



# Tax Planning for Property & Other Investments

19 July 2023

**Now, for tomorrow**



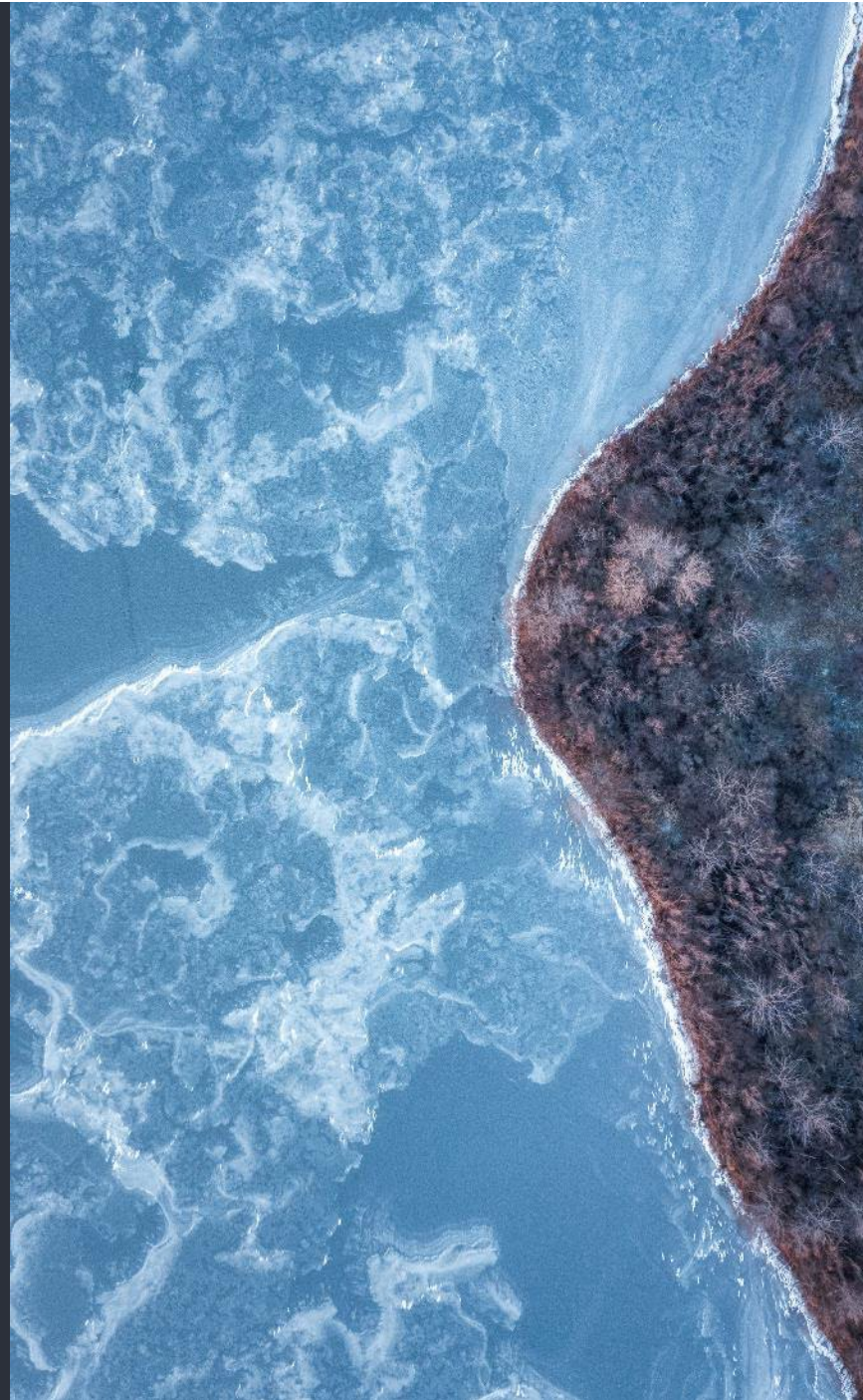
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# Contents

1. Tax implications of Holding investments in a Family Investment Company
2. Structuring a Family Investment Company
3. Tax planning opportunities for existing investment companies
4. Alternative structures





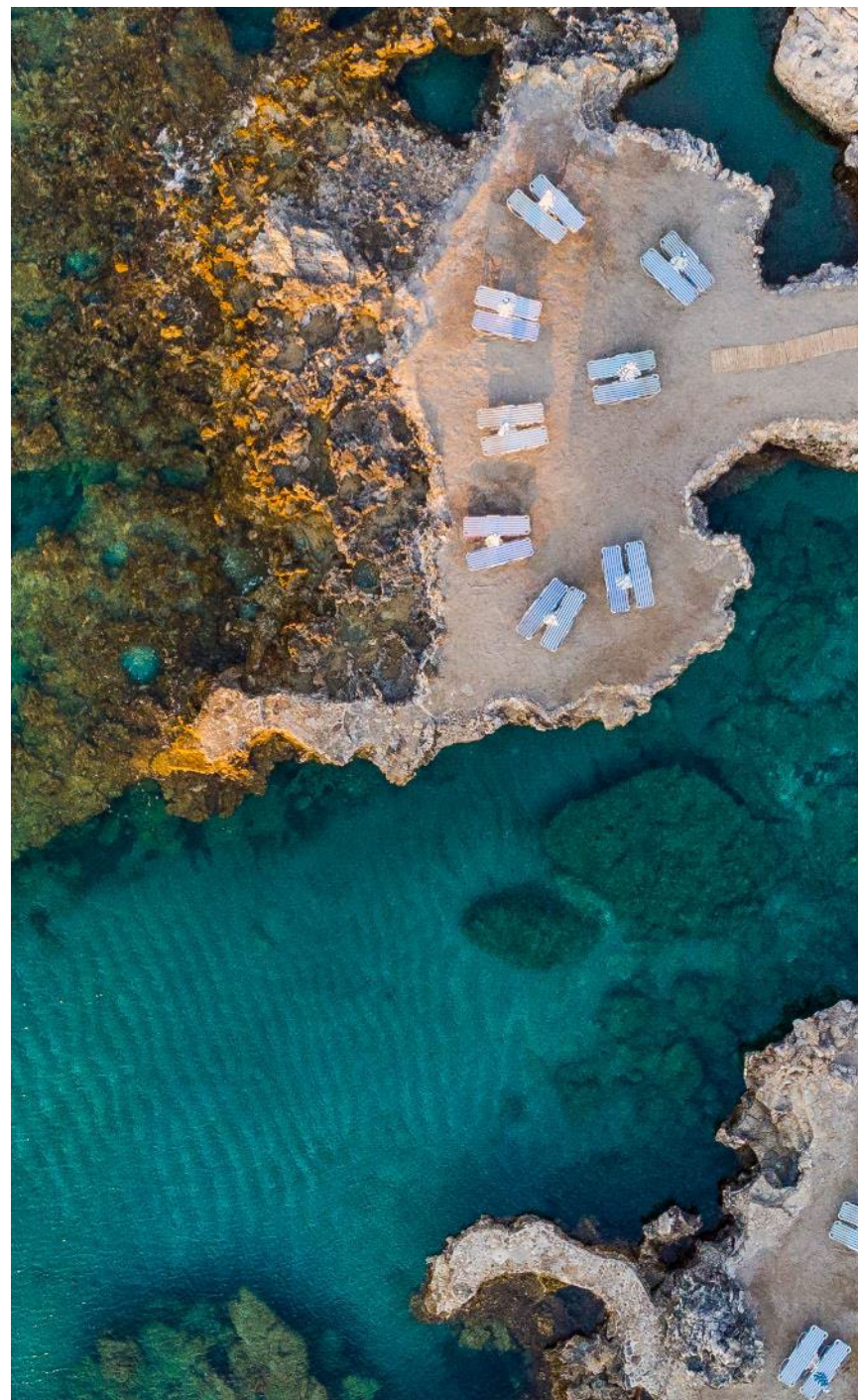


PART 1

# Tax Implications of Holding Investments in a Family Investment Company

# Corporation Tax from April 2023

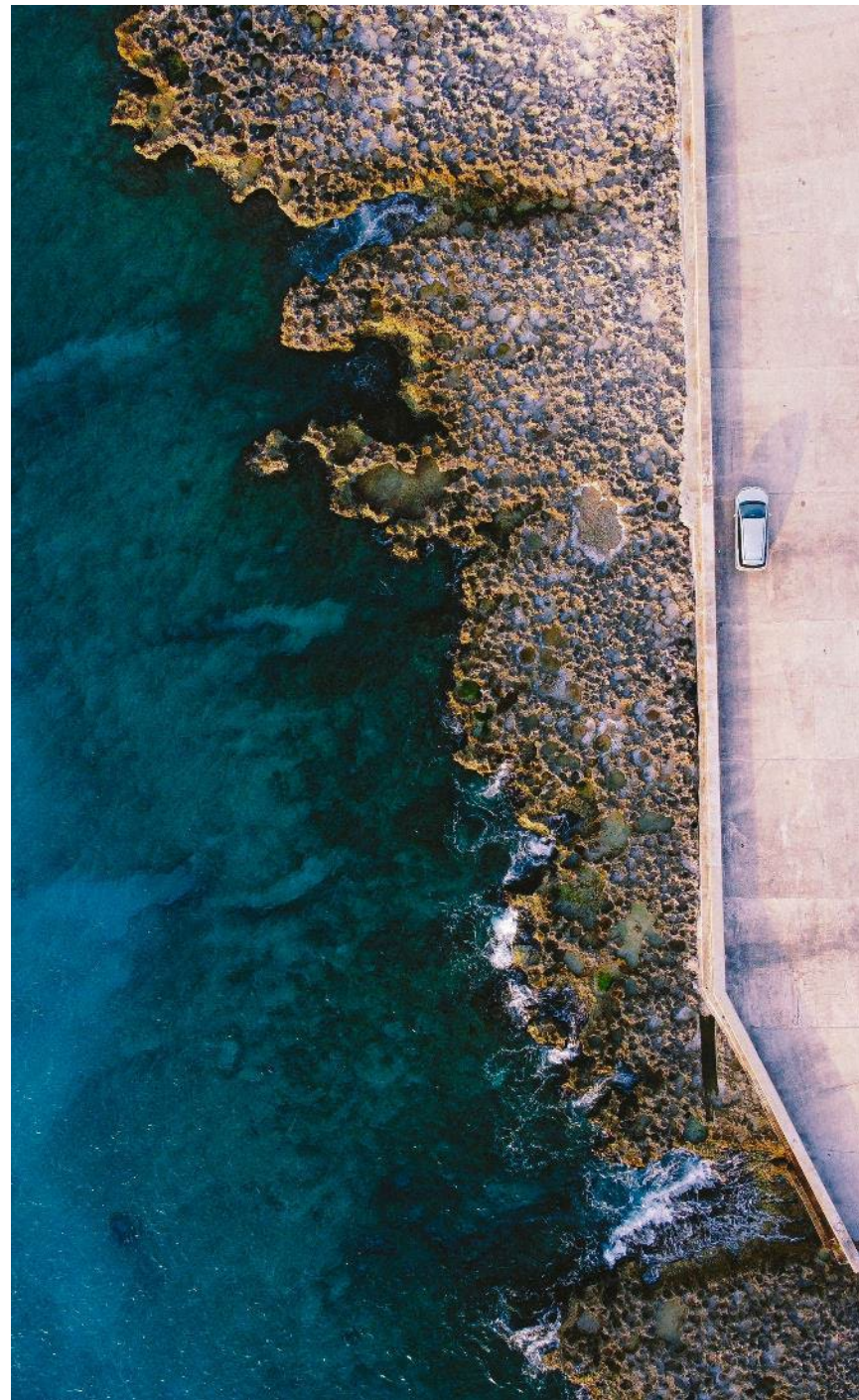
- Companies with profit (taxable income and gains) less than £50,000 will still be taxed at 19% (the small profits rate).
- Companies with profit (taxable income and gains) in excess of £50,000 will now be taxed at a flat rate of 25%.
- Companies with taxable profit between £50,000 and £250,000 benefit from marginal relief, which reduces the actual CT payable.
- Companies with taxable profit in excess of £250,000 will be taxed at the flat rate of 25% with no marginal relief.
- Investment companies do not benefit from the 19% rate or from the marginal relief (but property investment companies do).
- All overseas companies within the charge to CT taxed at the flat rate of 25% with no marginal relief.





# Capital Gains Tax

- The main rate for individuals is 20% or 28% for residential property.
- Annual exemption reduced to £6,000 for 2023/24 and £3,000 for 2024/25.
- Companies liable to CT on chargeable gains at up to 25%.
- But then capital profits may need to be extracted.
- The best available rate is 20% on a MVL creating an effective rate of up to 40%.



# Trading vs Investment

- Investment business are within the charge to Inheritance Tax.
- IHTA1984/S105(3) – The investment exception to Business Property Relief.
- This means investment (including property investment) business where income is derived wholly or mainly from the underlying investments, irrespective of the degree of activity undertaken, will not be relevant business property.



**A business or interest in a business, or shares in or securities of a company, are **not relevant business property** if the business or, as the case may be, the business carried on by the company consists **wholly or mainly** of one or more of the following, that is to say, dealing in securities, stocks or shares, land or buildings or **making or holding investments**.”**

# Trading vs Investment

- It is important to understand the distinction between:

1

**The passive holding of investments and a business**

2

**Business and trade**

- If there is a business incorporation relief under TCGA 1992/S162 may apply to the transfer of an unincorporated business to a limited company. That does not mean there is a trade.

“... conducted a continuing activity on what seems to have been sound business principles and in a manner characteristic of commercial landlords of like properties. Those features, I think, elevate her activities from mere ownership or mere investment into a business ...”

“The activities which a landlord carries out because he is obliged to under the lease are incidents of the tenancy and so fall on the ‘holding investments’ side of the equation... The activities carried on by the landlord which are not required under the lease and for which he receives no separate consideration will fall on the ‘holding investments’ side of the equation if they are connected with and incidental to the holding of the property as an investment.”

(Executors of Moore Deceased (1995))

“It is a peculiar feature of United Kingdom tax law that the activity of letting furnished flats or rooms, while it may be a business and, in this case, a demanding and time-consuming business, is not a trade”

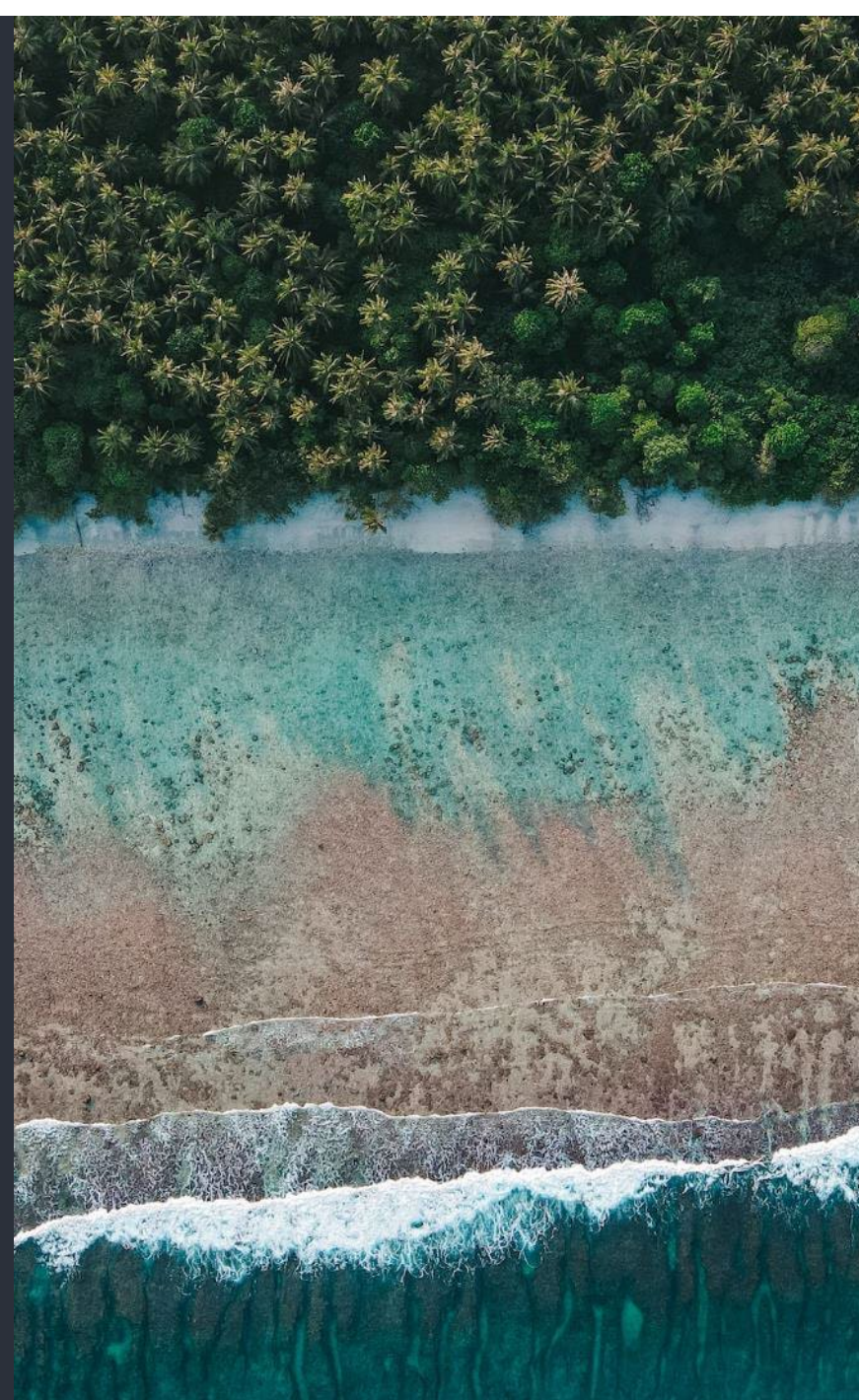
(Griffith v Jackson)



# Trading vs Investment

## Capital Gains Tax

- The transfer of investments or an interest in an investment business will not qualify for holdover relief under TCGA1992/S165.
- The relief potentially applies to transfers of assets used in a trade or shares or securities of a trading company or holding company of a trading group.
- “Trading company” means a company carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities. S165A(3). This is an 80% test rather than the 51% test that applies for BPR.
- Exposure to IHT creates a desire to undertake IHT planning, but possible CGT on transfers makes such planning difficult.





# Investment Companies – Scenarios

## Scenario

- Husband and wife property business
- High earners (>£150K other income each)
- £6m property portfolio
- 50% LTV
- 5.5% mortgage interest rate
- Rental yield 4%
- Rental costs 20% of income

Company		Individual	
Rental Income	£240,000	Rental Income	£240,000
Costs	£48,000	Costs	£48,000
Mortgage interest	£165,000	Mortgage interest	£165,000
Profit	£27,000	Profit	£27,000
27000 @ 19%	£5,130		
PAT	£21,870	Add mortgage interest	£165,000
		Taxable profit	£192,000
		IT @ 45%	£86,400
		Mortgage interest relief @20%	-£33,000
		Total Tax	£53,400
		PAT	-£26,400
		Effective Rate	198%

# Investment Companies – Scenarios

## Scenario

- Husband and wife investment business
- High earners (>£150K other income each)
- £3m to invest – stock market investments?
- 4% income yield – say £60K dividends and £60k interest
- Costs say 1.5% value of investments

Company		Individual	
Dividend income	£60,000	Dividend income	£60,000
Interest income	£60,000	Interest income	£60,000
Costs	-£45,000	Costs	-£45,000
Profit	£75,000	Profit	£75,000
Corporation Tax		Income Tax	
60000 exempt	£0	60000 @ 39.35%	£23,610
15000 @ 25%	£3,750	60000 @ 45%	£27,000
		Total Tax	£50,610
PAT	£71,250		
		PAT	£24,390



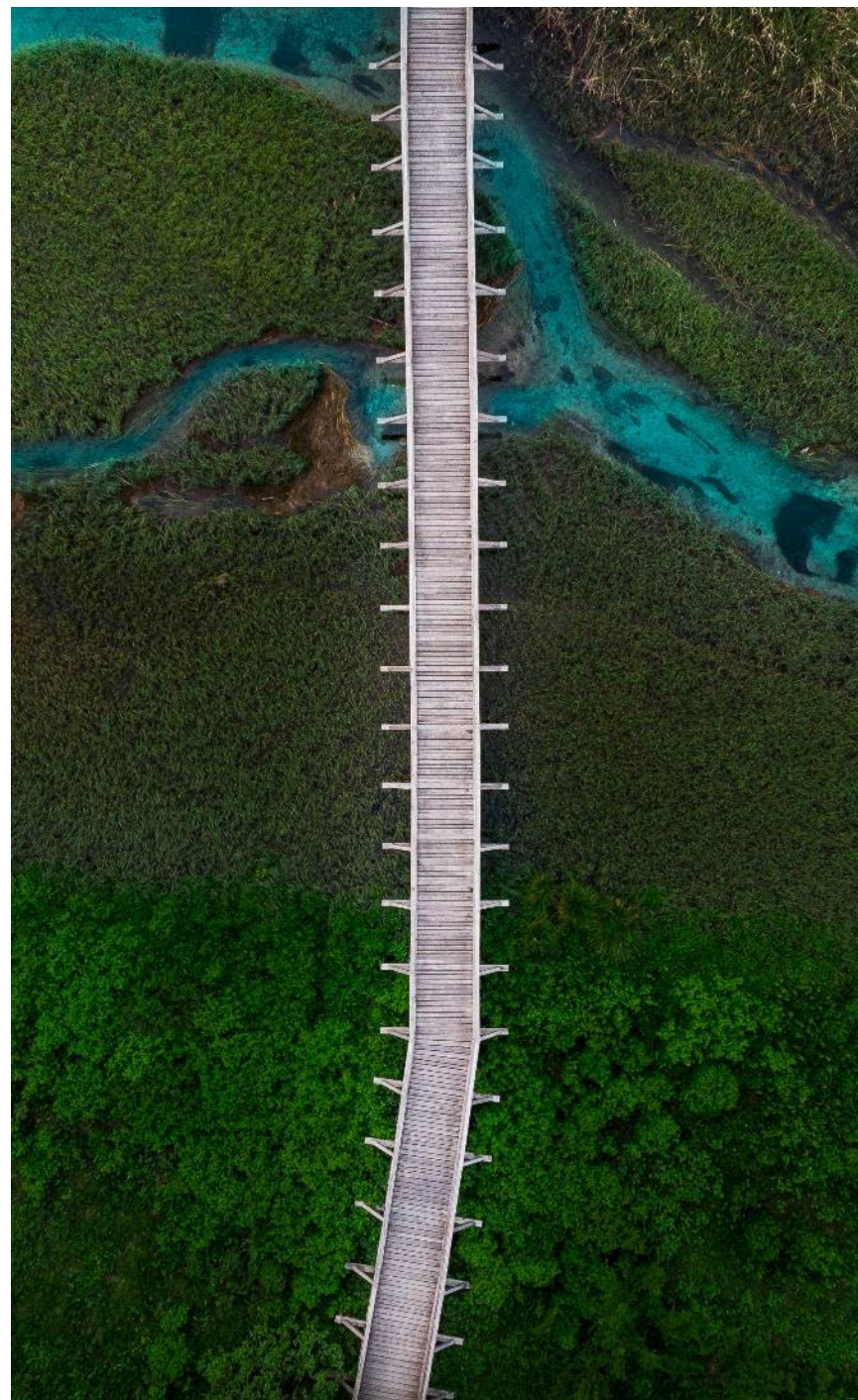
An aerial photograph of a winding road through a forest. The trees are mostly green, but many have turned bright yellow and orange, indicating autumn. The road has a double yellow line and is flanked by power lines. The overall scene is dark, with the bright foliage providing a strong contrast.

**PART 2**

# Structuring a Family Investment Company

# What is a Family Investment Company?

- A Family Investment Company (FIC) is a bespoke vehicle which can be used as an alternative to a family trust.
- It is a private company whose shareholders are family members.
- A FIC typically enables parents to retain control over assets whilst accumulating wealth in a tax efficient manner and facilitating future succession planning.





# What is a Family Investment Company?

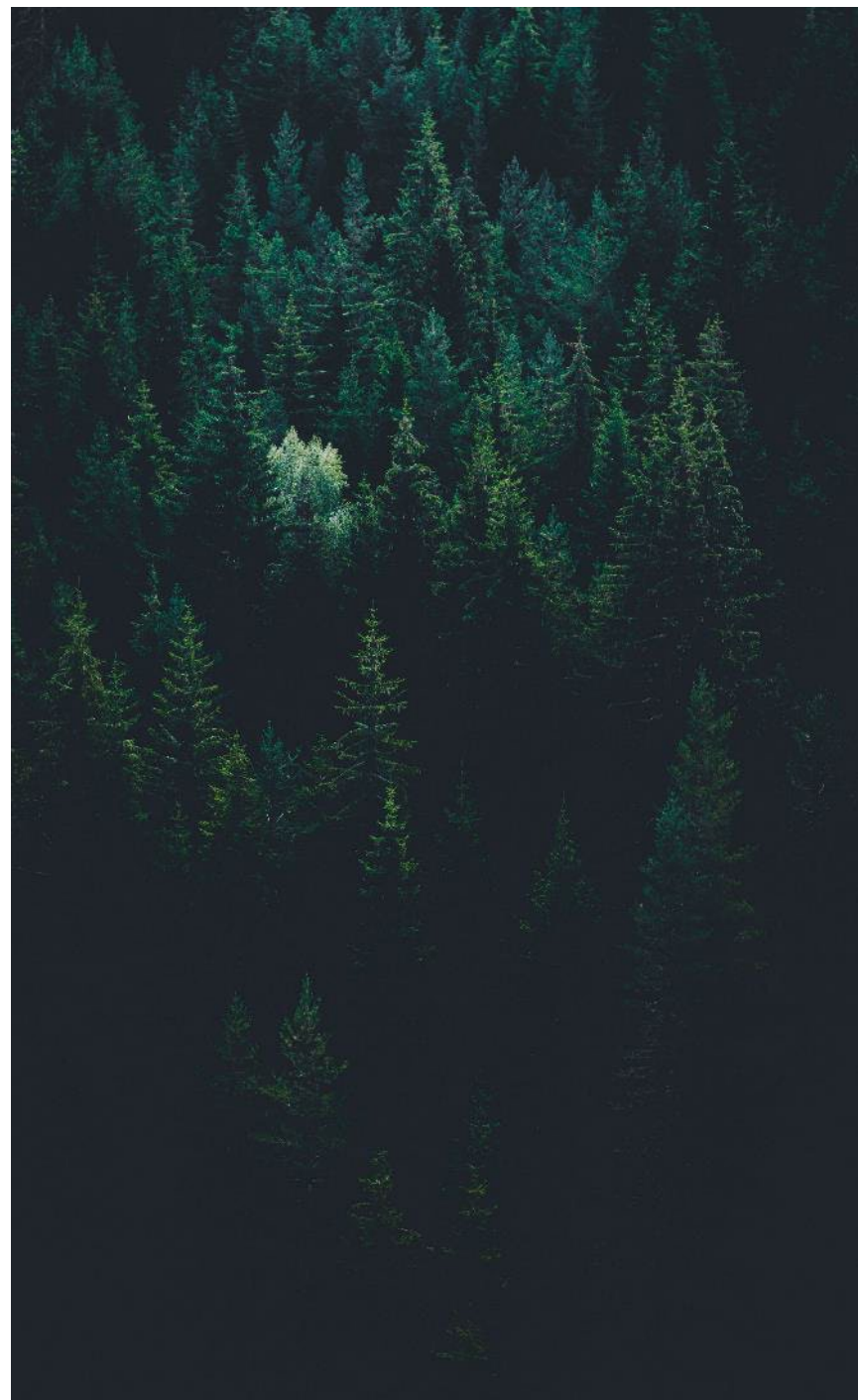
- FICs should not be subject to the relevant property regime. They allow the donor (equivalent to the settlor) to exercise control over the arrangement and in certain cases to continue to draw down funds (either as repayment of capital or income).
- HMRC have concluded their examination into FICs: Conclusion: FICs are reasonable tax planning.
- They rely on principle that interests in a company (shares) carry income, capital and/or voting rights so there is scope for planning by:
  - Management shares and non-voting shares
  - Alphabet shares
  - Growth shares
  - Dividend waivers



HMRC have concluded their examination into FICs: [Wealthy External Stakeholders Forum - minutes \(13 May 2021\) \(publishing.service.gov.uk\)](#)

# What is a Family Investment Company?

- Gifts of shares to other individuals should be potentially exempt transfers (PETs) not immediately chargeable transfers.
- Shares split between family members reduce the total value of the assets held by the family (i.e. the total value of the shares is less than the total value of the assets held by FIC).
- Following the April 2023 CT changes, UK FICs which are used for property investment will potentially be taxed at the 19% CT rate (if profits are £50k or less) and marginal relief (if profits between £50k and £250k.)

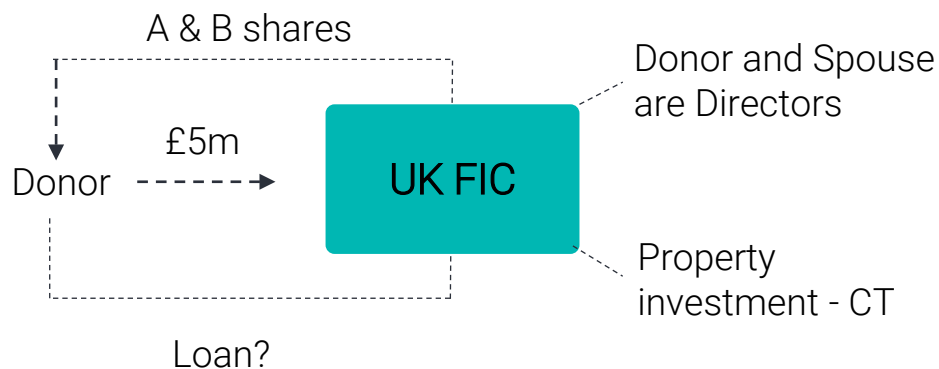






# Property Investment FIC, UK Resident Founder

**Step 1:** Donor subscribes for shares in FIC.



Donor holds:

- A Shares (Voting)
- B Shares (Capital and Income)
- Loan?

**Step 2:** Donor gives away all B shares and some A shares to children.

**Result:** Gift of B shares is a PET and after 7 years Donor is subject to IHT only on the IHT value of the A shares.

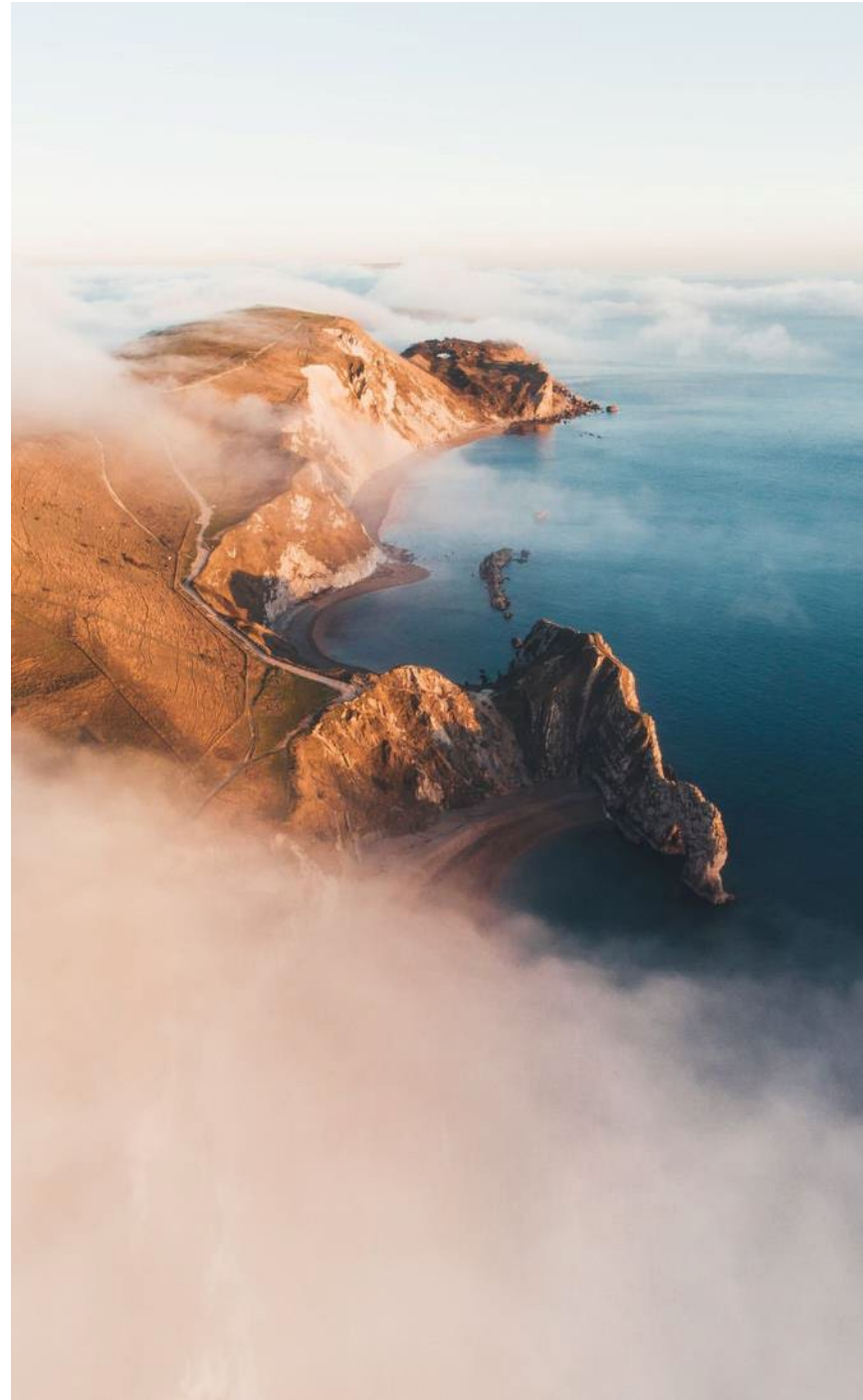


**Watch for:**

- Settlements Legislation
- Gift with Reservation of Benefit
- ATED
- Transactions in Securities

# Settlements Legislation

- Settlor retains an interest if “that property or any related property is, or will or may become, payable to or applicable for the benefit of the settlor or his spouse or civil partner in any circumstances whatsoever” ITTOIA2005/S625(1).
- Wide definition of Settlement, consider in particular:
  - Spouse and minor children
  - Funding arrangements
  - Dividend waivers
- Outright gifts to settlor’s spouse or civil partner are excluded provided it is not substantially a right to income.





# Settlements Legislation: Dividend Waivers

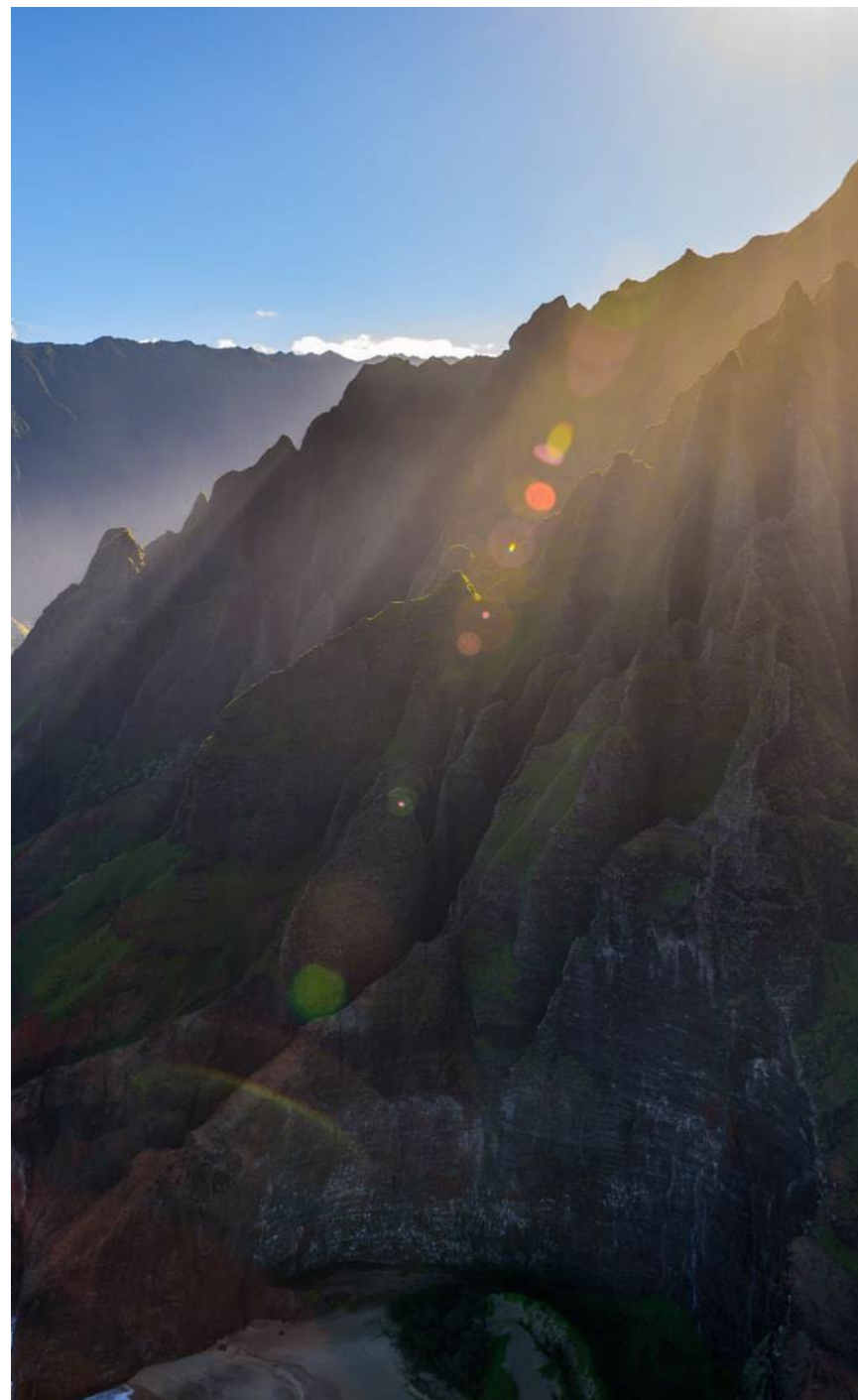
- There have been two dividend waiver cases. In *Donovan v HMRC* [2014] shares were held by H (80%) and W (20%). In *Buck v HMRC* [2008] the disparity was more extreme as H had 999 shares and W had 1 share. In both cases, H waived dividends, so that W received dividends (and the object was that these should be taxable at W's lower rate).
- Running through s.624:
  - (1) The waiver is a settlement-arrangement.
  - (2) H (the waiving shareholder) is the settlor.
  - (3) The income arising under the settlement is the additional dividend received by W (the dividend recipient) as a result of the waiver (the **"waiver-enhanced dividend"**).
  - (4) The property from which that income arose is:
    - (a) W's shares; or arguably
    - (b) H's sharesEither way this is property in which the settlor (H) had an interest.
  - (5) The s.624 spouse exemption does not apply.
- In both cases H was taxed on the waiver-enhanced dividend.

# Settlements

## Legislation: Donee not spouse/minor child

- What about a dividend waiver where the dividend recipient (the non-waiving shareholder) is not a spouse/minor child of the waiving shareholder, but, say, an adult child or cohabitee?
- TSEM4220 says:

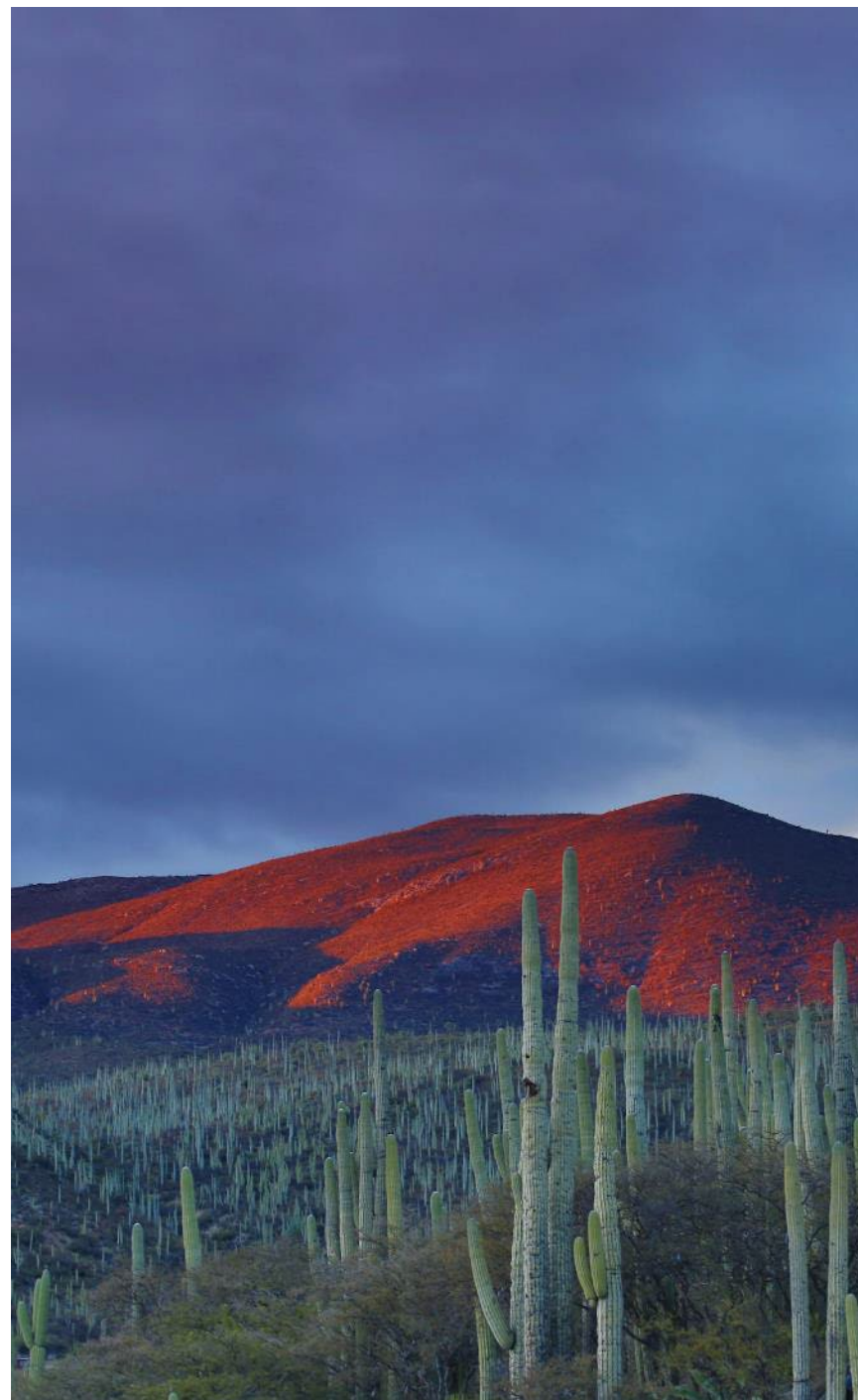
“Where the person benefiting under the arrangement is not a spouse, civil partner or minor child the settlements legislation will not apply unless there are arrangements under which the money will be paid, or used to benefit the settlor (or spouse etc).”
- The income arising under the settlement is the waiver-enhanced dividend.
- The HMRC analysis assumes that the property from which that income arises is the shares held by the dividend recipient (the non-waiving shareholder). Generous?





# Reservation of Benefit

- For a reservation to apply:
  - There must be a gift;
  - The property is not enjoyed to the entire exclusion of the donor.
- If parents hold an equity stake and retain wide rights to determine income distributions – is that a reservation of benefit?
- Consider restricting dividends payable through the articles of association.
- Consider each class of shares having a fixed entitlement to profits.





PART 3

# Tax Planning Opportunities for Existing Investment Companies



# Settling shares onto Discretionary Trust: IHT Planning

## Scenario

- Husband and wife company
- They own entire share capital
- Net asset value £2M
- They wish to settle the maximum number of shares onto Discretionary Trust without IHT entry charge

- Transfer of value = diminution in value of estate of Donors
- Gift up to 25% of the shares

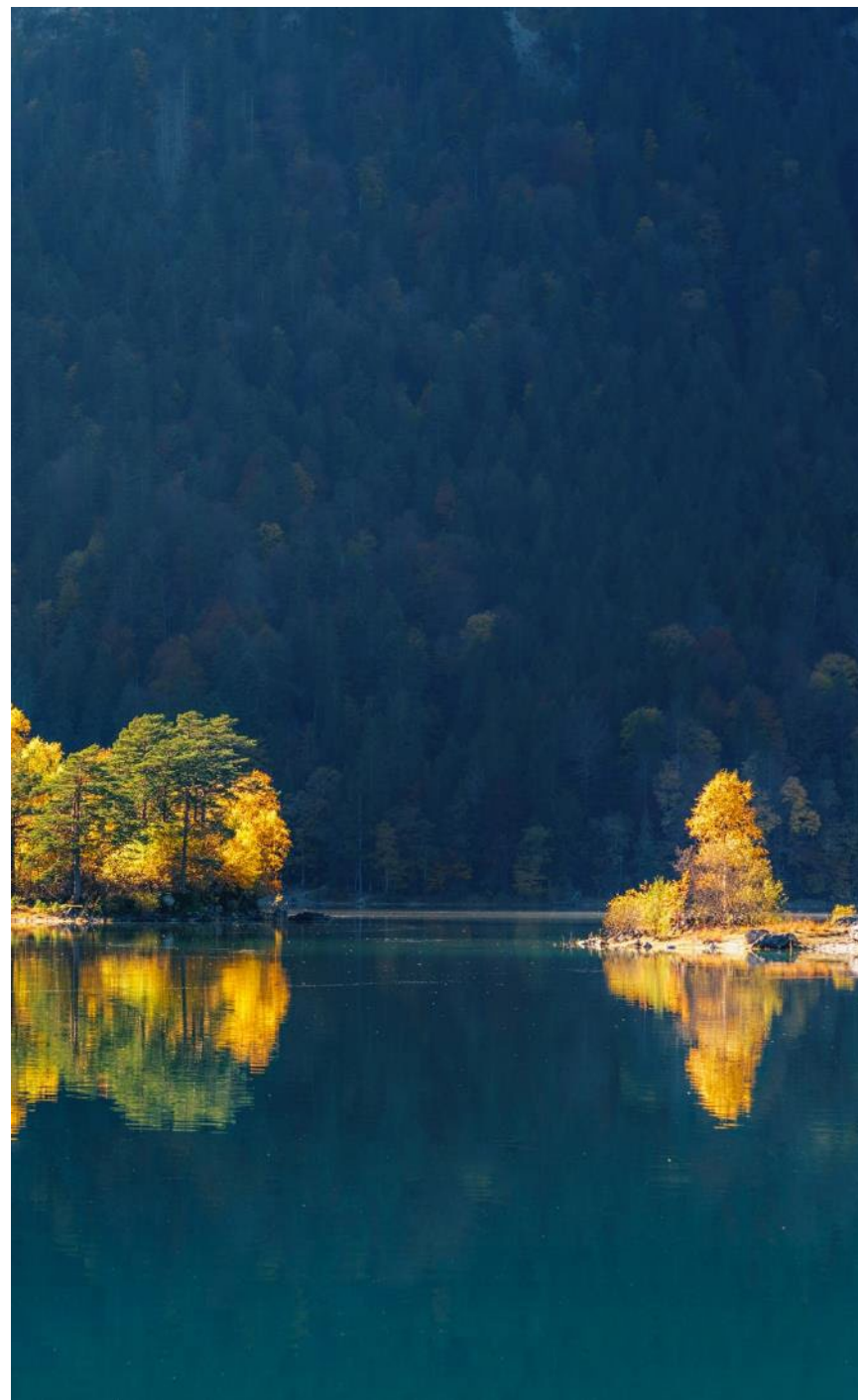
Whole company valuation	£2,000,000
Value of 75%	£1,500,000
Less 10% discount	(£150,000)
	£1,350,000
Transfer of Value	£650,000

# Settling shares onto a Discretionary Trust: IHT Planning

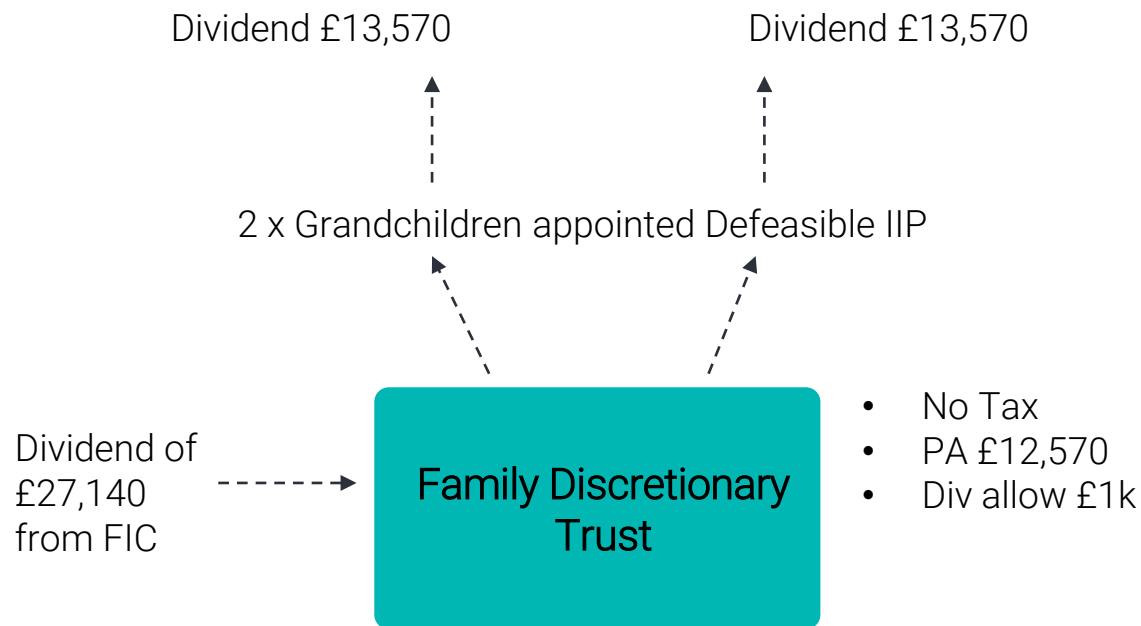
- Holdover relief under TCGA1992/S260.
- No IHT entry charge. After 7 years donor only subject to IHT on retained shares.
- No relevant property charges in first ten years of the Trust.
- Value of retained shares may benefit from valuation discount for IHT.

Heading	Heading
Whole company valuation	£2,000,000
Proportionate value of 75%	£1,500,000
Discount of say 10%	(£150,000) *
Discounted value of 75% may be	£1,350,000

\*ACCA Technical Factsheet 168: Majority interests > 50% in property companies enjoy a valuation discount of 5% to 10%.



# Settling shares onto a Discretionary Trust: Income Tax Planning





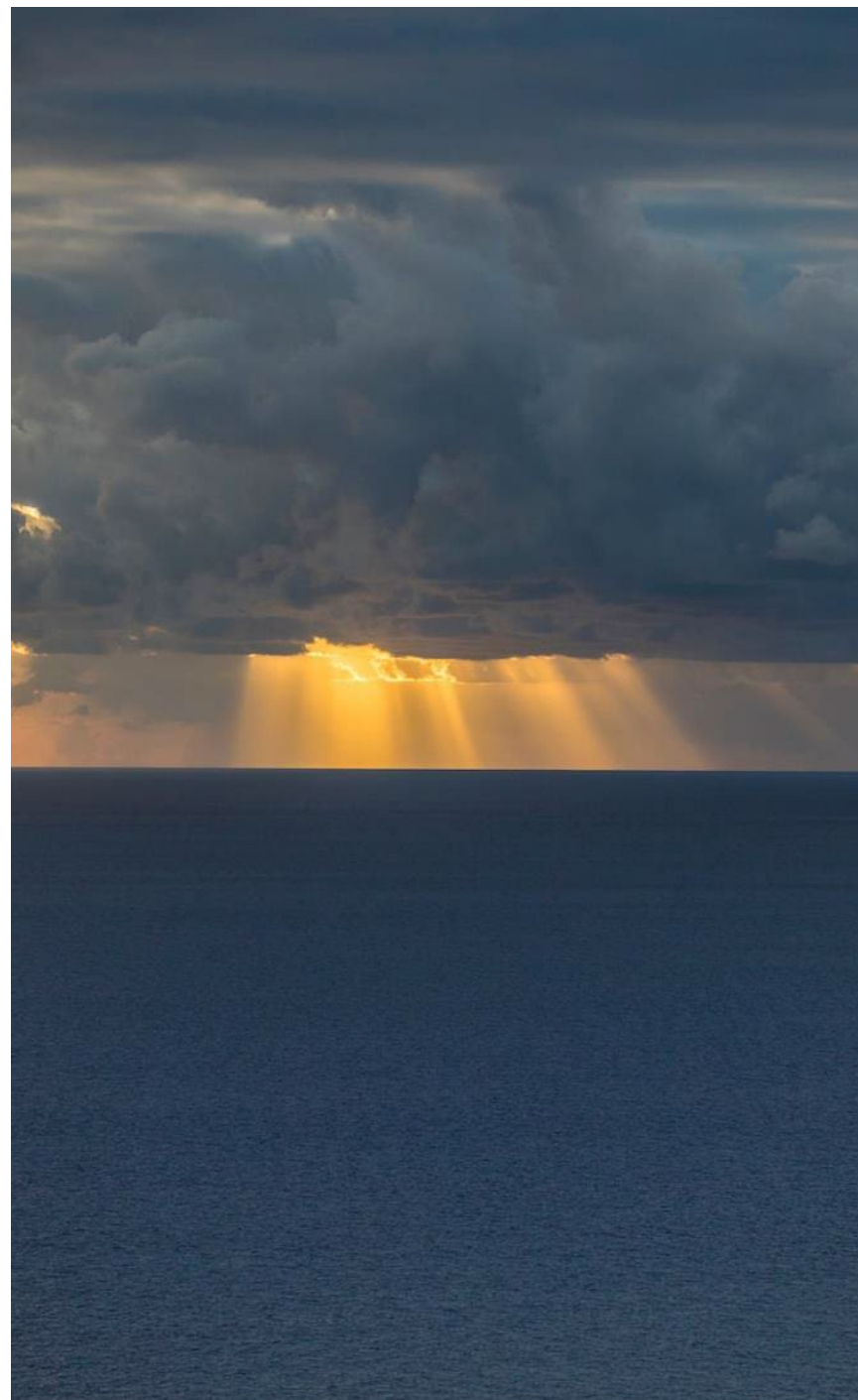
# Growth Share Plan

- The principle is that the current value of the business is 'frozen' into the existing shares and new "growth shares" shares are issued to capture any future growth in value of the company.
- Growth shares can then be passed into the ownership of other family members or trusts to remove the future value of these shares from the existing shareholders' estates for IHT purposes.
- Valuation of growth shares and important.



# Growth Shares – an example

- Property investment company, 4 x adult shareholders (two married couples)
- Whole company value £11M
- Hurdle value £12M
- Growth shares value for CGT: £1M
- Direct gift = CGT at 20% and PET for IHT
- What about a gift to a Discretionary Trust to avoid CGT on transfer of growth shares?



An aerial photograph of a boat's wake in the ocean, showing white, frothy water trailing behind the vessel against a deep blue sea. The wake forms a wide, V-shape that fills the upper and lower portions of the frame. A small, solid teal rectangle is positioned at the top center of the white text area.

PART 4

# Alternative Structures



# Jointly Owned Property

- Refer to HMRC Property Investment Manual PIM1030
- Watch spouses (ITA2007/S836) and minor children (ITTOIA2005/S624)



**The share of any profit or loss arising from jointly owned property will normally be the same as the share owned in the property being let. But joint owners can agree a different division of profits and losses and so occasionally the share of the profits or losses will be different from the share in the property. The share for tax purposes must be the same as the share agreed”**

# Bare Trusts

- Can be used where a settlor wishes to make an absolute gift without transferring legal title to the property to the beneficiaries.
- A good example is where the beneficiary is a child who is incapable of holding the legal title.
- Management of the trust fund is in the hands of the trustees, rather than the beneficiaries.
- Can also be a vehicle to arrange that the value of an investment company passes to children whilst retaining a single shareholder with control.





# Bare Trusts

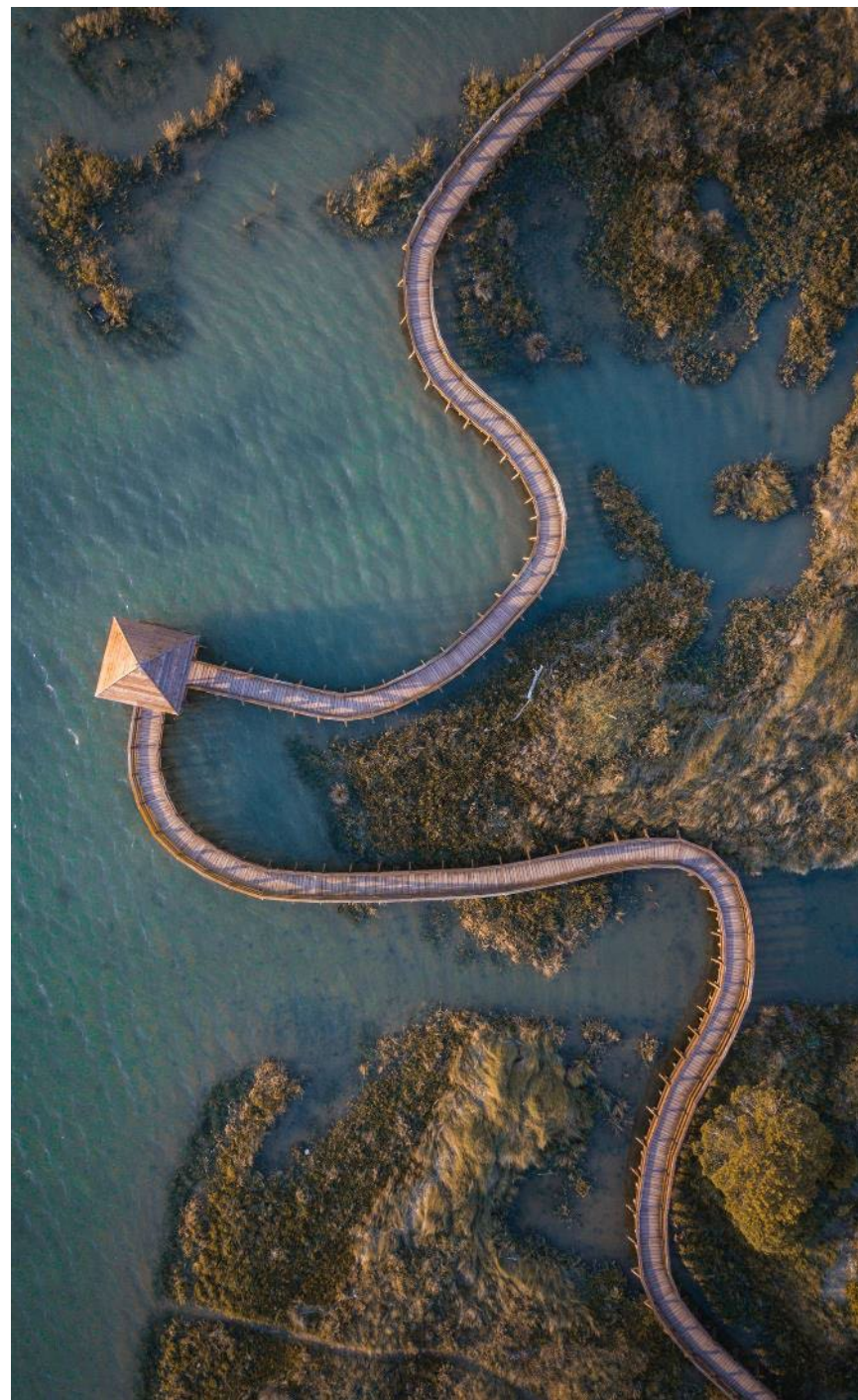
- Not a settlement for IHT so outside the relevant property regime. Gifts onto bare trusts are PETs and the trust fund is in the estate of the beneficiary.
- The income and gains belong to the beneficiary. Watch settlements legislation where beneficiary is the minor child of the settlor, so in practice they are more likely to be made for grandchildren rather than children.
- If a sole beneficiary attains 18, they can call for the fund to be transferred to them. If a joint beneficiary attains 18, they can call for their share to be transferred if it is easily divisible.
- If there is more than one beneficiary, investing the property into an indivisible asset would prevent an individual beneficiary from being able to obtain their share.





# Partnerships

- Consider a Family Limited Partnership (“FLP”) using a partnership registered and regulated by the Limited Partnerships Act 2007 if you to replicate some of the features of a trust but without the relevant property IHT regime or the corporate tax regime that applies to FICs.
- A limited partnership has two types of partners: general partners who manage the business and bear unlimited liability to creditors; and limited partners whose liability to creditors is limited and who do not manage the business.
- A limited partner may only assign their share with the consent of the general partners.
- A limited partner is not entitled to dissolve the partnership by notice.
- A limited partnership with an individual as general partner does not need to file accounts at Companies House.





## Contact Details



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