

Using AIM Stocks in Inheritance Tax Planning

Introduction

Inheritance tax is **charged on the property you own when you die**, including any gifts you make in the seven years before your death. For background information on inheritance tax please refer to our three-part Fact Sheet: *Dealing With Inheritance Tax*.

There are **a number of estate planning measures** that can be taken to mitigate the effects of inheritance tax on your estate and the general rule is that the earlier you start such planning the better. A number of these measures rely on making gifts (possibly into trust) to beneficiaries **at least seven years before your death**.

Using AIM Stocks

This fact sheet deals with one estate planning measure that **has really only been used by the super wealthy** but which is **now accessible to a much wider range of people**. This coincides with the fact that inheritance tax is also now an issue that has to be faced by a very much larger proportion of the population mainly as a result of property values far outstripping the "nil rate band" for inheritance tax (£285,000 in 2006/07).

This estate planning measure involves **investing some of your estate in the Alternative Investment Market (AIM)**. Any money invested in AIM listed companies falls **outside of your estate for inheritance tax purposes after just two years**. Furthermore, unlike many other solutions to inheritance tax, you retain **access to your money** at all times.

Such an investment is very high risk and that fact alone will mean that **it should not be considered by the majority of people** seeking to reduce the impact of inheritance tax for their beneficiaries. On the other hand, if you do nothing, 40% of your estate in excess of the nil rate band is certain to be paid to the Revenue rather than your chosen beneficiaries.

Alternative Investment Market

The London Stock Exchange (LSE) launched the Alternative Investment Market (AIM) in 1995 to provide **market facilities for companies either too small or too new to apply for the Official List**.

AIM can also be used as an interim stage to a full listing. Although the AIM is properly regulated by the LSE, its conditions are less demanding than those on the Official List.

At April 2006 there were **1,501 companies trading on AIM**, with a market value of just over £78 billion. **Trading turnover on AIM is now running in excess of £5 billion per month**.

Under AIM rules, **company prospectuses must carry the warning** that the AIM is designed for emerging or smaller companies, and that its rules are less demanding than those of the Official List. More than 70 companies have now progressed from AIM to the main market and for tax reasons some have moved in the opposite direction.

Business Property Relief

The reason that investment into companies listed on AIM is attractive for inheritance tax planning is that such **many stocks on it benefit from business property relief**.

This relief was introduced in the 1984 Inheritance Tax Act, which, as amended by later legislation, states that AIM listed securities, **held for two years or more at the time of death**, are **exempt from inheritance tax**.

In addition, as AIM stocks are classified as business assets, when they are sold they qualify for **higher rates of capital gains tax taper relief**.

One aspect of the risk that has to be faced is that **the Government could decide to remove business property relief** from AIM stocks. Such a move would be bound to result in a large sell off of AIM stocks and a major fall in the value of their shares.

Management Services

It would be difficult to invest directly into AIM stocks with a view to obtaining exemption from inheritance tax because **the rules as to which stocks qualify for business property relief are complex**.

Furthermore, in order to reduce the risk of total capital loss **you would ideally need to invest in a number of different stocks** trading in different markets. You would also need to keep a watchful eye on your stocks as a takeover by another company or a move to the Official List **would mean that your stock would no longer qualify for exemption from inheritance tax**.

The solution is to use one of the professional management services that is available. Companies such as **Brewin Dolphin, Close Brothers, Octopus, Rathbones and Williams de Broë** run actively managed AIM portfolios.

Such schemes typically invest in a portfolio of **10 or more established qualifying stocks**.

The Benefits for Inheritance Tax

We have been careful to explain the risks involved in using this method of mitigating inheritance tax. However, for part of a person's estate in excess of the nil rate band there are some very positive benefits from investing in AIM stocks:

- A** Investments made into AIM listed stocks are **exempt from inheritance tax after just two years**. This compares with a number of other estate planning measures which take seven years before they are fully exempt from inheritance tax. For those who have left their estate planning rather late in life, and where they and their beneficiaries are aware of the risks involved, this could be an excellent way to proceed.
- A** Investments made into AIM listed stocks **remain in your control at all times**. This is quite different from many other estate planning measures where control is passed to trustees or assets are passed absolutely to beneficiaries. Should there be **a need for capital in later life**, for example for nursing home fees, part or all of the portfolio of AIM stocks can be sold.
- A** Investments made into AIM listed stocks **do not involve trust documents** or other complicated legal structures.

Preserving the Value of Your Estate

The reason for investing in a portfolio of AIM stocks to mitigate inheritance tax is to avoid 40% reduction in the value of the estate being passed on death to beneficiaries. Of course, **if the AIM portfolio falls in value by 40% or more at the time of death**, nothing has been achieved and "the treatment has proved worse than the condition".

In view of this it has been preferable, where possible, for people investing in a portfolio of AIM stocks to reduce inheritance tax, **to take out a whole of life assurance policy** for, say, half the amount invested in AIM to protect the portfolio from such capital losses.

The premiums required later in life, even for someone in good health would, however, be substantial. For many people, particularly those whose health is below average, the premiums would be unacceptably high, or there would be no possibility of obtaining cover anyway.

One company, Octopus, has now addressed this issue in a very helpful way and it is expected that others will follow.

Octopus Protected ITS

The Octopus Protected Inheritance Tax Service (ITS) invests in a **diversified portfolio of AIM listed companies**. The portfolio will consist of 20 to 50 AIM listed companies and the focus will predominantly be on established companies.

These companies must occupy **strong market niches** and have **proven management teams with a clear record of success** in growing their company's business. To understand and evaluate each investment opportunity, Octopus goes through **a rigorous process** that involves spending time with a company's management team, evaluating their competitors and assessing financial projections.

Portfolios are **typically invested within 10 weeks**. Investments fall outside of the estate two years after AIM investments are bought.

Protection

Even faced with a 40% inheritance tax charge on a large part of your estate you may be **hesitant to use the AIM market** and the potential for capital loss.

The difference between this and other such services is that if the portfolio rises, you take all of the upside, however, if the portfolio falls in value, the original investment (less the initial charges) **is the minimum amount that is payable on your death**. Any growth in the portfolio is retained and passed on to your beneficiaries.

The protection is provided by **a life assurance policy issued on a group basis to all of the investors in the scheme**. In other words if the original net investment had fallen in value by, say, £30,000, then the group life policy would pay out £30,000 to your beneficiaries in addition to the value of the portfolio of AIM stocks.

The life assurance is **written in trust** so that the payment to your beneficiaries is free of inheritance tax. This benefit is paid for by the dividend income on the portfolio. Octopus estimates the dividend income to be 1.5% to 2.0% a year and this is not paid to you in exchange for the protection of your capital.

There is **no maximum age of entry** to this scheme and you can invest between £30,000 and £250,000.

Holding Period and Withdrawals

There is **no minimum or maximum holding period**. If your circumstances change and you need to access your money, you can withdraw money at any time and there are **no penalty charges**.

Funds will normally be paid within 10 days although very large transactions may take a few days longer.

Any money withdrawn from the Octopus Protected ITS **will not qualify for inheritance tax relief** as investments in qualifying AIM shares must be held by you at date of death and must have been held for a minimum of two years to qualify for inheritance tax relief.

If you decide to unwind the investment, **capital gains tax is levied at 10%** on those investments which you have held for at least two years.

Charges

The initial charge is 5% plus VAT and the annual management charge for this service is 2% plus VAT.

There is a dealing commission of 1% on all transactions (plus stamp duty reserve tax, currently 0.5%) payable to HM Revenue & Customs.

Octopus Investments

As it has an unusual name for an investment house a little background about Octopus will be helpful. From its establishment in 2000, Octopus has become to the world of private equity **what New Star has become to the unit trust industry**.

It has funds under management of more than £160 million, of which most is invested in AIM stocks and unlisted companies. The company has a young team of directors led by **Simon Rogerson** who are majoring on providing **innovative products and an excellent service**, and a large and very experienced investment team lead by **veteran venture capital investor Chris Allner**.

Risk Factors

- ❑ Past performance is no guide to future performance and there is no guarantee that a portfolio's objective will be achieved. There can be no guarantee of investment performance or the level of capital gains or income that will be generated by a portfolio of AIM stocks.

The value of investments and the income derived from them may go down as well as up and you may not get back the full amount invested.

- ❑ Investments made into AIM stocks are higher risk than securities on the London Stock Exchange Official List.

These risks include, but are not limited to, the loss of a key member of a company's management team and the fact that, due to the relatively thin trading market for many AIM stocks, it can be difficult to sell them at a fair price. You should not invest in an AIM portfolio unless you have carefully thought about whether you can afford it and whether it is right for you.

- ❑ Rates of tax, tax benefits and allowances referred to in this Fact Sheet are based on current legislation and HM Revenue and Customs practice. These may change from time to time and are not guaranteed.

This type of scheme is vulnerable to attack through amendments to the business relief rules. These rules are very generous and exploitation of reliefs can lead to their being limited or even abolished.

- ❑ This investment is not suitable for all investors. Potential investors are recommended to seek specialist independent financial advice before investing.

- ❑ AIM portfolios set up for inheritance tax purposes are designed with UK resident taxpayers in mind. If you are not resident or ordinarily resident in the UK for tax purposes it may not be appropriate or advantageous for you to invest in such a scheme.

- ❑ Companies in an AIM portfolio may cease to be qualifying investments for inheritance tax purposes. In this case the relief available on that particular investment (and not the overall portfolio) will be lost.

- ❑ In some instances investments in particular companies will be sold if the portfolio manager believes that the investment rationale outweighs the tax benefits associated with retaining the holding. This may give rise to a capital gains tax charge.

- ❑ If the investment was qualifying at the time of the sale and a new qualifying investment is acquired with the proceeds of sale, the two year holding period can be satisfied by combining these periods of ownership. If not, the relief available on that particular investment will be lost and the two year holding period will begin afresh.

For Further Info

If you would like to discuss how an investment into a portfolio of AIM listed stocks could be used in your estate planning or to discuss inheritance tax planning generally please ask your usual Arch adviser or contact us via one of the following:

Tel: **0845 3700 661**

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