

FOCUS

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Talbot & Muir is an independent company providing specialised pensions administration services and technical information for SSASs and SIPP.

Pension Scheme Investments in Unlisted Shares

Many small businesses are currently looking to sources other than lending from high street banks to meet their financial needs, including the sale of equities. Depending on their pension arrangements and their pension provider, investors may be able to use some of these funds to invest in unlisted companies in a tax-efficient way.

The difficulty with pension scheme investments in unlisted shares – and what makes this such a technical area, usually restricted to specialist SIPP and SSAS providers – lies in HMRC's rules regarding indirect investments in taxable property (assets such as residential property, or plant and machinery, which would attract tax charges if the pension scheme were to purchase them directly).

Broadly speaking, there are two alternative approaches in the pensions industry when it comes to making investments in unlisted shares:

1. Allowing investments only in tax-exempt "trading concerns".
2. Allowing investments only in businesses that do not hold any taxable property.

If an unlisted company owns taxable property but qualifies as a trading concern, there will be no tax penalties. Likewise, if the company owns no taxable property the investment will not be penalised. Both approaches have their own technical challenges and potential pitfalls.

Trading Concerns

The trading concern rules allow pension schemes to participate in arm's length investments in trading companies. They exclude investments in companies over which the scheme member (and their associates, usually close relatives) exercise "control", according to the statutory definition provided in sections 450 and 451 of the Corporation Tax Act 2010.

The rules will be breached if the investor owns or is entitled to acquire the greater part (i.e. 50% or more) of the company's share capital, income, or assets. For directors, this limit is lowered to 20%, which is why some pension providers, including Talbot & Muir, limit investments of this kind to 19.99% of a company's share capital.

If an investor or a controlling director purchases shares in an unlisted company over which they have "control", that investment is not regarded as a trading concern, and unauthorised payment tax charges may apply.

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The big advantage of this approach is that the taxable property owned by the company is irrelevant: no matter what taxable property is held, an investment in a true trading concern will not attract tax penalties.

Limiting Taxable Property

The second approach to this type of investment – **which has not been adopted by Talbot & Muir** – is to limit investments in unlisted shares to companies that hold no taxable property whatsoever. As taxable property is the issue at stake here, investments that do not involve the direct or indirect investment in taxable property should be exempt from any tax penalties. In theory, this approach should be much more permissive than the limits required by the rules on trading concerns, but in practice it is not so simple.

Firstly, limiting investments of this type only to companies that own no tangible moveable property – such as large pieces of machinery – will automatically disqualify large sectors of UK businesses. Which manufacturers, hauliers, or retailers have no tangible moveable assets, for example? We suspect very few.

Secondly, in many cases pension providers that adopt this route place the burden of determining the ownership of tangible moveable property on the unlisted company or their accountants. How much reliance can the provider place on undertakings received from the company, given the complexity of HMRC's rules?

Another worrying aspect of this kind of investment is the reliance often placed by the pension provider on the "£6,000 rule". Briefly, if an asset is held for the purposes of the "administration or management" of the company, and is not used or occupied personally by the scheme member or anyone connected to them, then provided the asset is valued at no more than £6,000 it can be discounted for the purposes of the taxable property rules. It is relatively straightforward (although perhaps not inexpensive) to ascertain the value of all of the company's moveable assets, but investors should be wary of pension providers who look no further than an asset's value.

Example

XYZ Taxis Limited

Roger is a controlling Director of the above company and wishes to invest some of his SIPP money into shares of the firm to raise capital for an expansion drive and a full makeover of their current premises, including some artwork and a large clock for the exterior of the building.

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His SIPP provider states that, as his firm is a trading company, their rules mean that this is an eligible investment as long as XYZ has no assets valued at more than £6,000 and that he does not use the assets personally. Roger states that all of their taxis have a market value of less than £5,000, and all other assets (computers, desks, etc.) are significantly under this threshold, and therefore proceeds with an investment of 25% of the company's share capital.

Talbot & Muir's stance

Roger could be in breach of taxable property rules, and therefore liable for tax charges of at least 55% of the investment, for the following reasons:

- The purchase of artwork and the external clock would certainly lead to an indirect ownership of taxable property by the SIPP as, although each item is valued at less than £6,000, these are not items used for the "administration or management" of the company. Although Roger's SIPP also owns an interest in the company's taxis, these may be exempt; the same "administration or management" test applies.
- As Roger is a controlling Director of XYZ, the investment could not qualify as a "trading concern".

In addition, whilst the SIPP owns these shares, XYZ Taxis Limited will always be effectively restricted by the £6,000 rule regarding the value of current and future purchases of tangible assets. Roger is limiting the company's future investments into assets that could support the expansion drive (e.g. the purchase of new taxis).

If Roger owned less than 20% of XYZ Taxis Limited – including any shares he owned personally, or that were owned by connected persons – there would not be any taxable property issues (subject to the "personal use" restriction) as the investment would qualify as a "trading concern".

For more information, please see our unquoted share rules on the Technical area of our website.

We would be delighted to hear from you on any subject relating to SSAS or SIPP. Please contact:

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