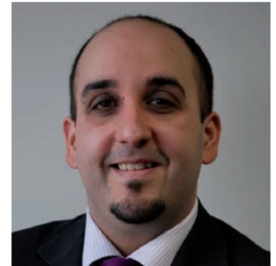
Succession Planning

In this article Paul Gosal provides some practical insight in relation to the Succession Planning process and outlines some of the key discussion points to raise with clients.



Paul Gosal is an AITI-Chartered Tax Advisor and Chartered Accountant with over 10 years' experience as a tax practitioner. Paul provides personal, corporate and capital tax consultancy advisory to a broad range of individual and corporate clients specialising in Family Business/ Corporate restructurings (including succession aspects); Personal Tax and Estate Planning for individuals; Personal Tax planning for internationally mobile directors/ employees; Revenue Audits & Investigations and Tax aspects of Debt Resolutions and Restructurings.

What is Succession Planning?

Succession can be defined as the action or process of inheriting title, property and assets.

In my opinion, the Succession Plan is about obtaining peace of mind for our clients in that they themselves are financially secure and that they provide for their family both now and in the future. This process also allows clients to time, manage and control wealth transfer to the next generation in as tax efficient manner as possible.

Statement of Affairs and Cash-Flow Planning

One of our clients key concerns is whether or not they will have enough money themselves to cover their lifestyle both now and in the future until death. It can also be commonplace that clients are not fully aware of their overall net asset worth at a particular point in time. Addressing these matters is a key starting point.

The preparation of an up to date Statement of Affairs will assist in identifying an individual's assets, associated liabilities and begin the process of focusing our clients on the potential beneficiaries. Cash-flow planning forecasts a client's income and expenditure in addition to their assets and liabilities throughout their lifetime which should provide clients with a clear picture as to whether or not their desired life expenditure is likely to be matched by their financial resources.

With financial clarity and certainty the client is better informed before making any key decisions on when, how and to whom their wealth is to transfer. For example, if the client has the comfort of knowing they are financially independent they could start the succession process at an earlier stage. Alternatively, if the client realises that they are not currently financially secure they can plan now to ensure that level of financial independence can be achieved at some desired point in the future.

Gift now or Inheritance later?

A frequent discussion that arises with clients is the timing of the wealth transfer. Should this happen by gift or inheritance? The simple answer is both. It is never too early to pass to the next generation if the client is financially secure, the transfer of the subject assets suits the family situation (i.e. the beneficiaries are of suitable age and responsibility) and capital tax liabilities can be kept to a minimum (or exemptions/ reliefs can be achieved).

A lifetime transfer of assets involves considering Capital Gains Tax (CGT) for the person making the gift with Capital Acquisitions Tax (CAT) and Stamp Duty being the considerations for the beneficiary. A transfer on death by inheritance only requires the consideration of CAT by the beneficiary as no CGT or Stamp Duty arises on death.

Some of the benefits of gifting now to outline to our clients are:

- Certainty of current tax legislation now
- Transfers at low values now with future asset growth in the family member's name going forward (reduction of a future inheritance tax liability on a higher value asset passing in the future)
- Stamp Duty being the only cost in particular if CGT/CAT exemptions and reliefs are available
- Minimal or no CGT where asset capital values are low (these could still be below costs due to reduction in property values during the recession – is now the most opportune time to gift?)
- Minimal or no CGT due to Capital losses which could shelter any chargeable gain arising on a gift (clients may have generated capital losses during the recession)

At this point in the process the client should have financial clarity in addition to a suitable strategy in relation to the timing of the succession plan. The next step would be to consider the main asset classes held by our clients and some of the key discussion points to raise with our clients.

The Family Company

In my experience the most complex asset to consider is the Family Company. The following questions are a good starting point:

1. Is there a successor for the business identified?
2. Is the client ready to start taking a step back from the business?

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3. What is the value of the business and the client's shares in the business?
4. What value does the client desire from the business?
5. What value does the client actually require from the business?

The answers to the above are client specific however let us consider the example of a family company where the majority shareholder is coming to retirement age and has identified a successor for the business. The most common value extraction strategy would be to maximise the client's pension fund value prior to retirement (potential of a €2 million pension fund) and to obtain maximum CGT retirement relief exemption in respect of their shares of €750,000 (assuming the individual is between 55 and 65 years of age). The key tax relief available for the successor would be to obtain CAT Business Property Relief (e.g. a 90% reduction) on the value of the shares they are gifted.

However, there is an obvious difference between the value a client desires to extract from a company and the value they actually require from the business. This is where the benefit of the Cash-Flow Planning and an up to date Statement of Affairs come into play.

In my opinion, if a specific requirement exists to extract value, for example to settle loan liabilities or provide much needed cash-flow for the client's retirement, then value should be extracted up to a targets level as identified by the cash-flow planning exercise.

If it is the case that the client is in reality financially independent of the company I would question as to why value extraction is required in particular if it is likely that in the future the value extracted may ultimately pass by inheritance to the identified successor in any event (partially or otherwise) subject to inheritance tax. The solution might be to simply gift the shares to the successor with the client availing of CGT Retirement Relief and the successor obtaining Business Property Relief which is a 90% reduction in the market value of the shares received.

The Family Home

The Family Home in the majority of cases is earmarked to pass on death of the last surviving parent by inheritance. A common position is that the home will be sold and the proceeds split in equal shares amongst the children. In a lot of situations this may in fact be the only option or perhaps the most "politically stable" option.

However, the availability of the Dwelling House Exemption must at the very least be discussed and considered with our clients. In short, if all conditions under CAT legislation are satisfied the beneficiary (e.g. a child), may obtain the family home tax free without utilisation of their Class A tax free threshold of €280,000. The beneficiary's tax free threshold is therefore preserved to shelter other benefits they may receive subject to CAT.

Not surprisingly there are a number of strict rules to satisfy with the core consideration for the recipient being occupation of the family home for a period of 3 years before and 6 years after the date of inheritance and to not have an entitlement to another dwelling house at the date of inheritance.

Ideally the client should try and identify a particular beneficiary who could claim this relief and who would have a desire to live in the Family Home. Identifying a particular beneficiary to obtain the Family Home subject to this exemption could also shape the wider succession plan for a client. A common difficulty for a client can be the case of "who gets what". The client could now be more focused on equalising the Estate after allocating the Family Home to a particular beneficiary.

Finally it is also worth noting that Dwelling House relief also applies to all residential properties and not just the Family Home. It is more commonplace for residential investment properties to pass by way of gift to beneficiaries and in this regard this option should be discussed with clients.

If structured correctly and depending on property values, a situation could arise where a gift of the residential property could be exempt from CGT (e.g. if the asset value is below cost or the client has capital losses) and exempt from CAT due to the Dwelling House relief. The only tax cost would be stamp duty at residential rates (1% on the first €1million; 2% on the excess over €1 million).

Cash – the Annual Gift Exemption

Where the client has the financial clarity and capability of doing so, they should consider gifting cash subject to the annual gift exemption of €3,000 to each beneficiary. This is a medium to long term strategy the effect of which is to pass wealth which can grow in each beneficiary's name without depleting the tax free thresholds available to the beneficiaries in question.

This strategy should be implemented as early as possible with clients who have young children to obtain maximum value transfer up to a certain age, for example the age of 21. Typically parents transfer monies into a special savings account or investment product in the name of their children until they are of a certain age. In effect it is a "bare trust" arrangement where parents legally control the cash but it is for the benefit of the children accordingly.

Consider the example of a married couple with two children who have implemented the above strategy as and when each child is born. Each child receives €6,000 from both parents per annum for 21 years which essentially has the effect of passing €252,000 total value (ignoring any return on investment) from the parents to the children free of gift tax.

Legal Considerations – the Will

The Succession Plan will also bring focus to your client's Will situation. Unfortunately in some cases clients do not have a Will in place or the Will may indeed be out of date. In the absence of a Will (or if the Will is invalid) the rules of intestacy would apply to the client's Estate. If we take an example of a married person with children, on death, two-thirds of the assets pass to the surviving spouse with the remaining one-third being divided between the children. This would not be a desirable situation for our clients.

Taxation input must be allowed in the Will drafting process to take advantage of tax efficiencies where possible. Asset protection may also be concern for our clients. For example, in the case of minor children it would be desirable to settle assets on Trust (usually a Discretionary Trust where uncertainty on allocation of assets exists) on death until such time as the minor children are of a suitable age to inherit specific assets accordingly.

In this regard, an up to date tax efficient Will, with an asset protection strategy should allow for our clients to manage and control the succession process in line with their wishes accordingly after death.

Summary

There are a lot of considerations and moving parts involved in creating and mapping out a Succession Plan for our clients. This article covers some of the high level considerations and discussion points to have with our clients from a financial, taxation and legal perspective. The key starting point for a Succession Plan is open dialogue with our clients to outline the benefits of planning as early as possible.