BUILD AN IHT-EXEMPT SHARE PORTFOLIO

Aim shares can be a great way to avoid inheritance tax, but you've got to be careful you don't get caught out by complicated rules. **Chris Boxall** explains

In addition to the potential for high growth and, on occasion, stupendous returns, a key attraction of Aim-traded companies for many UK investors is the possibility of 100 per cent relief from future inheritance tax. While it's never a good policy to let tax legislation dictate investment decision making, investing in Aim stocks – principally for inheritance tax (IHT) planning purposes – has been an excellent policy to follow over the past few years, with many 'qualifying' Aim-traded companies proving to be star performers.

A feature in Investors Chronicle in October 2013 ('How to avoid IHT using Aim') highlighted not only the attractions of Aim for IHT planning but also the difficulty in being able to assess what does and does not qualify for IHT planning purposes. Unless investors have a firm grasp of the rules and keep up to date with which companies qualify, there is a high risk that what appears to be an excellent tax-saving ploy may ultimately backfire and result in an unexpected IHT bill on the estate.

My company, Fundamental Asset Management (*www.fundamentalasset.com*), has extensive experience investing in Aim for IHT planning purposes, and has researched the entire Aim market to establish not only what does and doesn't qualify, but also what partially qualifies and where further ambiguity lies. Our research is based on the Business Property Relief rules laid down by HMRC, which form the basis of the IHT reliefs.

Fundamental's research has uncovered 727 Aim companies that fully qualify for IHT relief out of a total of 1,087 Aim companies at the end of January 2014. Of the 360 companies that Fundamental considers do not 'fully' qualify, 82 have dual listings and 188 are either investment companies or their principal activities do not qualify. The balance either partially qualify or are structured in such a way that it is hard to determine unequivocally whether they qualify or not. But with a large number of highly attractive 'qualifying' investment opportunities available, it seems imprudent to push the qualification rules to the limit and invest in shares that may not fully qualify

HMRC qualification rules

Business Property Relief (BPR) is available for assets qualifying as 'relevant business property' that have been held for a minimum period of two years. The two-year qualification period is what makes Aim an extremely attractive tax-planning solution compared with other, more complex trust-based options, especially for very elderly UK taxpayers.

The Inheritance Tax Act 1984 states that 100 per cent relief from IHT is available for ordinary shares in companies not listed on a recognised stock exchange (unquoted), which qualify as 'relevant business property'. Unquoted in this instance includes shares that are traded on Aim.

Shares that are listed on a recognised overseas stock exchange are quoted for IHT purposes, even if they are also traded on Aim – ie, dual-listed shares would not normally qualify and should therefore be avoided by IHT investors.

But that's not always the case – HMRC further complicates the qualification process by also granting 'unquoted' status to certain overseas exchanges, so investors shouldn't necessarily dismiss an Aim stock just because it's listed on an overseas exchange.

Making sense of the dual-listing rules

Total Produce (Aim: TOT) is a fresh produce distributor that demerged from Fyffes (FFY) in 2007. Total Produce generated sales of over €2bn (£1.67bn) in 2012 and could therefore be viewed as a good, solid investment proposition by many risk-averse 'Aim for IHT' investors who are wary of investing in very small companies. However, its dual listing on the Irish Stock Exchange may put off many IHT planning investors. But closer inspection

Can I trade Aim shares?

Many investors considering investing in Aim for IHT planning purposes are under the impression that it is necessary to hold the same shares for the entire two-year period. This is not the case and relief is not necessarily lost if the investor disposes of qualifying shares and replaces them with other qualifying shares, with each period of holding counting towards the two-year period. However, in order to still qualify for relief, the whole of the sale proceeds must have been used to purchase the replacement shares, suggesting that a partial sale and reinvestment of a holding may not be the best course of action. HMRC is very generous in the time it allows for reinvestment with the both the sale and purchase only having to take place within three years of each other.

For IHT planning purposes companies, don't have to be UK resident – therefore shares in companies domiciled overseas may also qualify. **Thalassa (Aim: THAL)**, the marine seismic group, is a British Virgin Island (BVI) international business company with operating subsidiaries based in the UK. Despite the BVI domicile of the holding company it still qualifies for IHT planning purposes.

With Aim shares permitted within individual savings account (Isa) wrappers from August 2013, the current Isa season could see even greater interest in Aim from IHT planning investors.

reveals that Total Produce's shares are actually quoted on the Emerging Securities Market ('ESM') of the Irish Stock Exchange. The ESM does not meet the HMRC definition of 'listed' for the purpose of HMRC legislation; therefore, shares in Total Produce would apparently still qualify for IHT planning purposes.

Fundamental's research revealed that 21 companies on Aim have such qualifying 'dual-quoted' status, the majority on the ESM.

Investors in **African Copper (Aim: ACU)** could have a particularly tough time determining whether their shares qualify, and they may need to seek specific guidance from HMRC directly. As well as being listed on Aim, the Botswana-based copper miner is also dual listed on the Botswana Stock Exchange, which isn't included in any of the HMRC tables.

A company's business activities also determine whether it qualifies for BPR or not. HMRC offers greater guidance of where relief cannot be claimed, summarised as follows:

(a) business or company is engaged wholly or mainly in dealing in securities, stocks or shares, land or buildings, or in making or holding investments;

(b) business is not carried on for gain;

(c) business is subject to a contract for sale, unless that sale is to a company that will carry on the business, and the sale is made wholly or mainly in consideration of shares in the company buying the business;

(d) shares in the company are subject to a contract for sale or the company is being wound up, unless the sale or winding up is part of a reconstruction or amalgamation to enable the business of the company to be carried on.

Resource companies in general introduce another layer of complexity to the understanding of qualification, as many are conceivably structured as investment companies with only minority stakes in different operating businesses.

Be careful with investment companies

It's sometimes very hard to determine whether a business is an investment company or not, and Aim-traded **Frontier IP (Aim: FIPP)** is a prime example of this.

The group website states that Frontier IP specialises in the commercialisation of intellectual property by establishing partnerships with individual universities and research institutions to assist with their spin-out and licensing activities. This description implies that it does indeed meet the BPR qualification rules. However, a quick glance at the balance sheet at 30 June 2013 reveals 'financial assets' with a value of £494,000, which is equivalent to 18 per cent of the group's net asset value. The majority of these represent investments in unquoted securities, suggesting that Frontier IP is a business that makes or holds investments.

The December placing of 3.75m shares to raise £750,000 of new money adds another twist to this tale, as Frontier IP obtained enterprise investment scheme (EIS) and venture capital trust (VCT) clearance for this raise, with EIS clearance suggesting that BPR relief also applies. The explanation for this is that, while Frontier receives shares in the university spinouts that it supports, these equity stakes represent payment in kind for services that it provides, albeit that the cash receipt is deferred. Therefore, although Frontier IP holds the shares that it receives, these holdings are a by-product of its trading activities.

Camco Clean Energy (Aim: CCE) refers to itself as "an experienced project developer working to develop, construct, deliver and operate projects that contribute to building a sustainable future". The balance sheet at 31 December 2012 reveals "investments in associates and joint ventures" with a value of €7.2m and the income statement for the year also highlights an "impairment of investment in associates and joint ventures" of €3.2m. These facts suggest that a large element of Camco's business would therefore be viewed as 'investment' and the business in its entirety would not fully qualify.

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With reference to (a), a retail stockbroker such as **Share (Aim: SHRE)**, whose activities mainly involve dealing in shares, wouldn't qualify but an investment manager, such as **Argo (Aim: ARGO)** – which derives its income principally from managing investments as opposed to trading activity – would seemingly qualify. However, (a) also makes reference to making or holding investments, and a quick glance at the balance sheet of Argo reveals that as at 30 June 2013 it had \$19m (£11.5m) of investments accounted for as 'current assets', being investments made in funds that it manages. It is therefore easy to argue that Argo would also be partially viewed as an investment company, deriving significant revenue from its investments and therefore may only partially qualify for IHT purposes. Investment managers generally like to have a significant investment in funds that they manage, and they may also derive revenue from trading activities, so the majority may only partially qualify.

Somewhat bizarrely, BPR relief may apply to the business of a market maker or discount house in the UK.

Property or not?

Aim companies that have significant property assets and only use these partially for their own use and, for example, rent out space to others might also be subject to the partial exemption rules. HMRC could class these as 'excepted' assets if they are not used wholly or mainly for the purposes of the business throughout the two-year period that the investor holds the shares. HMRC states that: "If the group includes any company whose own business falls outside the scope of the relief, business relief is only given on the value that would be appropriate if that company were not part of the group. In applying the rules for excepted assets, the group is considered to be one concern."

Packaging group **Robinson (Aim: RBN)** can trace its roots back to the 1600s, when the Robinson family set up and ran pottery businesses and the group's ▶

Part qualifying

Fundamental's research has uncovered over 92 Aim companies whose business activity suggests that they may only partially qualify for a multitude of different reasons, or where it is hard to accurately determine whether they meet all the qualification criteria.

Criteria (b) and (c) cover the instance of a business subject to a contract for sale – a subject that is highly relevant to Aim, which sees many of its constituent companies attract approaches from predators. The rules suggest that investors should be wary when an offer is made that becomes unconditional, and the prudent course of action would probably be to dispose of the holding well before the deal completes.

Andor Technology (Aim: AND), the developer and manufacturer of digital cameras for academic, industrial and government applications, was a favourite of many IHT planning investors. The company has recently been acquired by fully-listed **Oxford Instruments (OXIG)**, with terms having been agreed on 10 December 2013, and the recommended 'cash offer' becoming unconditional on 22 January 2014. Following HMRC rules, IHT planning investors may have been wise to have sold their shares on or around 10 December 2013.

With many listed businesses essentially structured as holding companies, thankfully HMRC rules are clear that relief may be available for shares or securities in a company that is a holding company, as long as the group is not wholly or mainly engaged in property, investment or dealing.

▶ packaging business itself dates back to 1839. With such a long history, it's no surprise that Robinson has collected a number of property assets over the years – some of which are not currently used in the current packaging business. However, the group has always intended to sell its property portfolio and has never actively invested in it or developed it. An example of this was the July 2013 sale of its Portland site in Chesterfield to Sonoco, following Sonoco's earlier purchase of Robinson's spiral wound paperboard business that operated on this site. The £4m sale proceeds were marked for "investment opportunities to expand its packaging business in Europe".

Unlike numerous Aim companies, which seem to have little knowledge of the IHT attractions for UK investors, Robinson has a helpful page on its website titled 'Tax & Aim' (*www.robinsonpackaging.com/investors/tax-Aim*) clarifying the reliefs and why the group believes it qualifies as "properties held are residue from previous trading activities and there is an active plan to dispose of them". If only all Aim companies could be so helpful.

Michelmersh Brick (Aim: MBH), the specialist brick manufacturer and landfill company, has a substantial portfolio of land assets born out of previous clay extraction activity for brick making. The group is negotiating the sale of its former factory land at Telford and further plots of land at this site might be developed for disposal under the group's option agreement with Persimmon. Management intentions seem clear that realisations of value from surplus assets will reduce borrowings further and also support investment in brick manufacturing. Accordingly, all the signs are that Michelmersh Brick would fully qualify for BPR purposes.

Housebuilders would generally qualify under the BPR rules; however, much like investment managers, many Aim-traded housebuilders seem to enjoy being in the investment business as well. **Abbey's (Aim: ABBY)** main activities are residential housing development and plant hire. But the group also appears to derive substantial income from its available 'for sale' financial investments and has €43m categorised as 'investment properties' and 'financial investments' on its Balance sheet out of total assets of €203m. It therefore appears harder to argue that the investment properties, which are commercial units let to third parties under operating leases, are residue from previous housebuilding activities, although they could conceivably be connected to the group's plant-hire activity.

Christopher Boxall manages Fundamental Asset Management's Aim portfolio

10 BPR-qualifying* Aim shares with great prospects

Name	Price (p)	Market cap (£m)	1-year change	Forecast PE ratio (x)	Dividend yield (%)	Description	Last IC view
Hayward Tyler (HAYT)	79.5	36.18	205.77	15.6	0.63	200-year-old Hayward Tyler is one of a handful of companies that can deliver powerful pumps and motors to the offshore oil and gas industry. A restructuring in 2013 has left the group in good shape to take advantage.	Buy, 69p, 28 Jan 2014
KBC Advanced Technologies (KBC)	117.75	69.66	77.74	16.1	0	KBC sells software and consultancy to the hydrocarbon processing industry, and despite a raft of major contract wins its shares remain cheap compared with peers.	Buy, 110p, 11 Dec 2013
Northbridge Industrial Services (NBI)	427.5	74.01	33.18	13.9	1.3	Despite a near doubling of its share price since we first suggested buying in 2010, there's enough demand in emerging markets for its power generation equipment to keep Northbridge on our buy list.	Buy, 423p, 16 Sep 2013
Plexus (POS)	265	224.97	24.41	na	0.37	Plexus is another company making good money servicing the oil & gas industry – its unique well head technology is in strong demand as a result of tightened safety requirements in the wake of BP's US disaster.	Buy, 254p, 23 Oct 2013
Pressure Technologies (PRES)	665	94.87	280	20.2	1.17	Pressure has been making its Chesterton seamless steel cylinders for a century – they're now used as 'motion stabilisers' in deep sea oil and drilling, and the company is busy diversifying into new industries including a promising entree into biogas power generation.	Buy, 628p, 5 Mar 2014
Sanderson (SND)	69	35.77	28.97	15.8	2.17	The UK's high street may be suffering, but online retail is picking up the slack – good news for Sanderson which provides the software to support e-commerce. A lowly valuation doesn't reflect its prospects, and a small but growing dividend is welcome, too.	Buy, 66p, 4 Mar 2014
Thalassa (DI) (THAL)	275.5	69.03	74.92	26.9	0	Thalassa provides 3D seismic modelling services for oil explorers and producers, including the likes of Statoil which pays it to permanently monitor large north sea fields. It's got a massive pipeline of work, yet poor sentiment towards oil and gas generally means the shares are cheap.	Buy, 302p, 26 Feb 2014
Utilitywise (UTW)	318.75	230.92	237.3	26.3	0.82	One of the IC's tips of the year, Utilitywise helps UK businesses get better deals on their energy, and also installs smart meters on behalf of utilities. Given the furore over energy provision in the UK, it's fair to say the company is in a growth sweet spot which justifies its punchy share rating.	Buy, 241p, 2 Jan 2014
Vertu Motors (VTU)	62	208.81	49.4	13.9	1.21	Car sales in the UK have defied all expectations in the past few years, although that's been primarily to the benefit of stronger dealers like Vertu that have been able to consolidate the fragmented market as a result – and attract more lucrative servicing business.	Buy, 61.5p, 16 Oct 2013
Zytronic (ZYT)	228.5	34.44	-21.21	16.6	3.98	Zytronic is a leading provider of touchscreens, technology which is becoming more widely adopted in both consumer and industrial applications – Coca Cola and BHP Billiton are customers. As with all technology, it's always racing to stay ahead of trends, but the shares look cheap nevertheless and offer a decent dividend.	Buy, 199p, 19 Dec 2013

*Based on analysis by Fundamental Asset Management
Source: Investors Chronicle & Thomson Datastream