



# Family Partnerships

## An alternative to trusts?

Since the changes to inheritance tax in 2006, advisors have been talking about the advantages of using family partnerships (FPs) as an alternative.

FPs are seen to offer many of the same features as trusts, but (crucially) without an immediate 20% inheritance tax (IHT) charge on their creation.

However, despite these seeming advantages, progress has been slow and few FPs have actually been created. There have been a number of reasons for this and the purpose of this briefing is to give a candid view of the benefits and pitfalls of FPs.

Our view is that FPs are often worthwhile, but – being more complex than trusts – should not be treated as a "packaged" product. Clients should only consider them if they are prepared to engage fully in the design process.

## What is an FP?

A "Family Partnership" is not a term of art. It simply refers to a partnership where the partners comprise one or more members of the same family. As such, a Family Partnership is no different to any other form of partnership.

FPs are typically used as an alternative to trusts, offering many of the same features.

FPs may be structured either as limited partnerships (sometimes called FLPs), general partnerships, or using a Limited Liability Partnership (LLP). The choice between these forms will often involve a balancing act between regulatory and practical considerations.

## What are the regulatory issues?

Without going into great detail, FPs may be treated as unregulated collective investment schemes. This could (although unlikely) incur sanctions from the Financial Services Authority and, potentially worse, make the agreement unenforceable.

There seem to be three main solutions to this issue:

- Use family members rather than professionals as "managing partner";

- Use a general partnership or LLP instead of a limited partnership and ensure that the "junior partners" have a real say in decision-making;
- Ensure professional trustees have proper CF30 authorisation from the FSA.

## Why use an FP - tax advantages?

The principal advantage of an FP compared to a trust is, as mentioned, the lack of a 20% IHT charge on its creation. However, if carefully drafted, FPs can offer several other tax advantages:

- The managing partner can be paid a reasonable commercial rate for work done in managing the partnership unlike a family trustee.
- Assets pregnant with capital gain can, if correctly structured, be added to an FP without an immediate CGT charge.
- The 50% income tax rate does not apply to FPs. Adult partners are taxed at their own rates; minor children at the donor's rate.
- 10 yearly and exit charges (the "6% regime") don't apply unlike for trusts.
- Land can be contributed to the FP without a Stamp Duty Land Tax (SDLT) charge, even if the FP takes over any borrowings.
- Non-resident partners do not, unlike trusts, trigger inadvertent tax charges and advantage may potentially be taken of non-resident status.
- A limited company can, in some circumstances, be brought in as an additional partner, offering access to lower rates of corporation tax rather than income tax.

## So why isn't everyone doing this?

The tax advantages need to be balanced against a number of practical factors. Chief among these – as seen above – are the potential regulatory issues.

The following points also need to be considered:

- **Business.** A partnership must carry on a business. This implies a businesslike level of activity. Simply sitting on an investment portfolio is not a business.
- **Agency.** Except for limited partnerships, all partners are agents of the partnership. Unlike beneficiaries of trusts, they can all act in the name of the partnership<sup>1</sup>.
- **Flexibility.** With careful drafting it is possible to reallocate partnership shares between partners, but this is more difficult than with a discretionary trust.
- **Capital Gains Tax.** If partnership shares are re-allocated this may cause CGT charges to arise.
- **Minor children.** Minor children can only be partners if they understand what being a partner means. Until then, someone else would have to hold their partnership share as nominee for them.
- **Unborn children.** It is possible to provide for, as yet unborn children, but a number of issues arise – see "Flexibility" above.
- **Divorce.** The position of partners on a divorce is uncertain – although it is generally thought that the position is similar to that of a trust.
- **Right to information.** Partners generally have wider rights to information than beneficiaries of a discretionary trust.

These issues are all potentially manageable but a careful balance needs to be struck in the way the partnership agreement is structured. This is the main reason why FPs will not become a "packaged" product. Each situation is different and needs to be planned for accordingly.

#### **At what value does an FP become worthwhile?**

The main cost-driver will be whether or not a professional managing partner is appointed – which in turn depends largely upon attitudes to the agency and regulatory issues.

The costs of a professional managing partner with the correct FSA authorisation will vary from provider to provider. However, as a general rule assets of around £5m would be needed to make these costs worthwhile.

Where a family member can act as managing partner the costs may be significantly reduced. An FP then becomes worthwhile with assets of around £2m or potentially even less<sup>2</sup>.

Legal fees to draft an FP will vary according to circumstances, but as a rough guide might be between £10,000 and £15,000 where a professional trustee is not involved.

<sup>1</sup> Limited partnerships offer a solution to this problem, but rule out one of the answers to the regulatory problem.

<sup>2</sup> The main consideration will often be at what level of assets one can justify running a proper "business" rather than simply a "portfolio".

For more information contact



**John Barnett**  
**Partner**

Tel: 0117 902 2753  
Email: john.barnett@burges-salmon.com



**Tom Hewitt**  
**Partner**

Tel: 0117 902 2717  
Email: tom.hewitt@burges-salmon.com