Passing on the Family Business

by Suzanne Parker

For most business owners in Ireland there will inevitably come a time when the matter of retirement and succession planning will need to be considered. This can be a daunting process and our clients need reassurance and guidance on how to pass their business on to the next generation successfully.

The purpose of transferring or selling a family business is to ensure survival and the problem is many businesses do not last to the next generation. The client would need to give a thought to who would be the best person to take the helm of the family business. If one child is involved in the business and other children are not, one child might be the best option, but it could cause family conflict if the one child is being favoured over the others.

If transferring to all the children is the best option for the family business, a shareholders or partnership agreement should be considered, to deal with running and key management decisions. Another option could be a re-organisation of shares splitting the income entitlements and voting rights to ensure the people making the business decisions are right for the role.

In any event, the transferor will need to consider capital gains tax (CGT) on the disposal and the beneficiary may have capital acquisitions tax (CAT) and stamp duty payable on receipt if the business is gifted. Irish tax policy is quite supportive of businesses transferring between family members and there are tax reliefs available all of which I will consider below.

CGT

A person is chargeable to CGT in respect of chargeable gains accruing to that person if they are resident or ordinarily resident in the state.

A person is resident if they are present in Ireland at any time of the day for 183 days in one year or 280 days over two years. To be ordinarily resident, the individual must be resident for three consecutive years.

A disposal takes place when there is a transfer of the beneficial ownership of an asset from one person to another. This can be done by gift or sale and therefore a transfer may be liable to capital gains tax even though no profit or monetary gain is made.

When calculating the gain for the disposal, the base cost (value at date of acquisition) together with any enhancement expenditure and the costs of acquisition and sale are taken away from sale price or current market value where the parties are considered connected parties under Section10 of the Taxes Consolidation Act 1997 (TCA). Indexation Relief and the annual exemption of €1,270.00 is also allowable when calculating a gain. The gain is taxable at a rate of 33%. These taxes may be a harsh consequence of selling a business and Revenue have introduced a relief to support the succession of a business.

Retirement Relief

Retirement relief can be claimed on the disposal of certain business assets. An important point to note on retirement relief is that the person does not have to actually retire and can remain involved in the business after the disposal.

The person must have reached the age of 55 years to claim this relief.

S598 TCA sets out the criteria for claiming retirement relief when transferring the business to a person other than a child. Full relief can be claimed up to the limit of €750,000.00 when aged between 55 years and 65 years. After the age of 66, the limit for claiming the relief is reduced to €500,000.00. Marginal relief may be claimed when the limit is slightly exceeded.

When the transfer is to a child S599 TCA applies and there is no limit on the gain for the disposal. Once the age of 66 is reached, the limit of €3,000,000.00 applies. The annual relief is not available to anyone claiming retirement relief and any previous disposals qualifying for retirement relief will be taken into account when making this disposal. The disposal or transfer must be made for a bona fide commercial reason and not form part of any arrangement or scheme for the avoidance of tax under S599 TCA.

Under this section a child can also be defined as:

- the child of a partner of the individual making disposal;
- the child of a deceased child;
- a niece or a nephew that has worked substantially full time in the business for the previous five years; or
- a foster child.

If retirement relief is claimed there will be a clawback if the child sells the business within six years of the disposal.

The relief will only apply on the disposal of assets which are considered qualifying assets under the legislation.

Qualifying assets would be considered:

- business assets used in a trade;
- qualifying business assets that are owned for at least 10 years ending on the date of the disposal;
- business assets owned by the transferor throughout the 10-year period ending on the disposal;
- shares in a family company - If the property being transferred consists of shares in a family company which is a trading company, farming company or a holding company, the individual making the disposal must have:
  - owned the property for at least 10 years ending on the date of the disposal
  - been working as a director in the company for at least 10 years; and
  - a full-time working directory for at least 5 years.

A family company is where:

  - the owner owns either 25% of the voting rights or
  - at least 10% of the voting rights where the family owns 75% of the voting rights; or

- land, machinery or plant which have been held for 10 years ending on the date of disposal.

Chargeable business assets must meet certain holding criteria and assets including goodwill and securities which are used by the trade or profession must be carried on by the individual.

The process for applying the relief would be to determine if the individual meets the retirement age and holding requirements of the property. The next step would be to determine if they are disposing of chargeable business assets and separate the qualifying business assets which meet the criteria for retirement relief. Once the qualifying assets are determined, the value of the transfer or disposal can be calculated, and any non-qualifying assets will fall under the normal CGT rules with no retirement relief.

Prior to any transfer of a business, it should be a priority to ensure that the client can fund their retirement. The client may be entitled to a state pension and any private pension which they have contributed to during their lifetime. This may not be sufficient to fund their current lifestyles and if the business is being fully gifted, the client would not be receiving any lump sum to use during retirement such as a share buyback or pension lump sum. They would also not have an entitlement to income from the business if they fully retire.

The fact that the client would not have to retire could be a way to obtain income from the business by working with it as a consultant or employee. However, they may not wish to continue working in a non-owning role or they may not physically be able to continue working. Based on the finance position of the business, all options of cash extraction should be considered.

Another option may be for the premises the business is run from is held and rent to paid to the client. The drawback of this is that any future sale would not be covered under retirement relief. It would have to be transferred with the business. Any further disposals should be under a Will to ensure that no further capital gains tax is payable.

Entrepreneur Relief

If the client does not have the relevant ownership requirements for retirement relief, entrepreneur relief could be considered. This relief was introduced in the Finance Act 2015 was created for entrepreneurs disposing of certain business assets. The relief provides that a rate of 10% would apply to any chargeable gains on a disposal of qualifying business assets up to the limit of €1,000,000. A qualifying business is a trading business and cannot be a company holding merely securities or investment assets. The relief applies to individuals only and not a business transferring a trade.

The criteria to qualify as a relevant individual for entrepreneurial relief is that they own the business for three out of the previous five years and worked no less than 50% of their working time in the service of that company, working in a technical or managerial capacity.

In the case of shares in a company, the person must have owned 5% of the ordinary share capital and owned the shares for a continuous period of three out of the previous five years ending on the date of the disposal. These periods of time are strictly enforced by the Revenue and if a person is considering selling a business, it would be recommended to wait until they have fulfilled these criteria.

CAT

If a business or shares are being transferred by way of gift, the beneficiary who receives the gift will be liable for CAT on receipt. Every person receiving a gift is entitled to a tax-free threshold and the value of this is dependent on the relationship with the transferor. In the case of receiving a gift from a parent, the current group threshold is €320,000.00 which they can receive from a parent tax free. This is a lifetime threshold and the gift is taxable in Ireland where the property being transferred is Irish, the transferor is Irish resident or the beneficiary is Irish resident.

Business Relief

S92 of Capital Acquisitions Tax Consolidation Act 2003 (CATCA) provides relief of 90% of the taxable value of the relevant business property when taken by a beneficiary. S94 CATCA states that relevant business property must have been part of and used in the business for a minimum of 5 years when the property is being given by gift. A period of ownership by a spouse or civil partner will count for satisfying the purposes of minimum period of ownership. There is also an allowance for the replacement of relevant business property to allow business people facilitate the buying and selling of various businesses during the transferor's lifetime.

Relevant business property only will qualify for the relief and there are four categories of relevant business property:

- Property consisting of business or an interest in a business;
- unquoted shares where the beneficiary on the valuation date must have either 25% of the voting rights, control of the company or at least 10% of the nominal value of all issued shares and securities in the company and the beneficiary has have worked in the business for a period of 5 years ending on the date of the disposal;
- the land, buildings and machinery owned by the transferor which were used in the business and not for investment only purposes; and
- quoted shares if they would have qualified for the relief if unquoted.

Under S101 CATCA there is a clawback in the event that within six years of receiving the gift that the assets cease to qualify for the relief as relevant business property or the business is sold and not replaced within one year.

Where all of the business property is being transferred, the issue is straightforward and business relief applied. However, if some of the property is being withheld, the assets must be examined to ensure the relief applies. Investment assets or an investment company would not qualify for business relief.

Agricultural Relief

Agricultural relief allows for a 90% reduction in the market value of agricultural property. With this relief only 10% of the market value would be taxable. Under S89 CATCA it provides that gifts and inheritance of agricultural property taken by a farmer on the valuation date will be allowed to apply this relief.

The conditions to obtain agricultural relief are that the property is agricultural in nature including pasture, woodland, crops, trees and farmhouses and other farm buildings.

The person receiving the gift to qualify for agricultural relief must be considered a farmer under the legislation. For the purposes of the relief, an individual's assets must be 80% agricultural on the valuation date of the inheritance. This farmer test is the first step in the computation of agricultural relief. If the person receiving the gift does not comply with this financial farmer test they cannot claim his relief. All property which they own will be taken into account and no consideration will be given for any mortgages on property except for debts in respect of a dwelling house.

Additional criteria to qualify for this relief is that the individual has an agricultural qualification and farms the property for 50% of their normal working hours.

Revenue suggests that normal working time for the purposes of this relief amounts to 40 hours per week.

They can work in off farm employment for 20 hours a week. This time is averaged over a year and if the farmer can show that their normal working time is considerably less than 40 hours a week, then the

50% requirement will be applied as long as the farm is farmed on a commercial basis and with a view to the realisation of profits.

Sometimes the requirements are clearly complied with. If there is any doubt Revenue will consider all information and request farming records to be provided by a farmer in relation to his or her normal working time and farming activities. This documentation may need to be prepared and begin to be compiled years in advance of an intended transfer to comply with the relief.

Under the legislation agricultural relief will cease and there will be a clawback if the agricultural property is disposed of or compulsory acquired within 6 years of the date of the gift. There is an allowance for reinvestment within one year in the case of a disposal or six years if there is a compulsory acquisition.

The main difference to note with business relief and agricultural relief is that with agricultural relief the market value is reduced by 90% but with business relief the tax itself is reduced by 90%. Therefore, it would be preferential to qualify for agricultural relief.

One issue that often arises with agricultural relief is that the land or some of the assets may not be owned by person and could be registered in another a spouse's name. Prior to property being transferred the parents may have to transfer the assets between them to ensure that the ownership is vested in the name of the person working on the farm or involved in the business. There would be spousal reliefs on these transfers and for CGT is would be treated as a no gain/no loss. The previous non-owning spouse would have the owning spouse's base cost and time of ownership included. This problem can be rectified but additional legal work and time is needed.

Stamp Duty

Stamp duty is a tax on documents and paid by the beneficiary of a gift or transfer. In the case of a gift where there is no value on the documents and the parties are connected, market value will be implied, and the documents stamped at the appropriate rate.

A document with fall under the charge to Irish tax when:

- it has been executed in Ireland,
- relates to Irish property or
- if it related to something which has to be done in Ireland.

The current rate of stamp duty for commercial property is 6%.

Consanguinity relief can apply to land transfers and this reduces the rate of stamp duty to 1% when the property is being transferred to a related person. This would include any lineal descendant, parent, grandparent or stepparent, brother, sister, niece or nephew.

Another relief which may be applicable is young trained farmer relief and this would give full relief to stamp duty is the criteria has been complied with. The farmer would also have to be under the age of 35 to be considered young.

As outlined, there is strict criteria for the reliefs discussed. Looking into the future and planning with clients may be needed to ensure that each party has complied with the legislation to qualify for the reliefs available and the transfer of the family business can be done with ease. This may be ensuring property and person working in the business is the same person or ensuring that a farmer is working on the farm and keeping the full records.

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