SPECIAL REPORT
BUSINESS PROPERTY RELIEF

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Using Business Property Relief

Fiona Bond talks to paraplanners about when and how they use BPR within inheritance tax planning and with which clients it tends to resonate

Four decades on from its inception, Business Property Relief (BPR) has evolved to become a valuable inheritance tax planning tool for advice firms. Hayley Broad, research director at Absolute Financial Management, says the firm uses BPR as one of its core IHT planning strategies for clients over the age of 60, in part due to its exemption rules. In contrast to gifts, which generally have a seven-year "survival period", BPR-qualifying investments are exempt from IHT within just two years.

"The two-year holding period has made BPR a very compelling investment strategy, particularly for our elderly clients, those in ill health or those who have recently inherited significant ISA portfolios from their spouse and need to mitigate their IHT," says Broad. "Compared to other estate planning options, BPR has the added attraction of providing clients with income and the opportunity for ongoing growth."

Originally designed to allow small, family-owned businesses to pass from generation to generation without falling prey to IHT, over time the scope of BPR has broadened to allow a greater number of people to invest in private businesses as a way of reducing their tax liability.

Crucially, BPR-qualifying investments remain under the control of the investor, enabling clients to balance estate planning with a change in their personal circumstances.

Rebecca Lucas, founder of Lime Outsourced Paraplanning, explains: "Client circumstances can change, particularly with longer life spans and care costs, so we find that the flexibility and financial control of BPR can be very attractive. In a sense, it provides our clients with a halfway house.

"The introduction of the ISA option in 2013, which made it possible for clients to hold AIM shares in their ISA, has also made it more accessible and straightforward and we saw a steady increase in the use of BPR directly after that time. We often use the Octopus AIM ISA with our clients."

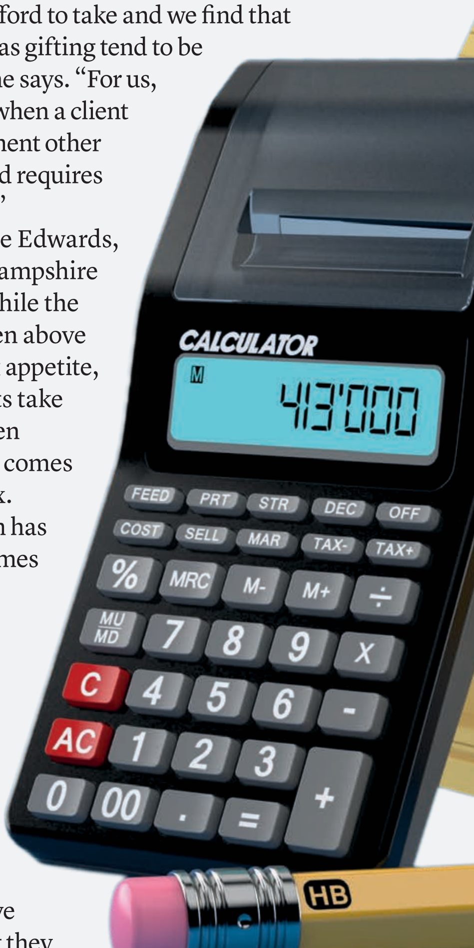
But, despite growing awareness, a client's capacity for loss and their personal circumstances must be carefully considered. As investments, there is the potential for the value to drop and this means robust client suitability checks and due diligence must be in place. For Broad, it is a matter of ensuring that clients understand the different objectives around IHT planning and investing.

"If clients, and particularly older clients, are quite conservative in their nature and have taken a cautious approach to investing, we explain the different objectives around IHT planning and ensure that while the level of risk may be higher with BPR, the overall risk profile of the clients' portfolio remains balanced," Broad says. "Our focus is on capital preservation for our clients, and we have taken the lowest possible risk during this turbulent time."

Lucas says clients must be careful not to prioritise IHT planning over the need for income in life. "While BPR can be very effective for certain clients, we are extremely careful about the level of risk that clients can afford to take and we find that alternatives such as gifting tend to be more popular," she says. "For us, BPR is best used when a client needs to complement other IHT strategies and requires something extra."

However, Reece Edwards, paraplanner at Hampshire Hill, notes that while the risk of BPR is often above clients' usual risk appetite, many older clients take an objective driven approach when it comes to inheritance tax.

The firm, which has used BPR eight times over the past two years, says all but one client were over the age of 70. Edwards says: "We find older clients tend to be very firm on what they want to achieve. They have a goal of ensuring they protect their children



"While BPR can be very effective for certain clients, we are extremely careful about the level of risk that clients can afford to take"

Rebecca Lucas, Lime Outsourced Paraplanning

from IHT and while they may be much more cautious with the rest of their financial planning, they are less concerned with risk when it comes to reducing IHT and much more about achieving the objective."

Edwards says BPR has worked well for two of the firm's divorced clients who wished to pass on wealth to their children from a previous marriage. He explains: "Making provisions for children from a previous relationship can be the elephant in the room at times, but BPR can be used to ensure a client's children are provided for rather than placing the onus on the current partner to make those provisions in the event of their death."

But, according to Edwards, BPR investments in a single client's name can also prove problematic. "The disadvantage for couples using BPR is that it provides one with control. In those instances, we would look at alternative strategies such as gifting," he adds.

There have also been some concerns that the Government may look to alter BPR as part of a wider IHT overhaul, but paraplanners agree that at a time when small businesses will be critical to the recovery of the economy, the Chancellor is unlikely to wield his axe.

Broad says: "A lot of the lower risk investments within AIM are focused on leasing goods to the NHS and public sector funding, which is great for investors looking to make a positive impact with their investments. As a business, we are really interested in a more sustainable approach and we are seeing growing interest from both existing and new clients in ESG."

"We find older clients tend to be very firm on what they want to achieve. They have a goal of ensuring they protect their children from IHT"

Reece Edwards, Hampshire Hill

Business Property Relief Q&A

Rob Kingsbury spoke to Jessica Franks, Head of Tax at Octopus about the benefits, risks and uses of BPR for advised clients

IS BUSINESS PROPERTY RELIEF (BPR) UNDER-UTILISED WITHIN THE INDUSTRY?

Advisers tell us they think BPR is under-utilised and every year when we survey them, they say they intend to write more BPR business in the coming year.

In our most recent survey, nine out of ten advisers said their clients have become more mindful of potentially needing access to their money in later life, while also being mindful of the inheritance tax (IHT) implications[1]. That sentiment points to the potential for advisers to be turning more to BPR in the future because of the client need.

Advisers and paraplanners who write BPR business say they will begin by looking holistically with the client at their exposure to IHT and then approach the subject. Often the conversation will turn to retaining control of their wealth during their lifetime. They won't want to gift it away, in case they need it for unexpected expenses.

But they might want the opportunity, based on current tax rules, to pass wealth on more tax efficiently if it means they can retain access.

For this reason, talking about BPR can be a door opener to conversations that are otherwise difficult to start. The thought of giving away assets is so difficult to be comfortable with and BPR can overcome that objection. Once the conversation has started, putting part of an estate in a BPR investment will appeal to investors with different risk-reward profiles for a range of different reasons.

WHAT ARE THE MAIN TAX PLANNING BENEFITS BPR OFFERS ADVISED CLIENTS?

There are various reasons people invest in BPR-qualifying portfolios. The primary reason is that it enables people to undertake estate planning while keeping control of their wealth during their lifetime.

There's also the fact that BPR investments only have to be held for two years (rather than the seven years needed for lifetime gifts to be effective) before becoming zero rated for IHT. It should be noted, though, that the investment has to be held until death to qualify for relief.

The two-year qualification is important because it gives investors more certainty that their estate is likely to benefit from the relief at the point they invest, enabling them to get more comfortable with taking investment risk.

BPR can also be useful also for clients who want to gift some of their wealth, for example so they can see their grandchildren benefit from it in their lifetime, but who want to retain control over other parts of their wealth. Another thing we see, is clients who feel gifting money would cause family tensions and would prefer to allocate money to pass on after their death, taking advantage of the tax benefits of BPR.

BPR investments offer favourable tax relief because it is the government's way of incentivising private investors to back smaller businesses in the UK. So many people also like to know they're putting their money to work in the UK economy, helping to provide jobs and promote growth in important areas like renewable energy, healthcare and infrastructure. This can be an extra benefit for clients.

BPR IS HIGHER ON THE RISK SCALE FOR CLIENTS. HOW BEST CAN PARAPLANNERS ADDRESS THE RISKS WHEN TAX PLANNING FOR CLIENTS?

Often we see BPR used as a part of a wider estate planning strategy, where for example, a client may gift some money, settle some assets in trust and use BPR alongside.

To qualify for BPR a company has to be trading and either unlisted or AIM listed, so you are inevitably dealing with smaller companies and typically with less liquidity. This is one of the main risks. These are equity investments, so investor capital is at risk and they may not get back the full amount they invest.

There is potential tax risk also, as BPR is only granted when someone passes away and a claim is made. This means the BPR rules applied are those in force at the time a claim is made, which may not be the same as those applicable today. Similarly, the company or portfolio invested in has to qualify for BPR at that time. Tax treatment depends on individual circumstances and could change in the future.

It's also worth remembering that the shares of unquoted companies and AIM listed shares are by their nature high risk, their share price may be volatile and they may be hard to sell.

For most of our investors, those risks stack up against the very generous tax relief they are likely to receive. A saving of 40% inheritance tax is very valuable for their beneficiaries and the investment profile that they are able to target.

Remember that investing through an experienced manager, who can look at the investment from both a performance and a BPR-qualification perspective, can help mitigate elements such as sector risk.

It's important to look at the underlying investments of any IHT service. Are the investments AIM listed or unquoted? Are higher levels of growth being targeted, or is the service targeting a more modest and steady return? These different approaches will likely be more suited to certain types of client based on their objects and risk appetite.

ARE THERE OTHER OPPORTUNITIES TO USE BPR?

There is a pocket of clients for which BPR applies instantly. For clients who have sold their business in the past three years and created an IHT liability, they may benefit from instant relief from inheritance tax if they reinvest the proceeds in a BPR-qualifying portfolio. Their own business would need to have qualified in itself for BPR. By investing some or all of the proceeds from the sale in another business qualifying for BPR, or a BPR portfolio run by a manager like Octopus, they would qualify for BPR instantly. It's called 'replacement relief'.

Something else we see are investors who settle BPR-qualifying shares into trust. That's because they are IHT exempt once held for two years and can then pass into the trust free from the chargeable lifetime transfer.

We're actually seeing more activity around trusts at the moment. It has to be noted that the client can lose control of the assets that are moved into trust. But it can be a popular option when planning for multiple generations, and in divorce and insolvency protection planning.

WHAT LEARNING MATERIAL DOES OCTOPUS OFFER FOR ANYONE WANTING TO KNOW MORE ABOUT BPR?

We have a range of useful tools, including calculators than can help quickly and simply work out what a client's IHT liability might be.

You can also find technical white papers on certain tax topics on our website. And through lockdown we have been running monthly online shows to give advice firms helpful insight into situations and conversations that are happening in the market at the moment.

I'd also highlight that we have a range of planning scenarios, showing how estate planning using BPR might work for particular clients. We try to make things as easy as possible for advisers and paraplanners and case studies are a great way of talking about situations that happen to real people and how they can be helped. Our most popular guide by far is *Untangling Inheritance Tax*. It's a simple guide to understanding and planning for IHT and is a starting point.

Visit octopusinvestments.com/guidetoiht/

[1] Source: Unlocking estate planning, Octopus Investments, February 2020.

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Guide to Business Property Relief

Jessica Franks, Head of Tax, provides an overview of Business Property Relief. She looks at why BPR is available and explores the main reasons clients could benefit from holding shares in a BPR-qualifying company

Business Property Relief (BPR) can be a valuable relief from inheritance tax. It allows certain investments to be left to beneficiaries free from inheritance tax.

A client who holds a BPR-qualifying investment for at least two years, and who is still holding it when they die, can pass it on without their beneficiaries having to pay inheritance tax.

That offers two clear advantages over gifting. The first is that it takes only two years to become zero-rated for inheritance tax. The second is that a BPR-qualifying investment stays in the client's name. If they need capital later on, they can request to sell the investment, subject to liquidity (see risks below).

People are living longer, so this second advantage is likely to grow in importance. Clients could find they live another 20 or 30 years after they first do their estate planning. So while they need to have planning in place in case they pass away earlier, there's an understandable reluctance to give away wealth they may later need. For some clients, BPR may offer a solution to this dilemma.

Why is BPR available?

Clients often want to know why it's possible to save 40% inheritance tax by making a BPR-qualifying investment. The answer is very simple. This tax relief exists as an incentive for investors to take on the risk of backing BPR-qualifying companies. These are unquoted or AIM-listed trading businesses that are making a valuable contribution to the economy.

Clients need to be aware that they're investing in the shares of one or more trading businesses. That means that investors' capital is at risk, and they may not get back the full amount they invest.

It can also be helpful to give clients a brief history of why BPR came into being, to better understand why this relief exists.

BPR was first introduced in the 1976 Finance Act. The idea was to make sure that, after the death of the owner, a family-owned business could survive as a trading entity, without having to be sold or broken up to pay an inheritance tax liability.

Over time, successive governments have recognised the value of a tax relief that encourages people to invest in trading businesses regardless of whether they run the business themselves, not least because such businesses provide jobs and support economic growth. So the relief was made more valuable and extended to cover minority stakes in unquoted businesses that meet the qualifying criteria, as well as qualifying businesses whose shares trade on the Alternative Investment Market (AIM).

Not all companies can qualify for BPR. For example, BPR only applies to companies not listed on the main London Stock Exchange. Companies must also be trading rather than investment companies, and they must not deal in stocks and shares, land or buildings. If a client is holding shares in a company as part of their inheritance tax planning, then it is crucial the company meets the BPR qualification criteria when the investor dies in order for the planning to work. So it is essential to use a specialist investment manager with experience of investing in this area when it comes to choosing the right BPR-qualifying investment for your client.

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Reasons why a client might make a BPR-qualifying investment

Every client's situation is unique, but here are three of the main reasons why a client might choose to make a BPR-qualifying investment.

Faster inheritance tax exemption: Whereas making a gift or putting assets in trust means they take seven years before they become exempt from inheritance tax, shares in a BPR-qualifying company or investment become exempt from inheritance tax after being held for just two years, provided the shares are still held at the time of death. Married couples and civil partners also have the benefit of a joint two-year qualifying period. This means that should the client die within two years of investing, the investment can be transferred to their surviving spouse or civil partner without resetting the two-year clock.

Greater access and control: Unlike with a gift, the investment stays in the client's name. That means they can request to sell the investment and get the proceeds back if they need to. However, shares sold or money taken out of the investment will no longer be exempt from inheritance tax.

Simplicity: Buying shares in BPR-qualifying companies is relatively simple compared to setting up a trust or using life insurance. There are no complex legal structures, and there is no requirement for client underwriting or medical questionnaires.

Estate planning within the ISA wrapper

Clients who have been making good use of their ISA allowances down the years can find themselves sitting on a substantial portfolio. And the fact that ISAs are subject to inheritance tax can be a problem for anyone who has accumulated large ISA sums over the years. Neglecting to include an ISA as part of the estate planning could prove a costly mistake.

Since 2013, it has been possible to invest in companies listed on AIM within an ISA. This change opened up the possibility of transferring some or all of an ISA pot into an ISA of BPR-qualifying companies as part of a client's inheritance tax planning. Such an ISA can then be passed on to beneficiaries when the client dies, and just as with other BPR-qualifying investments, if this is more than two years after the investment is made there will be no inheritance tax to pay.

It's important to note that an ISA featuring AIM-listed shares is likely to have a higher risk profile than ISAs with investments in more mainstream equities, bonds or cash. BPR is not available on every AIM-listed company.

What are the risks of making a BPR-qualifying investment?

Clients must be made aware of the risks involved in making this type of investment as part of their inheritance tax planning.

Capital is at risk: The value of a BPR-qualifying investment, and any income from it can fall as well as rise, as it will depend on the performance of the underlying companies. With an investment like this, investors may not get back the full amount they invest.

Tax relief isn't guaranteed: Tax treatment depends on a client's personal circumstances and tax rules could change in the future. Also, whether the investment qualifies for BPR will depend on the portfolio companies maintaining their qualifying status. HMRC will consider a claim for BPR based on the facts when a claim is made, including the relevant legislation in place at the time.

Shares could be more volatile and less liquid: Shares of AIM-listed and unquoted companies are likely to fall or rise in value more than shares listed on the main market of the London Stock Exchange. They may also be harder to sell.

Business Property Relief case study: Clients who want to retain access to their capital

This tax-planning scenario is designed to help paraplanners and advisers develop appropriate planning strategies for their clients. Paraplanners and advisers should consider, among other things, the value of tax reliefs for their client. You will also need to consider the impact of charges (including initial fee and ongoing fees such as annual management charges) relevant to the products represented and/or any specific product you have chosen.

Carol is 86. Her estate is valued at £1.5 million. Carol understands this means that when her grandchildren inherit, they'll need to pay an inheritance tax bill.

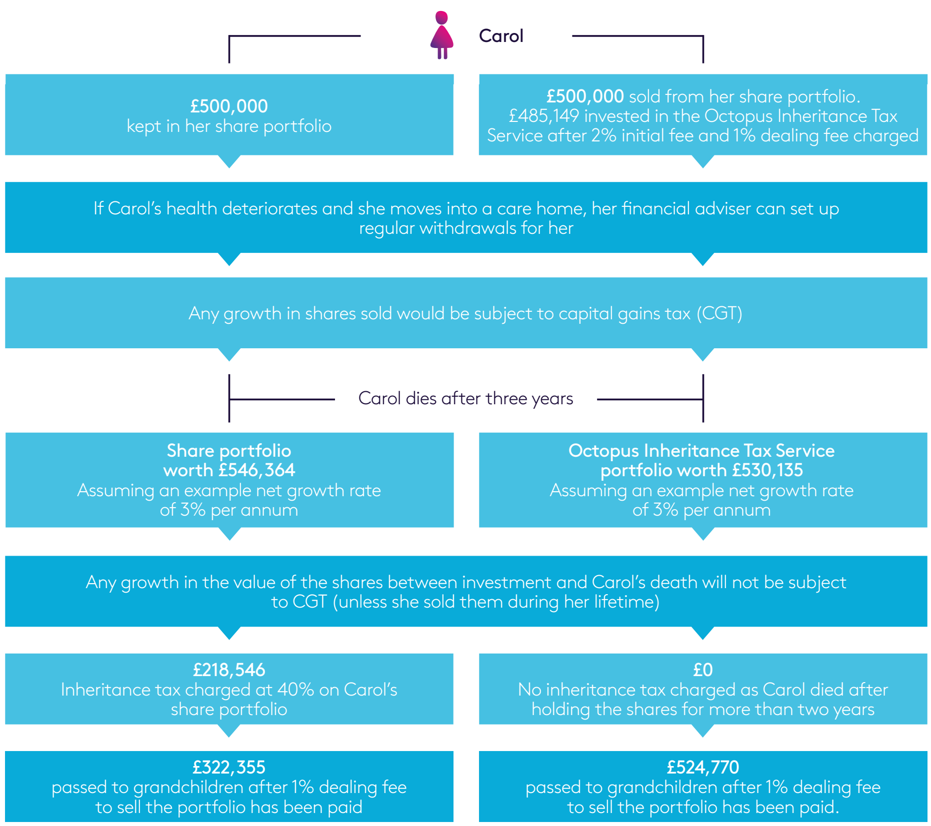
Carol meets with her adviser to talk about estate planning, and he explains that she can afford to give away some of her assets. But Carol has been in control of her wealth all her life and is reluctant to make gifts or use trusts. She worries that if her health deteriorated, she might want to use the money to pay for her care. And in seven years she'll be 93. She's worried that if she passes away before then, she will still leave her beneficiaries with an inheritance tax bill, even if she gives away assets immediately.

Carol's adviser assesses her needs and objectives, appetite for risk and capacity to bear losses and deems her suitable for an investment that qualifies for BPR. If BPR-qualifying investments are held for two years and at the time of death, they should be able to be left to beneficiaries free from inheritance tax.

BPR-qualifying portfolios invest in the shares of one or more unquoted or AIM-listed companies. They are higher risk investments than Carol's portfolio of main-market listed equities, and the tax relief is designed to provide some compensation to investors for taking additional risk.

Carol inherited a large investment portfolio from her late husband. So her adviser suggests selling £500,000 of this portfolio and reinvesting the proceeds in BPR-qualifying shares. While Carol is not expected to need to access this pot of money during her life, the investment will remain in her name, and so she can request a withdrawal should she need to. Her adviser makes it clear, however, that withdrawals cannot be guaranteed.

HOW THE OCTOPUS INHERITANCE TAX SERVICE CAN HELP CAROL RETAIN ACCESS TO HER CAPITAL WHILST PLANNING FOR INHERITANCE TAX



Please note: This example is for illustrative purposes only and each investor's own tax situation may be different. It assumes that the investments will be held until death, the nil-rate band is offset against other assets and that the investment in the Octopus Inheritance Tax Service qualifies for BPR at death. It is important to remember that the risk profile of each portfolio, and any growth or losses, is likely to differ. This example does not include any charges paid for financial advice. The Octopus Inheritance Tax Service has an initial charge of 2%, a deferred annual management charge of up to 1%+VAT per annum and a dealing fee, for investments and withdrawals, of 1%. We only take our annual management charge after the investor or their beneficiaries ask us to sell shares. Also, we will only take our full annual management charge if the investment has delivered the annual target return of 3% over its lifetime, after our charges have been taken into account.