OHT Guide

Succession Planning

Parents who are considering the transfer of wealth to their children generally want to ensure that they safeguard the value of assets and businesses, maintain family wealth levels, and pass wealth on in a tax efficient manner. The following points should be considered by a taxpayer who is preparing to pass on valuable asset to family members.

1. It is important to establish if an interest in a business can avail of tax reliefs such as CGT retirement relief, CAT business or agricultural relief (for more details on the reliefs available see OHTs article Passing Wealth to the Next Generation).

2. It may be advisable to consider re-organising corporate structures in order to reduce the level of non-qualifying assets held in businesses that may prevent the company qualifying for tax relief, and to split businesses and value across several companies if a parent wants to pass the value on separately to individual children.

3. Valuations may need to be obtained for private companies to consider the likely exposure to tax. In addition a valuation of the underlying assets in a company can assist in establishing if investment asset levels will preclude relief. For example CAT business relief is not available where a company is wholly or mainly an investment company (i.e. more than 50% of its value comes from investments).

4. Any possible exposure to foreign tax should be considered. For example if foreign investments are held (such as UK assets) there will be an exposure to UK inheritance tax at 40% once the estate threshold (currently Stg£325,000) is exceeded.

5. Residence planning may be considered to avoid the imposition of Irish inheritance tax, especially in the case of a non-domiciled person.

6. The transfer of pension funds into ARF structures means that the capital value can be preserved for the family and consideration should be given to who should receive the ARF.

7. If a taxpayer wants to pass on the value of a company but retain control of the business, the voting rights can be retained in a separate class of shares, so that the remaining shares and value are passed over but the voting control is retained.

Key Documents

Certain key documents need to be considered when advising on an inheritance plan.

Will

A testator should appoint an executor to manage the estate and run the business. He needs to give the executor sufficient powers to act and sufficient protection to ensure that the executor is willing to act.

Shareholders' Agreement

Where the estate includes shares in a company which has other key shareholders a Shareholders' Agreement is a good idea as it ensures that all affected parties focus on the needs of the business, and of the surviving family early on, and agree the best method of securing the value of the business for the family without damaging the viability of the business.

Keyman Policy

Frequently the best option in a shared business is for the surviving owners to buy out the estate's interest in the business. This is likely to give rise to funding problems (especially if the business is incorporated). A keyman policy which provides funds for the purchase of the estate's interest can provide a solution.

Enduring Power of Attorney

If a client who is running a business suffers a premature stroke (or other medical condition), or is involved in an accident giving rise to mental incapacity but not resulting in death, he cannot legally make decisions or transfer control of his assets, and no-one can step in to replace him.

If an EPA has been signed, it can be registered once the donor is incapacitated, so that assets can be dealt with for his benefit.

The Use of Trusts

The classic use of a discretionary trust is a Will Trust set

up to protect young children, or to make provision for children who have special needs and will need assistance with their financial affairs in the future.

The main disadvantage of a discretionary trust is discretionary trust tax ("DTT"). However DTT does not arise while a principal object (i.e. the spouse or children of the disponer) is under the age of 21.

In addition there is an exemption from DTT where the trust is set up for a named beneficiary who is not a principal object (i.e. a spouse, child or minor child) and who is under the age of 18. This can protect a trust set up for grandchildren from DTT. It should be noted that if there are other beneficiaries named in the trust deed who are over 18 years and one beneficiary is under 18 years, then DTT will be triggered by the fact that there is a beneficiary over 18 years of age, where there are no principal objects.

CAT does not arise for the beneficiary until assets are received from the trust, so the payment of gift/ inheritance tax is deferred.

Protective Trusts

In some cases a client will see the tax issues as secondary and will be more concerned with protecting the assets or the beneficiary than with minimising tax. If a family member has a substance abuse problem, or a mental illness, or other incapacity he may be particularly in need of assistance in dealing with assets. A settlor or testator whose child has special needs will typically want to set aside a proportion of his estate for the benefit of that child. A discretionary trust offers flexibility and if the trust is protective, set up solely for that individual, because he is incapable of managing his affairs due to incapacity there is an exemption from discretionary trust tax.

Generation Skipping Trusts

Where a family has very substantial wealth and children are wealthy in their own right (and will never need the assets that can be passed down by parents) a "generation skipping" trust may be considered. Instead of passing assets to children (subject to CAT), with the children ultimately passing on to grandchildren (another layer of CAT), the grandparents may set up a trust for the grandchildren, skipping the intervening generation.

A fixed trust can be used if the DTT cost will be high. The trust will be subject to DTT (if it is discretionary) but if it is set up for named minor grandchildren DTT should not arise until the eldest is 18. If there is a wide age spread among the grandchildren consideration might be given to setting up separate trusts for each grandchild (so that the DTT only arises as each child reaches 18 years).

A generation skipping trust may also be considered if children have run into severe financial difficulties, to the extent that any assets passed down by parents are likely to be absorbed by creditors. In such a case the family position may be better if the assets can be left on to the grandchildren, skipping the insolvent child.

The CGT cost of a generation skipping trust also needs to be considered.

Interest in Possession Trusts (e.g. Life Interest)

Interest in possession trusts are provide a beneficiary with an interest in the income of an asset for a fixed period, or for life. However the capital value is retained in the control of the settlor and passes to a selected remainderman. For example a testator who is married to a second spouse can give a life interest in the family home and an investment fund to the spouse so that the spouse can continue to live there and would be entitled to any income from the investment fund. However the capital value will pass in due course to the children of the first marriage.

Trusts can be a useful planning tool in the context of succession planning, and consideration should be given to the benefits of passing assets via a trust.

If tax advice is required on any of the points covered in this article , please email info@ohanlontax.ie.

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Caveat: *These notes are intended as a general guide . OHT has endeavoured to provide an accurate commentary but the notes cannot cover all circumstances. OHT strongly recommends that formal tax advice be obtained before any steps are taken that may have a tax effect.*

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