if he "controls" the company immediately before the relevant transfer (note, however, that although the property must have been owned by the transferor and also used by the business for at least two years prior to the transfer, "control" of the company is only required immediately before the transfer).

It is perhaps ironic that the increased inheritance tax attractions of a partnership should arise at a time when there is considerable pressure for the incorporation of professional partnerships. Of course, where professional rules allow more than 25% of the equity in the company to be held by outside investors (as it is understood is the case for chartered accountants under the ICAEW rules) it may be possible to attract outside investors by offering them a carrot of an inheritance tax exempt (or 50% relieved) asset - maybe this will also be of interest to former and retiring partners of the firm!

Conclusion

It is hoped that for those readers who have arrived at the conclusion of this article it will be clear that the Finance (No.2) Act 1992 changes have introduced an increasing variety of possible strategies and certainly a well-advised client should now be in a position to avoid most, if not all, inheritance tax liabilities on his or her business assets.