The Timebank Research

Function	**Initial Research**
Product Name	Inheritance Tax Portfolios – Discretionary Management Service
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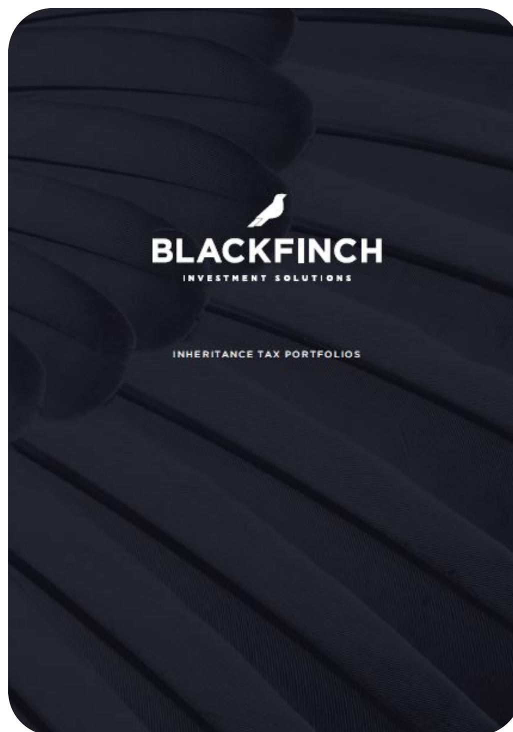

Initial Assessment
Of

Blackfinch Inheritance Tax Portfolios – Discretionary Management Service

Prepared by

Prepared for

Please note that this plan was prepared in the 2013/14 tax year and therefore the tax rates and assumptions used are those that were applicable.

This is an initial assessment made on the investment's literature, and precedes full due diligence.

This document neither endorses nor rejects the product but enables the adviser to make an informed decision on how it may be appropriate for client needs.

This is not in any way any form of advice and is an internal document that forms part of the wider, rigorous process of selecting any investments.

Advisers have responsibility to ensure that individual advice is based on individual needs.

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AIM

The aim of the Blackfinch IHT Portfolio is to help reduce an individual or couples inheritance tax (IHT) liabilities through use of Business Property Relief, whilst targeting the preservation of capital within the underlying investment content. By using Business Property relief this will potentially take capital out of the estate after two years investment.

STRUCTURE & TERMS

The plan is open ended, although the investment must be held for at least two years and maintained until death or gift/transfer of the investment into trust to qualify for Business Property Relief and be removed from estate calculations by the deceased's executors. Shares inherited from a spouse qualify for Business Property Relief if the combined period of ownership is two years or more.

Importantly, shares in existing companies qualifying for Business Property Relief can be reinvested without prejudicing any qualifying periods, essentially rolling over the qualifying term provided that the original and replacement property is, together, held for at least two of the five years prior to the transfer.

The minimum investment is £25,000, although additional amounts can be added from £10,000. Any new payments will then have to be invested for 2 years to qualify for Business Property Relief.

The investment of funds is made into shares of unquoted companies where qualification for Business Property Relief can be achieved. All unquoted shares are held in companies in which the activity will be commercial lending at the time of this report.

All companies are to be true trading companies; they are fully functioning companies which provide commercial loans to borrowers. This commercial lending activity has precedent from Her Majesty's Revenue & Customs (HMRC) case law as a qualifying activity for Business Property Relief.

Blackfinch confirm they will obtain verification from an independent accountancy firm on each 'trading sector' and the underlying company activity, to ensure that the activity and share property will fit within the current HMRC legislative ruling for qualification of business property relief. This will take place prior to any share purchase in the company from the Blackfinch IHT Portfolios.

Blackfinch indicate that where HRMC challenge their view they would contest this opinion and would expect full support from the accountants who have provided the opinion.

The portfolios will be managed on a discretionary basis by Blackfinch and the target return for portfolios is 7% per annum. Each company within the portfolio will differ in its structure and arrangements and the mandate of Blackfinch is to manage it in alignment with qualification for business property relief and to target returns of 7% per annum.

The majority of arrangement fees and costs will generally be paid by the borrower under loan agreements. The returns are generated through a combination of interest rates throughout the terms of the loans, as well as any backend fees upon completion.

They will commercially benefit within the minimum target return, before the company managers are paid their fees from the running of the companies, and will participate in the profits which they generate within the underlying companies. The profit share for these individuals will not kick in until around 4.60% - 6%, depending on the company activity, meaning that the investor is paid accordingly within the minimum target return.

This is part of the Blackfinch strategy to align all parties with the mandate and act in the interests of the investor in achieving the initial minimum return of 4%, as both Blackfinch and the company management team will not take any annual management fee or profit share until this level of investor return is achieved (See 'Charges' for further details).

Security is taken on land and buildings to cover the loan principle and often interest, with the expectation that in a worst case scenario (loan recovery) the capital and interest can be recouped fully through an auction or sale. In the event of a property development loan failing, Blackfinch has management teams in place which can parachute in other experienced developers to finish the project and then exit via the originally projected strategy.

Blackfinch are comfortable that business opportunities can be found to a high quality for the envisaged future investment volumes, with further asset classes, sectors and management teams being constantly monitored and sourced to provide further capacity and diversification. Blackfinch will ensure that it is able to meet its mandate through the deal flow for the companies in which shares are purchased.

During 2014, additional activity will also be sourced for other areas of business property relief qualifying trading, such as asset leasing and renewable energy based lending which will provide more scalability and diversification to ensure that they cater for all scenarios in their fund raising. In their informed opinion there is sufficient demand, largely as a result of the liquidity shortages in the lending markets.

Initial Fees
An initial fee of 2% is deducted from the amount invested, to cover the costs of establishing the IHT portfolio.

Ongoing Fees
An annual management fee of 0.50% plus VAT. Blackfinch only take the fee once returns on investment are above 4% per annum. As fees are left inside the plan, the investor can achieve a return on these as they remain effectively part of the assets. Payment of the fee is deferred until the planholder realises their investment, transfers it into a trust, or dies. On transfer into trust the fee will be taken on an annual basis.

When fees are deducted they are taken through the shareholdings. In the event of a claim Blackfinch use the Net Asset Value of holdings at the time of the claim and only take their fees once the portfolio has achieved a return of 4%.

Dealing Fee
A dealing fee of 1% applies to all investments and withdrawals. This mainly covers the cost of stamp duty incurred in the buying and selling of shares. Dealing is generally kept to a minimum, which reduces the impact on portfolio costs. This is achieved by using incoming investments to purchase shares, which incurs a 1% fee that will cover the stamp duty for both buyer and seller. The only time when the dealing fee would significantly adverse portfolio costs would be in the event of a fire sale, where no new funds are being received.

Advice Fees
Any upfront or ongoing advice fees that have been agreed with an FCA authorised adviser can be facilitated within the contract. Upfront advice fees are deducted from the amount invested, whereas ongoing advice fees are deducted from the portfolio once a year and then paid to the adviser. Ongoing fees will reduce the net return.

Execution Only Applications
For non-advised (execution-only) applications submitted via introducing agents that are not FCA authorised, an initial fee of up to 3% may be payable. The introducing agent may also receive an annual fee of 0.50% each year, paid through a deduction from the portfolio.

DISTRIBUTION

Investors have the option of taking a regular payment of up to 4% per annum which is facilitated by a sale of shares. Consideration needs to be given to the tax consequences of any withdrawals, which can be assessable against Capital Gains Tax or Income Tax. The primary aim to meet withdrawals will be to sell investor's shares to a third party by matching withdrawal requests with new subscriptions. The proceeds in excess of the initial cost of the shares will be subject to Capital Gains Tax assessment. If this is not possible shares will be sold back to the investment companies via share buy-back and proceeds will be treated as a dividend and thus will be assessable to Income Tax.

Also capital withdrawn in this way will no longer qualify for Business Property Relief and if withdrawals are retained by the individual, rather than spent, then they could form part of the estate. Blackfinch state that no dividends will be paid out.

Partial withdrawals can be taken, however the minimum withdrawal is £3,000.

TERM

The Blackfinch IHT Portfolio is intended as a long term investment, given the make-up of the portfolios and the share exposure.

Any withdrawal, whether regular, one off or to facilitate adviser charging or commission payments, will reduce the value of the portfolio and such withdrawals will cease to qualify for Business Property Relief.

There are no penalties for withdrawing funds, but a dealing fee on exit will apply to cover the cost of stamp duty and administration costs. Blackfinch will try to meet withdrawals by selling investor's shares to a third party by matching withdrawal requests with new subscriptions, however if that is not possible they will aim to facilitate a share buy-back. The withdrawal process can take between three and six months to complete.

LIQUIDITY

If an investor's circumstances change they have the option to withdraw some or all of their capital. This is facilitated by selling shares in the underlying businesses which will usually take 3–6 months. The minimum amount for partial withdrawals is £3,000.

Withdrawals will reduce the amount sheltered from IHT and no guarantee is provided that investors will be able to access their investment in that timescale.

On the death of the investor, the financial adviser or the executors of the estate, notify Blackfinch of the death and must request a valuation as at the date of the death. The executors must complete an IHT 412 form, which includes details of the Blackfinch IHT Portfolio. This should be sent to HM Revenue & Customs (HMRC) as part of the probate process by the executors.

HMRC will review the information and assess whether the investment qualifies for BPR.

Once this is confirmed, the value of the investment at the date of death is exempt from IHT calculations on the estate. They will then sell or transfer the investment, according to the executors' instructions. The process of selling can be done one of two ways either through matched bargains (using incoming subscriptions to facilitate the purchase of the beneficiary's shares) or company buy backs.

Blackfinch quote a timeframe of 3-6 months to realise capital for the estate and use planned deal flow exits to build cashflows which provide ongoing liquidity within the portfolios. Additionally, they keep small elements of cash within the underlying companies to assist with the buy back of shares in these circumstances. Their policy states that they provide priority for clients in the death scenario, over living investors.

Whilst they quote 3-6 months and would target this, with incoming investments and cash reserves this should mean that they can target something much sooner, possibly around 1-2 months.

EXIT

The Blackfinch IHT Portfolio is intended as a long term investment. Investments in qualifying companies have to be held for at least two years and at the date of death in order to benefit from the IHT relief.

Investments made by Blackfinch IHT Portfolio, are in unquoted companies and therefore are not readily realisable, unlike companies listed on the London Stock Exchange. Blackfinch should be able to redeem an investment within 3-6 months, but if it is necessary to institute a share buyback because of unusually large withdrawals then the process could take longer.

Any withdrawal, whether regular or one off will reduce the value of the portfolio, erode future returns and such withdrawals will cease to qualify for Business Property Relief.

There are a number of areas that an individual needs be aware of prior to investing, and these are not exhaustive:

- Investment will include exposure to shares in unquoted companies. The value of the investment and the returns achieved are dependent on the value of the assets in the company or companies that are held within the portfolios.
- The value of the investment is not guaranteed, although the aim of the portfolios is for capital preservation. Share prices are set by calculation of the monthly Net Asset Value of portfolios. The Net Asset Value methodology will be verified and checked by independent accountants.
- As these types of companies are generally less capitalised than mainstream listed companies, there is a greater risk of their entering liquidation, which will impact on the plan value. However this is minimised by securing loans on a first charge basis with a conservative Loan to Value, capital and interest can be recovered through auction or sale. Bad debt provision is in place and factored in within the Net Asset Values.
- All unquoted shares are held in companies in which the activity will be commercial lending. With any form of lending there is a risk of defaulting on the loan. Blackfinch minimise this by securing lending on a first charge basis.
- The portfolios are effective for IHT based on the qualification of the underlying assets for Business Property Relief. Although this tax relief has been established since 1976, to what extent is it likely that this tax legislation could be changed and what impact would this have on the portfolio holder(s)
- Withdrawals of capital to fund income can be assessed against Capital Gains Tax or Income Tax. If the sale of shares has been secured through matched bargains via incoming investments, proceeds will be assessable against Capital Gains Tax. In the event of share buy-back, proceeds will be assessable against Income Tax.
- Funds are not instantly accessible on withdrawal due to the make of the portfolios which includes shares that are not traded on a day to day basis. Individuals are warned that it could take between 3 and 6 months to access funds, and potentially longer if it is necessary to institute a share buyback.
- Whilst investment is made into companies which Blackfinch believe will qualify for Business Property Relief, they cannot guarantee that such investments will remain a qualifying investment at all times or in the future.

RESIDENCY

The Blackfinch IHT Portfolios are regulated by the Financial Conduct Authority and all unquoted companies within the IHT portfolios are UK based.

Proceeds from withdrawals in excess of the cost of shares will be subject to Capital Gains Tax.

Capital will need to be invested for at least two years and continue to be held at the date of death, in order to become an exempt asset for IHT purposes

Financial contagion
The Service involves investors purchasing and owning unquoted shares in various trading companies within the portfolios. Unquoted shares are not eligible investments that are protected by the Financial Services Compensation Scheme, therefore if the investment fails, then investors would not generally be entitled to compensation. However, in the event of the investment failing there are certain circumstances in which an investor will have a potential claim. This will involve either Blackfinch or another Financial Services Compensation Scheme participant (i.e FCA regulated adviser) mis-selling the service to an investor.

Investors would typically have a potential claim against the compensation scheme in two scenarios:

- Investors have a proven claim for mis-selling against Blackfinch or another Financial Services Compensation Scheme participant AND Blackfinch or the Financial Services Compensation Scheme participant is not able to satisfy judgement against them (i.e they are insolvent);
- The custodian of the investor's assets (including shares or money) becomes insolvent and has not properly segregated the investor's assets to protect them against claims by its creditors.

The Financial Services Compensation Scheme therefore would appear to provide only limited protection to investors.

Taxation
The proposal is attractive based on the potential to receive 100% tax relief after just two years in comparison to gift and trust arrangements, which can take seven years to achieve full exemption. Whilst being a well established IHT relief, there can be no guarantee that tax legislation will be maintained in the future.

It should be noted that the period of ownership commences on the date that the individual directly subscribing for shares through the nominee company subscribes for and acquires the beneficial ownership of shares in a Business Property Relief qualifying company.

There may be a delay between the investor making their investment into Blackfinch and their investment qualifying for Business Property Relief and the sooner that the funds paid into Blackfinch are either invested directly into the Business Property Relief qualifying company or via the trading vehicle into the Business Property Relief qualifying companies on behalf of the investors, the sooner the two year period will start to run in respect of Business Property Relief.

Withdrawals of capital may be subject to Capital Gains Tax for investors where proceeds have been secured through matched bargains and they exceed the initial cost of shares. Alternatively, in the event of a share buy-back proceeds will be distributed in the form of a dividend and may be subject to additional Income Tax for higher rate tax payers.

Income and Distributions
Withdrawals of up to 4% per annum can be facilitated by a sale of shares, however on withdrawal capital will no longer qualify for Business Property Relief and therefore lose IHT efficiency.

Financial Commitment
Investors need to retain their holdings in Business Property Relief qualifying companies for two years and still hold them at the time of the chargeable event (investor's death, gift or transfer) to qualify for Business Property Relief and thereby be exempt from IHT.

Although the portfolios aim to preserve capital, investment includes shares in unquoted companies and these are unlikely to be appropriate for more cautious investors. Investors need to weigh up the potential IHT benefits against the specialised nature of the underlying asset values and the risks associated.

Liquidity
The underlying investment includes shares in small unquoted companies which are not readily realisable and will take three to six months to complete a sale.

The investor needs to ensure they do not require access to the funds invested as these are not immediately realisable and the IHT benefit will fail on return of funds back to the investor.

Asset Value
The value of an investor's holding are dependent on the value of assets in the company or companies that Blackfinch IHT portfolios invest their money into. Assets are valued on a monthly basis and half yearly plan valuations are provided to investors.

Localised Market and Unsystematic Risk
Although Business Property Relief is not restricted to businesses situated in the UK, the Blackfinch IHT portfolios invest within unquoted companies based in the UK.

The Blackfinch due diligence process includes spending over a year with each company to assess their suitability for investment, however the portfolios appear to lack diversification to minimise this type of risk as they specialise in companies in which the activity will be commercial lending, specifically agricultural lending and property development finance.

Wider Market and Systematic Risk
Systematic Risk can be reduced by investing across a range of asset classes. The Blackfinch IHT portfolios do not benefit from this as they specialise within a particular type of unquoted company. The type of companies that they invest in, within the portfolios, leave them exposed in the event default. The typical length of the term of each loan is not determinable, however they portfolio example they provided does indicate that no defaults have transpired since 2010. Lending would appear to be made on a first charge basis. It would also appear that Blackfinch do make some bad debt provision, which was 1.50% on the example portfolio they provided.

SUMMARY

This is a product which can provide IHT savings for individuals with liabilities who wish to move funds out of their estate quickly compared to traditional gift and trust arrangements, and provide a more flexible approach in terms of retaining accessibility to the investment.

The management team behind this have a good depth of financial services experience which includes individuals who have specialised in the development and distribution of IHT solutions.

The main characteristics which set it apart from other similar offerings are the detail over the underlying activities and the fact that ongoing charges are deferred until a minimum level of return is achieved.

The target return of 7% is quite high, although Blackfinch will not receive their fee until an initial investor return of 4% has been achieved and plan charges would appear to be competitive in comparison to similar products.

However, as investment is within unquoted companies, specialising in commercial lending, this is a high risk area for an individual to consider and is going to be inappropriate for more cautious investors. Individuals considering this type of plan need to weigh up the potential IHT benefits against the investment exposure and consider the likelihood of their accessing capital.

In addition they must factor in the lack of protection from the Financial Services Compensation Scheme in the event of the investment failing.

ADVISER CONCLUSIONS