TURCAN CONNELL

Briefing Note

Family Partnerships

Background

Parents or grandparents wishing to gift assets to children or grandchildren as part of inheritance tax (IHT) planning have traditionally tended to use trusts as the preferred wealth planning structure. Trusts allow a 'donor' of assets to continue to exercise effective control over the assets while still removing their value from his or her estate. Trusts also provide protection against asset risks such as divorce or creditor claims, as well as from the beneficiaries themselves particularly when young. However, the Finance Act 2006 fundamentally altered the IHT treatment of trusts making them far harder to use for these purposes.

The Finance Act 2006

The post 2006 regime now makes it very unattractive for UK based individuals to contribute significant assets to a trust as a vehicle for protecting family wealth.

Gifts to a trust with a value in excess of £325,000 (per donor) incur a 20% IHT 'entry charge' unless the assets transferred qualify for Business Property Relief or Agricultural Property Relief, or fall within the normal expenditure out of income exemption.

The value of assets in trusts established after 2006 are also subject to IHT charges of up to 6% on each ten year anniversary of the trust and on capital distributions from the trust.

While utilising trusts to the nil rate band (currently £325,000) and with assets qualifying for IHT reliefs is sensible and effective planning, family partnerships represent an alternative vehicle as a means of preserving family wealth through successive generations without the adverse IHT implications now associated with trusts.

Why family partnerships?

The aim of a family partnership is to allow parents or grandparents ('the donor') to pass wealth to children or grandchildren while retaining a degree of control over the assets until the recipients reach a sufficient age and maturity to hold those assets in their own right. Critically, the establishment of the partnership does not result in a 20% IHT entry charge, provided the family partnership is structured carefully.

How a family partnership is structured

Partnerships are traditionally used as a vehicle for individuals to carry on business together. More recently, partnerships have also been used for investment activities, commonly for property and private equity investments. It is important for the partners to demonstrate that they are participating in an active investment business rather than merely co-owning property.

A family partnership is typically established by the donor contributing to the partnership the cash or assets which he or she wishes to give away. The intended recipients become partners with a nominal capital account and are subject to the terms of the partnership agreement. The donor then gifts most of his or her interest in the partnership to the intended recipients.

A family partnership agreement contains restrictions as to how and when capital can be withdrawn from the partnership, thus providing some control over assets being withdrawn particularly while the ‘beneficiaries’ are at a young age. The donor, as ‘senior partner’, or in control of the general partner, has control over particular decisions affecting the partnership, for example on withdrawals of capital, management decisions etc.

Tax treatment

Family partnerships are generally treated on a ‘transparent’ basis for UK tax purposes which means that:

- There is no 20% IHT entry charge on the establishment of the partnership or on further transfers to the partnership. Transfers to the partnership instead qualify as potentially exempt transfers for IHT and fall out of account seven years after they have been made. (Care is required in drafting the partnership agreement to ensure that a gift with reservation of benefit does not arise which would negate the aim of reducing the donor’s estate for IHT purposes.)

- There are no ongoing IHT ten year or ‘exit’ charges.

- A gift of cash to the partnership is free from capital gains tax (CGT). A gift of an asset is a disposal for CGT purposes and any gain on the asset is subject to CGT (at the rate of 28% for higher rate tax payers).

- Income and capital gains on partnership assets are generally assessed against each individual partner at his or her marginal rate after personal allowances. Where income is paid to a minor child of the donor, that income is assessed against the donor. However, in these circumstances the donor would be entitled to reimbursement from the partnership for the income tax paid.

- No Stamp Duty Land Tax arises on transfers of land to the partnership or among the partners provided that all the partners are ‘connected persons’ which is generally the case in family partnerships.

Is a Family Partnership Right For You?

Family partnerships do not offer the same degree of control or asset protection as a trust. However, the use of trusts for UK domiciled individuals has been significantly curtailed following the Finance Act 2006 so family partnerships provide a useful alternative. General or limited family partnerships can therefore have an important role to play as part of wealth planning for the next generation.

General v Limited Partnerships

An important decision is whether a general partnership or a limited partnership is the most appropriate structure for a family partnership

General Partnerships

General partnerships can be established with less formality and tend not to be subject to the financial services regulatory rules.

Limited Partnerships

Limited partnerships tend to allow more control to be exercised over the partnership assets. The partners in a limited partnership comprise a general partner and a series of limited partners. The general partner may have only a small economic interest in the partnership but has all the management powers of the partnership. Usually the general partner would be a company owned by the donor(s). The recipients are appointed as limited partners. The limited partners have an economic interest in the partnership but, by law, are permitted only to have a passive role in the management of the partnership.

A limited partnership is subject to financial regulations regarding collective investment schemes. These regulations require an FSA authorised person to act as the operator of the partnership. This adds an additional administrative cost to the partnership but the cost of outsourcing the FSA regulated activity has come down in recent years. It can also be possible to establish the limited partnership outside of the UK to avoid these rules.

Further Alternative Structures

In addition to general and limited partnerships, the relatively new quasi corporate limited liability partnership may be appropriate in certain circumstances and in respect of certain assets, and family investment companies can also be used in a similar manner for wealth planning purposes.

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If you would like to discuss the issues involved in setting up a Family Partnership, please contact your usual Turcan Connell contact or Alexander Garden at alexander.garden@turcanconnell.com

This note is intended as a brief summary of the taxation and legal position surrounding Family Partnerships as at July 2012. Taxation is subject to change and depends on the individual circumstances of each client. Legislation is also subject to change. No responsibility can be accepted for any action taken in reliance of this note and specialist advice should be taken in every case. Turcan Connell would be happy to provide such advice.

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