



For intermediaries only



Business Protection – Business property relief



Business succession – have your business customers made a corporate will to make sure their business arrangements are inheritance tax (IHT) efficient?

Throughout this document we've highlighted various technical 'protection' terms in *italics*. An explanation of what these mean are given in our 'Dictionary of protection terms' on page 5.

The following information is based on our understanding of current legislation, taxation law and HM Revenue & Customs (HMRC) practice, which may change.

What is business property relief (BPR)?

BPR is an important and valuable IHT relief that can reduce the value of *relevant business property* when it's transferred either in life or death. *Relevant business property* includes certain business interests and assets used in a business. When BPR is available the rate of relief will either be 100% or 50%.

What can a BPR check achieve?

A BPR check can help your client plan for the future and make sure they have the necessary arrangements in place to qualify for 100% BPR on the transfer of a business interest in life or death.

Why should you carry out a BPR check?

A BPR check lets you review your clients' business to make sure that the necessary arrangements are in place to qualify for BPR. It can help put your client in control of their interest in the business and make sure that it goes to the right person in a tax-efficient way if the unexpected happens.

Who should consider it?

BPR is a worthwhile consideration for:

- sole traders;
- partners or members, and
- shareholders.

If your clients fall into any of the above categories and have owned the *relevant business property* for at **least two years** then their business interest could qualify for **100% BPR**.

What is the qualifying criteria?

Not all business interests will qualify for BPR.

For BPR to apply:

- the business must be a *qualifying business*;
- the asset must be *relevant business property*, and
- the asset must meet the minimum *period of ownership* test.

Please see the 'Dictionary of protection terms' for a full explanation of the qualifying criteria.

When is BPR not given?

BPR isn't given for a business whose activities consist wholly or mainly in dealing with:

- securities, stocks, shares, land and buildings;
- making or holding investments, or
- excepted assets – these are assets which weren't used wholly or mainly for the purposes of the business throughout the last two years before the transfer (or since acquisition if more recent), or required at the time of transfer for the future use of the business.

For example, if the shares of a company qualify for BPR and the company owns a house which is used solely for the benefit of a shareholder, the house would be excluded from the valuation.

Care must be taken to avoid the company or business becoming an investment company or business. This can happen if significant sums of cash remain on *deposit for a period of time* and aren't reinvested into relevant business property shortly after. It will be difficult to argue that cash is needed for future use if it remains on deposit for a long time.

How is BPR calculated in practice?

The value of a business or an interest in a business will be the value of the assets, including goodwill, used in the business at the date of transfer less liabilities incurred for the business. Excepted assets are excluded from the value.

Why is BPR relevant to business protection?

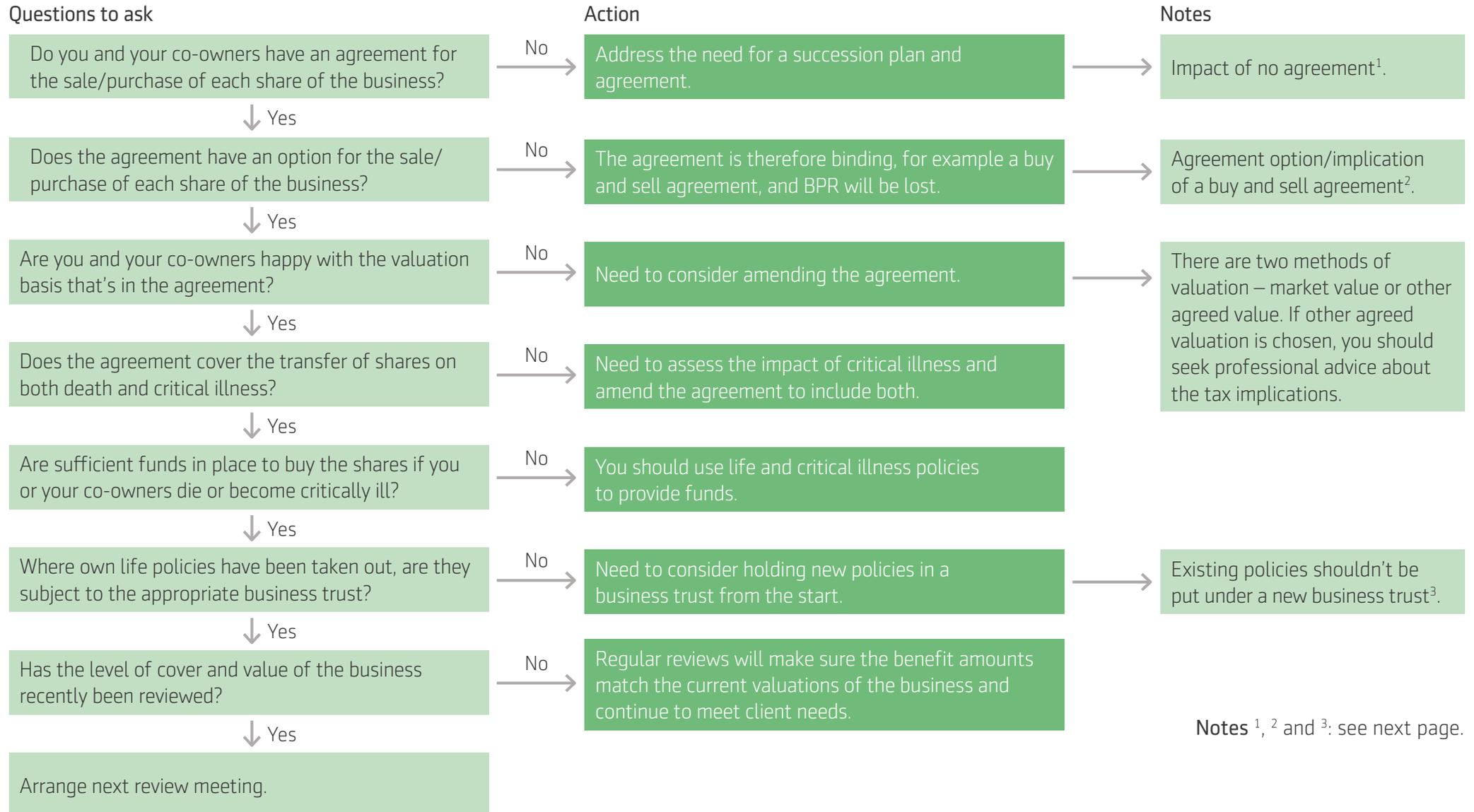
Where an individual transfers *relevant business property* and BPR of 100% is available, this property won't be liable for IHT. However, on the death or critical illness of a partner, member or shareholder, the continuing partners, members or shareholders may want to arrange for a cash sum to be available so they can buy the interest of the deceased or critically ill partner, member or shareholder. In exchange for the interest in the business, the personal representatives of the deceased or critically ill person receive a cash amount equivalent to the value of their interest.

There are different ways of achieving this protection using life and critical illness policies. However, the IHT implications of a chosen method should be considered. It's important that any protection arrangement doesn't have adverse IHT implications.

You can use the flowchart on the next page for partnerships, limited liability partnerships or companies to identify the need for cover.



The flowchart highlights the questions you could ask to arrive at a solution that's IHT efficient. The resulting actions highlight the need for your professional advice.



Notes ¹, ² and ³: see next page.

Own life under business trust is just one method of shareholder protection.



Notes

- 1 The critically ill or deceased shareholder's shares may pass to a third party, or the deceased shareholder's husband, wife or civil partner may decide to hold onto the shares and become involved in the business – even if this is against the wishes of the other shareholders.

This may also be problematic for the critically ill shareholder or the family of the deceased, as the price that the shares might fetch could be adversely affected by their lack of marketability.

The husband, wife or civil partner of the deceased shareholder may have no knowledge of the business and may want a cash settlement instead of the shares.

- 2 **Double option/Cross option agreement**

The surviving shareholders have an option to buy the deceased's shares and the personal representatives of the deceased have the option to sell. If either party exercises their option within a specified timeframe, the other party must comply. We have a [sample double option agreement](#).

Single option agreement

The solution may be to have a single option agreement which would allow the critically ill shareholder to sell their shares, but doesn't give the other shareholders an option to insist that they sell. We have a [sample single option agreement for critical illness](#).

Buy and sell agreements

HM Revenue & Customs (HMRC) considers there to be a binding contract for sale where the shareholders enter into a buy and sell agreement. Under this agreement the deceased's personal representatives are obliged to sell and the surviving shareholders are obliged to buy the deceased's interest. So, at the date of death, the deceased has cash rather than shares, and cash is fully subject to IHT.

The loss of BPR might not be an issue if the shares in the business pass under the will or intestacy to a surviving husband, wife or civil partner. It would pass by way of exempt transfer and there wouldn't be any IHT to pay on a shareholder's death. However, this doesn't help unmarried shareholders and shareholders whose civil partnership isn't registered. In these cases, the preservation of BPR is important and a cross-option agreement will be preferable to a

buy and sell agreement.

- 3 It's very important that an existing policy isn't assigned into the trust as this would make the policy second-hand, meaning the claim proceeds would be liable for capital gains tax.

Where we refer to shareholders this also includes partners of partnerships and members of limited liability partnerships.

For more information on how HMRC defines and assesses business property relief visit [gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm25000](https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm25000)



Dictionary of protection terms

Throughout this document we've highlighted various technical 'protection' terms in *italics*. The following explanations should help clarify what these mean.

Qualifying business

The question of whether there's a business being carried on must be ascertained. The business must be carried on for gain. In the VAT case *Commissioners of Customs & Excise v Lord Fisher* (1981) STC 238 Gibson J identified six indicators, some or all of which should be satisfied to identify an activity or activities as a business. He stated that these indicators are also applicable as a test for IHT purposes. The six indicators are:

- overall context of business;
- capital employed;
- time spent by the proprietors;
- time spent by employees;
- turnover, and
- profits.

Essentially BPR isn't available for investment type businesses. For example, a business which lets furnished flats on shorthold tenancies is likely to be denied BPR. Business or interest in a business, or shares or securities of a company, won't qualify if the business or the business of the company consists **wholly or mainly** of dealing in securities, stocks or shares, land or

buildings or making or holding investments, unless the business is:

- wholly that of a 'market maker' or that of a discount house and, in either case, is carried on in any European Economic Area state, or
- that of a holding company of one or more companies whose business does qualify.

There are no set guidelines, though the meaning of consists '**wholly or mainly**' is taken to mean a business satisfying a quantitative test of 50% or more. The 50% threshold is sometimes, but may not exclusively be, taken to refer to net profits.

Relevant business property

Relevant business property is defined at s105, **IHTA 1984**. Some of the main types of relevant business property and the rates of relief they attract are:

- A business or interest in a business – 100%
- Shareholdings of unquoted companies – 100%
- Controlling shareholding in a quoted company – 50%
- Land, buildings, machinery and plant used for a business carried on by a company controlled by the transferor or a partnership in which they were a partner – 50%

A business or an interest in a business is intended to cover unincorporated businesses such as sole traders and partnerships, including limited liability partnerships. Shareholdings in unquoted companies

will cover the situation for most shareholders of small companies. HMRC defines a person as having control of a company if they can control the majority (more than 50%) of the voting powers on all questions affecting the company as a whole. Assets owned by the transferor will only qualify for relief if the business or interest in it or the shares or securities in the company are also relevant business property.

Period of ownership

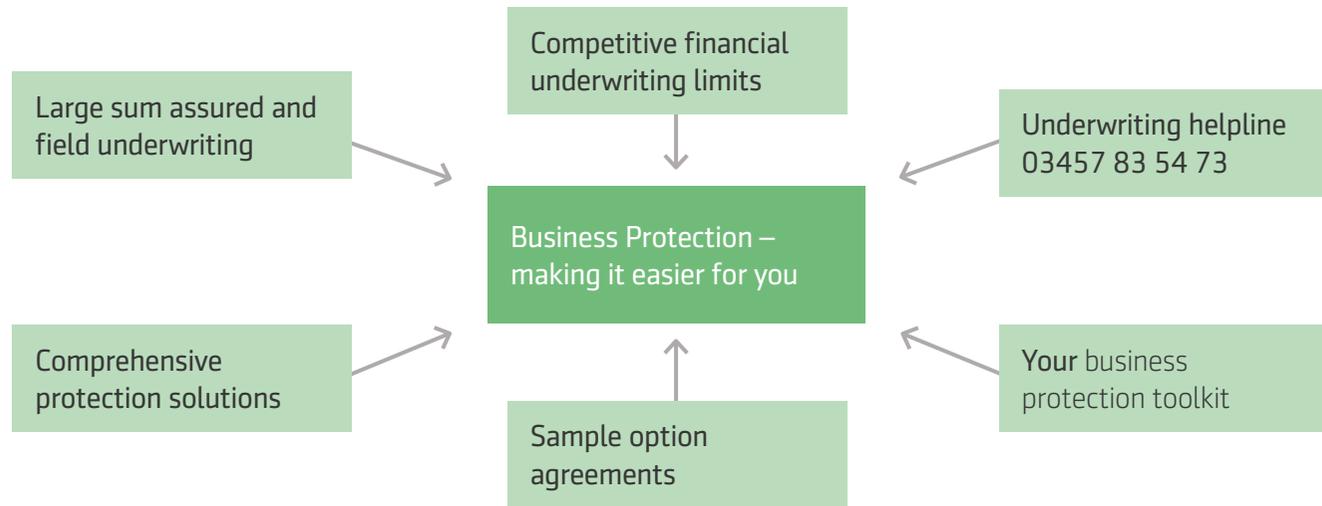
The property transferred must have been owned for at least two years before the transfer. Where an individual becomes entitled to property on the death of another person they're treated as having owned it from the date of the other person's death.

The two-year test is modified in the following certain situations:

- Where the deceased became entitled to property on the death of their husband, wife or civil partner, they're treated as having owned the property for any period during which the husband, wife or civil partner owned it. The principle of aggregation doesn't apply to lifetime transfers.
- Where the property replaced other property which qualified (apart from the two-year period) immediately before the replacement and both properties were owned by the transferor for at least two years out of the five years immediately before the transfer.

Business Protection

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