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# Family businesses - is there still a role for trusts?


Presented by

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25 January 2016

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# Howard Hackney

Howard escaped from Grant Thornton UK LLP in 2008 where he had been a partner for over 25 years to establish his own boutique practice. During his time at Grant Thornton he was head of professional practices for the North West and head of family businesses for the UK. At Grant Thornton he had a variety of roles including office Managing Partner, North West regional marketing partner and membership of the partners appointments panel. Howard specialises in advising mid market professional practices and family businesses. In 2002 he won the CBI's national award as "Best Business Adviser".

Howard's current focus is providing "special projects" advice to family businesses with turnovers up to £30m and professional firms with up to 20 partners. His experience extends from first generation to eighth generation family businesses with all the succession issues that involves.

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# Agenda

- Family business context
- Key tax rules
  - CGT & IHT
  - BPR/APR
  - Trusts
- Case study
- Family Limited partnership
- Questions  & burning issues throughout

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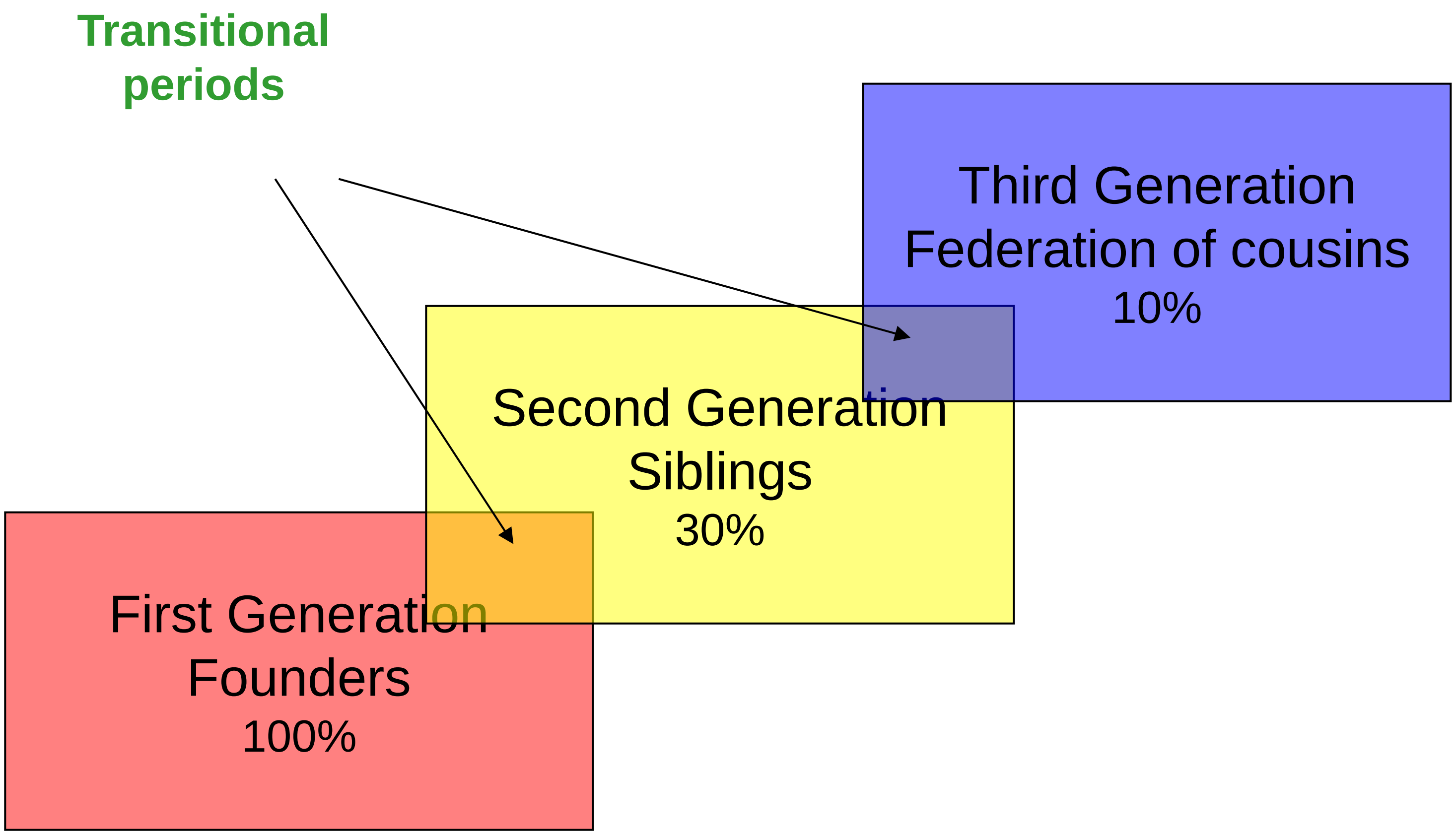
# Family business perspective

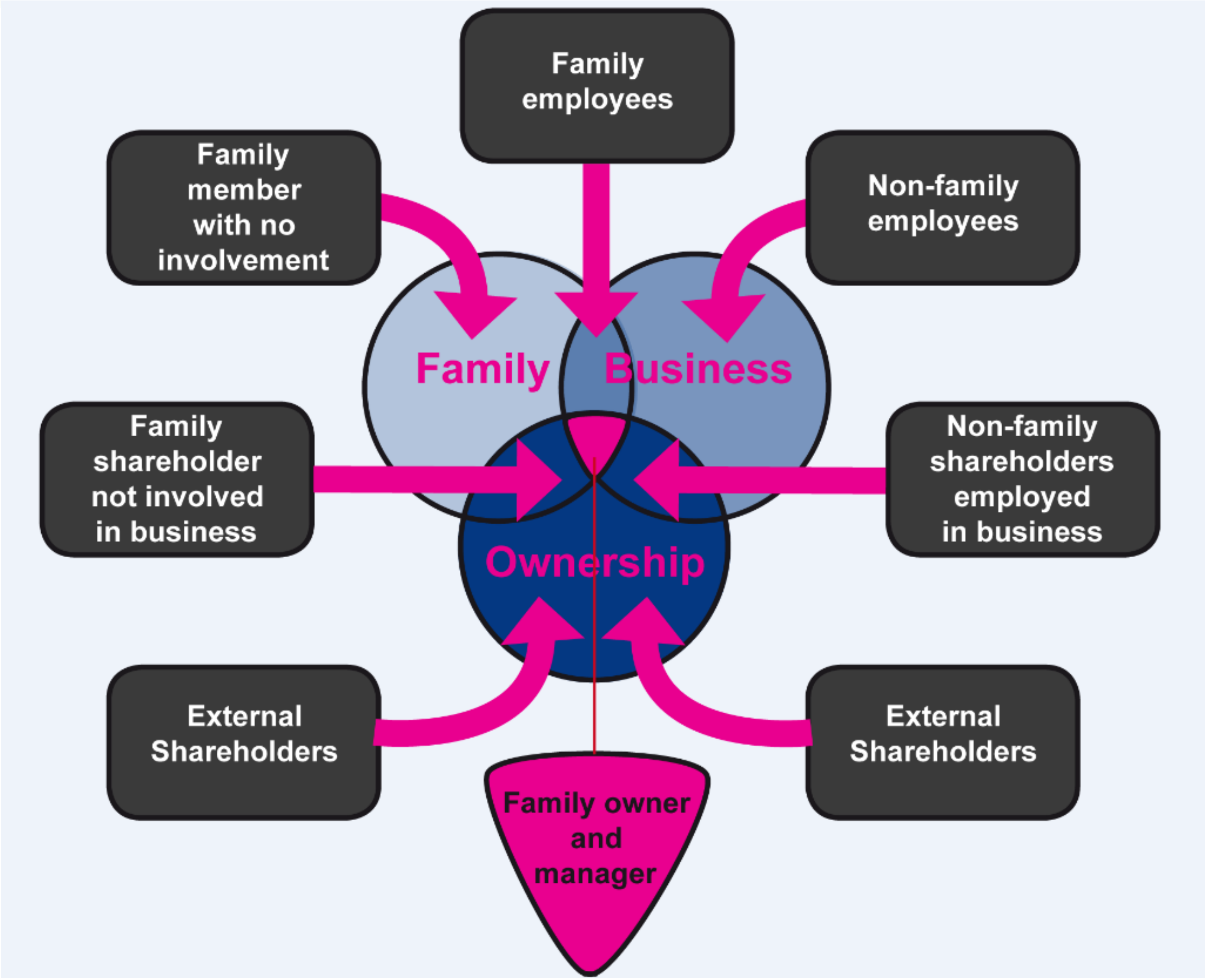
# Context

- Definition of family business – more than one generation involved
- Size – perhaps £1m to £50m turnover
- Conceptual background
- Parameters
- Why out of favour

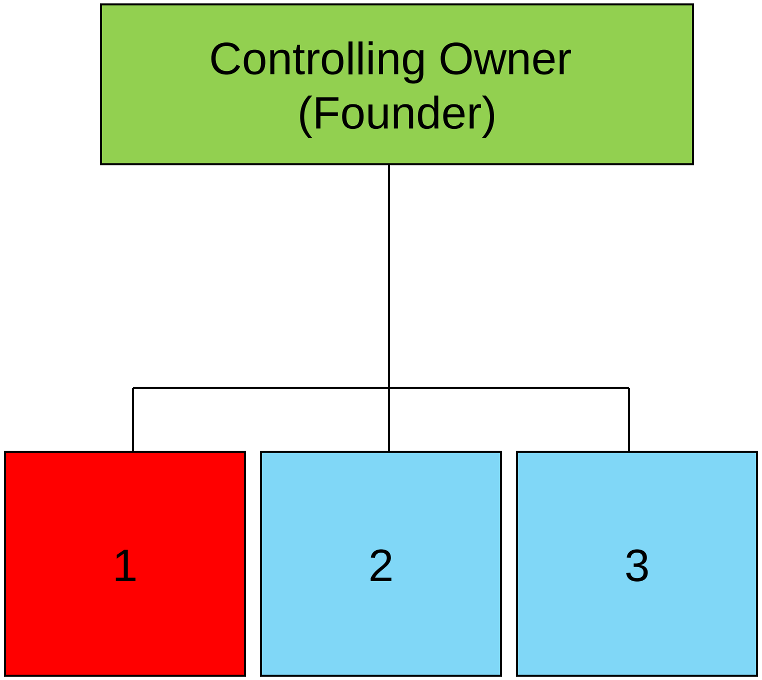
# Transition


Transitional periods
Third Generation
Federation of cousins
10%
Second Generation
Siblings
30%
First Generation
Founders
100%

# The individuals in the family business



# Transition to sibling partnership




Favoured by many parents who want harmony, equality and business survival through the family with more or less equal division amongst a group of siblings

BUT

Please avoid if possible

# Some parameters

- Try to limit the spread of shareholding
- Try to give management voting control
- Use other wealth (or loan notes) to balance fairness between siblings
- Have independent wealth outside the business – pension?
- Allows management to be able to risk passing on control

# Avoiding shareholder disputes

- Keep shareholding base narrow
- Shareholders agreement and family constitution
- Have agreed valuation criteria
- Create an internal market for shares
- Agree a dividend policy
- Board appointment based on skills alone not shares
- Family Council
  - Akin to an institutional shareholder
  - Strategic issues only & no management involvement
- Trust can be a shareholder & party to these

# Why out of favour?

- Complexity
- Cost
- Continual changes to the rules
- Other effective reliefs e.g. BPR after 2 years, no CGT on death
- Availability of Entrepreneurs relief difficult

- BUT genuine uses – case study

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# Key tax rules

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# Issues

- CGT
- IHT
- Business & Agricultural Property Relief (APR & BPR)
- Trusts

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# Key tax rules - CGT


- Outright gifts are subject to CGT on gain
- No CGT on death
- Entrepreneurs Relief (ER) (10% CGT) on sale
  - Must be whole business (80% trade)
  - Must be a commercial trade (as opposed to business)
  - Partial gifts will NOT attract ER
- CGT can be held over into & out of a trust at cost of 20% IHT on value > £325k unless APR applies
- CGT base cost uplift on death
- Incorporation into shares
  - CGT can be held over and assets have base cost uplifted
  - BUT must be a business (not trade) c.f. professional lamdlords
  - AND be the whole business

# Key tax rules – IHT

- IHT chargeable on death at 40% on amounts in excess of £325k
- Outright gifts of assets are Potentially Exempt Transfers (PETs) and fall out of charge after 7 years & are not taxed at time of gift
- Gifts into a trust are a chargeable transfer at half the death rates – 20% when in excess of £325k
- Gifts fix value now but not future nature so:
  - If APR/BPR applies now on value > £325k
  - But if not at DofD or distribution then becomes chargeable
- Gifts out of surplus income exempt
- Watch reservation of benefit rules
- BPR/APR gives 100% relief

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# BPR/APR

- Trading (wholly or mainly i.e. >50%) businesses attract 100% BPR/APR after 2 years ownership
- Farmland - If operating or renting out with vacant possession available in < 12 months - 100% APR after two years ownership
- Excepted assets can be an issue even if > 50% trade
  - Surplus cash in a company
  - Investments
  - BUT property investment business OK


- Value attributable to “hope” etc. not farmland will not attract APR
- AIM shares attract BPR

# Trusts - 1

- Ability to have extensive list of beneficiaries
- Gifts into trust an actual transfer which attracts 20% IHT when > £325k
- Still needs to survive 7 years to fall out of estate
- Must give up beneficial ownership to be effective
- Trustees control the “asset”
- 10 year charge on value at that date at upto 6% but subject to APR/BPR
- Can be avoided by distribution pre 10 years whatever value if < £325k initially

# Trusts - 2

- Income tax on trust at the highest (45%) rates BUT if distributed refund down to beneficiaries rate
- Assets in trust at date of death:
  - To continue to get APR/BPR must retain their nature
  - BUT value at date of gift not affected
- All trusts are treated the same except an IPDI – Immediate Post Death Interest = old life interest trust created in a will or intestacy where asset treated as that of the life tenant.

# Case study - Bill

# Background information

Your family background is such that you are aged 68, divorced and have three children. Your daughter – Alex – is married to Jon and it is with the three of you that we met. You have a further daughter and a son. You are fit and active but do have some health issues.

Your business activity is that of farming and you have approximately 120 acres. You inherited 100 acres from a family trust approximately seven years ago and bought a further 20 acres recently for £4,500. The farm is operated commercially and profitably – you use outside contractors to harvest your usual crop of potatoes and also raise dairy young stock.

The profits from the farm plus your pensions are sufficient to meet your personal day to day living expenditure.

You estimate that the current value of farm land is anywhere between £10,000 and £17,000 per acre.

The principle issue that gives rise to this assignment is the fact that you have recently obtained planning permission on a small strip of land amounting to 1.4 acres which has resulted in the value increasing to approximately £1m. In turn there are a further 26 acres which adjoin land on which Costain are currently building. Whilst your land is not currently zoned for development in the local Council's plan you would not be surprised if it were and that as a result planning permission may be given on these further 26 acres. This could potentially increase the value of this land to say £20m.

# Instructions

The key issues you wish to address focus on tax planning and in particular on CGT and IHT as far as the 26 acres are concerned with a view to taking action now before any uplift in value. You wish to assess your likely exposure to both taxes and the way in which they can be mitigated.

We discussed and you are aware that there is no CGT on death but (unless Business Property Relief is available) there will be IHT (at 40%). You are also aware of the fact that if you operate as a business Entrepreneurs Relief is such that CGT can be brought down to 10% from 28%

The most important aspect of this assignment is to address what you personally wish to achieve (being a comfortable income and cash cushion) balancing those wishes with the best long term decisions for your children and with tax savings.

# The numbers

| £'000s | Acres | CGT base cost | Estimated Value | Potential value |
|---|---|---|---|---|
| With planning permission | 1.4 | 5.4 | 1,000 | 1,000 |
| Potential planning permission | 26.0 | 99.7 | 390 | 20,000 |
| Remaining farm land at £15k per | 92.6 | 355.0 | 1,400 | 1,400 |
| Other assets | N/a | 0 | 10 | 10 |
| | 120.0 | 460.0 | 2,800 | 22,410 |
| | | | | |
| Less APR | | | (1,790) | (1,790) |
| IHT personal exemption | | | (325) | (325) |
| Subject to IHT | | | 685 | 20,295 |
| | | | | |
| IHT on death at 40% | | | 274 | 8,118 |

Base cost = £455k plus purchase of 20 acres for £5k

# Keep it simple

- Farmland **itself** attracts APR & no CGT on death so no action
- BUT wish to carry on farming and is it actually farmed commercially?
- Gift of the land with hope value now – a PET (no IHT) at todays value
- Need to survive for 7 years to entirely fall out
- CGT payable now (subject to hold over) on value compared with base cost at 28%

| £'000s | £20k/acre | £15k/acre | £5k/acre |
|---|---|---|---|
| Base cost | 100 | 100 | 100 |
| Value | 520 | 390 | 130 |
| Gain | 420 | 290 | 30 |
| CGT at 28% | 118 | 81 | 8 |

- Hold over of CGT if land attracts APR
- Who would gifts be made to?

# Use of Limited company

- CGT free uplift on value exchanged for shares **IF** a trade & the whole trade
- Ability to gift shares thereafter
  - Who to?
  - But CGT on shares with nil base cost
  - Ability to hold over this gain if it is trading and >5% share ownership?
- CGT & profits in company at 20% or less on planning gain
- BUT additional tax to extract profits – so double charge
- Except if borrow short term pre incorporation to extract value at that date (excluding planning gain)
  - Ability to do so
  - Creates IHT issue on cash extracted

# Use of Limited company

- APR on the farmland element only of value in shares
- Future of such company
  - Cash cow
  - Liquidation – CGT at 28% having suffered 20% on profits
  - Likely change in Budget 2016 re liquidation & start up within 2 years
  - Start trading but who owns

# Use of a trust

- Gift 26 acres
- Keep remaining 92.6 acres to provide income and no CGT or IHT on death - if carrying on farming
- IHT
  - Immediate IHT on value in excess of £325k at 20% - perhaps nil
  - Need to survive 7 years to fall out
  - Fixes value at date of gift
- CGT – can be held over (as actual IHT transfer) in and out
- Wide class of beneficiaries and those not yet born

# Use of a trust - issues

- Complexity and cost
- Trustees
- 10 year charge at upto 6%
- 28% CGT i.e. ER difficult without beneficial ownership
- 45% tax on undistributed profits
- BUT will be distributed as part of education planning
- Flexible beneficiaries
- Probably provides protection from bad marriages

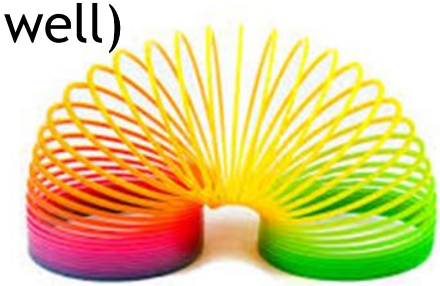
# Matter actually agreed

- In spite of preference for simplicity use a trust to allow any planning gain to pass to grandchildren
- Transfer 17 acres into this trust soonest
- Retain ownership of 9 acres for personal financial security
- After realisation seriously consider investing in BPRable assets e.g. basket of AIM shares to obtain BPR after two years ownership.
- Detail – to action soonest
  - Farm accounts to be amended for 2014 and 2015 to change description of rent and other income
  - Alex to instruct commercial valuers to provide robust tax valuations of 17 acres on
    - Open market value
    - Agricultural value if different
  - Expression of wish to be prepared as part of trust documentation re the 17 acres

# Other vehicles

# Family Limited partnership (FLP)

- Talked about but personally never used
- Would apply to the largest businesses given the cost – UK FLP = collective investment →FCA regulated.
- Offshore alternative – BUT exceptionally specialist
- Usually a 1908 Limited partnership (but 2000 LLP as well)
  - Must have an objective to make a profit
  - Limited partners cannot be involved in management
  - General partner often a limited company



- Entirely flexible & transparent – CGT, IHT & IT at personal (not company) rates
- No IHT or CGT on transfer of assets into the FLP in exchange for equivalent value

# Family Limited partnership (FLP)

- BUT IHT & CGT on transfer of interest (value) in the LLP
- BPR & ER usually not available
- General partner retains control of the asset (like a trustee)
- Income and capital can be separated
- Less flexible than  a trust – but no 10 year charge
- Probably provides protection against a bad marriage
- A useful solution if wish to retain control (but not benefit) while making a substantial PET without any in built gain.

# Questions

Links/ contacts for Law Society and other external resources that may offer further information

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# Thank you

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