



KEEPING IT IN THE FAMILY

Passing the reins of ownership to the next generation in a family business raises a number of issues, not least of which are the tax considerations that arise, as Alan Lawlor explains

The proprietors of a limited company would not consider changing or expanding its core business without a detailed analysis of its available resources and financing requirements.

However, the same analysis does not always apply in relation to passing on the business to family members. This can lead to a number of significant problems including:

- the reins of management in the hands of people with a lack of business or leadership experience;
- a sense of injustice on the part of other siblings; and,
- a sense of alienation among non-family members in the company.

Adopting a succession strategy
Subjective and family considerations will play a huge role in defining a succession strategy. The adoption of certain general principles or ground rules can help form the basis of a smooth succession strategy. These would include the following:

- consider appointing a suitably qualified independent advisor to oversee the process; and,
- with the aid of this advisor, formulate a succession plan which sets out:
 - (a) any objective criteria to be met by the successors in terms of financial goals, etc.;
 - (b) the timing of the implementation of the succession plan;
 - (c) the manner in which other family members who have not been earmarked for succession are to be catered for; and,

- (d) the impact of this plan on the continuity of the business during the transition stage.

A plan of this nature must be reviewed on an ongoing basis and must be capable of flexibility.

The impact of taxation

The importance of sound professional tax advice, both in terms of formulating, and implementing, a succession plan, cannot be overstated. Irish tax legislation contains many relieving measures aimed at facilitating a smooth transition in ownership of a family business.

The two most important tax reliefs of relevance are:

- relief from capital gains tax on a disposal of an interest in a business; and,
- relief from capital acquisitions tax on receipt of an interest in a business.

Capital Gains Tax

Under first principles, a Capital Gains Tax liability will arise on the disposal of any asset to another party on the difference between the sales proceeds arising and the initial cost of that asset. Where the disposal takes place to a 'connected' person (a family member), open market value will be imposed in lieu of the actual proceeds arising. The current capital gains tax is 22%. Sections 598 and 599 of the Taxes Consolidation Act (TCA) 1997 provide a measure of relief from Capital Gains Tax once certain conditions are met. Section 598 TCA 1997 grants a complete exemption from Capital Gains Tax on

the sale of all, or part of, an interest in a person's 'qualifying' assets where the gross proceeds are less than €750,000.

Qualifying assets are defined as an interest in an asset used in an unincorporated business, or shares in a family company, in so far as they derive their value from trading activities. A 'family company' is defined as a company in which either of the following conditions are met:

- the individual owns at least 25% of the shares; or,
- the individual, together with other family members, own at least 75% of the shares, with not less than 10% of the shares being owned by the person making the disposal.

The relief will only apply where the person making the disposal is aged 55 years or more and has owned the shares or interest in the business for a period of at least 10 years, five of which were when he, or she, acted as a full-time working director in the case of a limited company.

It should be expressly noted that the relief will not apply on the disposal of non-business assets.

In the case of shares in a limited company, this can give rise to significant issues where part of the value of the shares is derived from non-qualifying assets of this nature. This is not an uncommon problem in traditional Irish companies and advanced planning is required to minimise the non-qualifying proportion of any gain arising. Section 599 TCA 1997 deals specifically with a transfer of business assets to a child of the proprietor. This section contains the

same conditions as Section 598, but, very importantly, does not impose a monetary ceiling on the amount that will qualify for relief. This section does, however, impose a clawback of relief where the child disposes of the qualifying asset within the following six years. The reliefs outlined under each section are not mutually exclusive.

Capital Acquisitions Tax

Quite often assets pass to a succeeding generation by gift. In the case of assets inherited by a child, from a parent, an exemption threshold of €542,544 applies to gifts or inheritances taken in the year ended 31 December 2009.

In determining whether or not this threshold has been exceeded, in relation to a particular gift or inheritance, it is necessary to aggregate all previous gifts and inheritances taken by that child from either parent since 5 December 1991. Where the aggregate total exceeds this threshold amount the balance is taxed at a rate of 22%.

This only gives a limited amount of relief in the case of most business asset transactions. Fortunately however, Irish tax legislation provides for an additional

relief in such cases known as business asset relief.

Business asset relief

In arriving at the taxable value of a gift or inheritance comprising of business assets, a deduction of 90% is allowed where certain conditions are met. Chief among these are:

- the assets must consist of a business or an interest in the business. This includes shares in an unquoted company where the shares derive their value from trading activities;
- in the case of shares, the beneficiary must, after taking the inheritance, own at least 25% of the shares in the company; this is reduced to 10% where he/she has worked in the company on a full-time basis for at least five years prior to the inheritance;
- where a property is owned by a 'disponer' i.e., the transferor, and it is used by a company controlled by him for business purposes, the relief will also be due in certain cases;
- the qualifying assets must have been held by the disponer for a period of two years before passing under an inheritance, or five years when passing

as a gift; and,

- the relief will be clawed back if the beneficiary receiving the asset under a gift or inheritance disposes of the asset within six years of its receipt and the full proceeds are not reinvested in other qualifying business assets. This clawback period is extended to 10 years in respect of land regarded as having development potential.

Opportunities


The combination of both Capital Gains Tax and Capital Acquisitions Tax Reliefs on the transfer of business assets to one's offspring can be achieved in a most tax effective manner. Careful and advanced planning is required so that unexpected pitfalls do not arise.

The establishment of a realistic market value of the assets will need to be considered and it may well be the case that the current sharp downturn in general asset values may give rise to planning opportunities in this regard.

Alan Lawlor FCCA is a tax director with Baker Tilly Glennon.

E-mail: alawlor@bakertillyrg.ie

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