Inheritance/Succession Planning

Educating and Developing Financial Professionals

KENNELLY Tax Advisers

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Topical Issues

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- Structures for owning businesses
- Gift and inheritance tax planning
- International inheritance tax developments
- Update on Irish gift/inheritance tax

We are seeing

- **Large increase in business sales**
- **Business owners taking cash out in return for reduction in shareholding (MBO)**
- **Real interest in succession planning driven by parent / child EUR280K threshold**
- **Use of dwelling house exemption**

Businesses

- **Succession**
- **Structuring generally**

Business relief – inter-family transfers

- **Transfer of a family business**
- **90% relief**
- **No limit**
- **Capital gains tax – limit is EUR3m over 66**

Business relief (example)

- Parent gives shares in family company worth EUR1m to child
- Value of shares for gift tax is EUR100,000
- Child has threshold of EUR280,000
- No tax and EUR180,000 of threshold left

PWC 2014 Irish Family Businesses Survey

- **Only 39% of Irish family businesses have next generation family members working as senior executives in the business**

- **No. of family firms who saw next generation as capable of managing business: 31% (down from 55% in 2012)**

- **“Head over heart” – recession sharpened family business thinking**

- **Widening generation gap**

In practice we find

- **Few parents transferring businesses to children**
- **Instead, focus is on maximising funds on sale of a business**
- **Many are de-risking by taking out cash (25% reduction)**
- **Business relief used as a way for parents to fund children starting up in business**

Business relief

- Daughter starting a new construction company

- Father funding EUR200,000 towards purchase of first site

PLAN:

- Daughter sets up company

- Father subscribes EUR200,000 for preference shares (no votes/rights to profits)

Business relief plan

- After 5 years father gifts shares to daughter
- Shares are still worth EUR200,000
- A business "controlled by the donee" qualifies for business relief
- Gift for tax purposes is EUR20,000
- 2 year holding period for inheritance

Business structures

- Looking towards a possible exit (sale or MBO)
- Want to minimise tax on exit
- Want to pass all or part of value tax efficiently to children

Exits – tax reliefs for trading companies

- **Holding company relief**
- **Entrepreneurs relief**
- **Retirement relief**
- **All applicable for both sales and gifts**
- **Ideal timing – when business has no value**

Retirement relief

- **EUR750,000 tax free if over 55 and under 66**
- **EUR500,000 if over 66**
- **Nothing tax free if significantly over limits e.g. sell for EUR2m – no retirement relief**
- **Family company (generally 25% minimum)**
- **Must be full-time working director for 5 yrs**

RETIREMENT RELIEF

Entrepreneurs relief

- New
- 20% CGT on the first EUR1m on sale of shares
- Saving is EUR130,000
- Must own at least 5% and work at least 50% of time in the business for 3 years
- No age limits
- Interaction with other reliefs - careful

Plan – double up

- Bank EUR1m entrepreneurs relief pre 55
- Get EUR750,000 retirement relief after 55

Plan – double up (cont)

- Partial sale for at least EUR1m before 55
- First EUR1m at 20%
- Keep at least 25% of company
- Sell for EUR750,000 after 55 – tax free

Double up - spouses

- **Husband and wife in business**
- **Entrepreneurs relief EUR1m @ 20% x 2**
- **Retirement relief EUR750,000 x 2**
- **Shareholdings must be in place for a number of years**

Holding company regime

- **Every person starting up or investing in a business should consider using a holding company**

- **Holding company structure is highly flexible and facilitates tax efficient succession planning**

Client

100%

Holding company

10%

Trading company

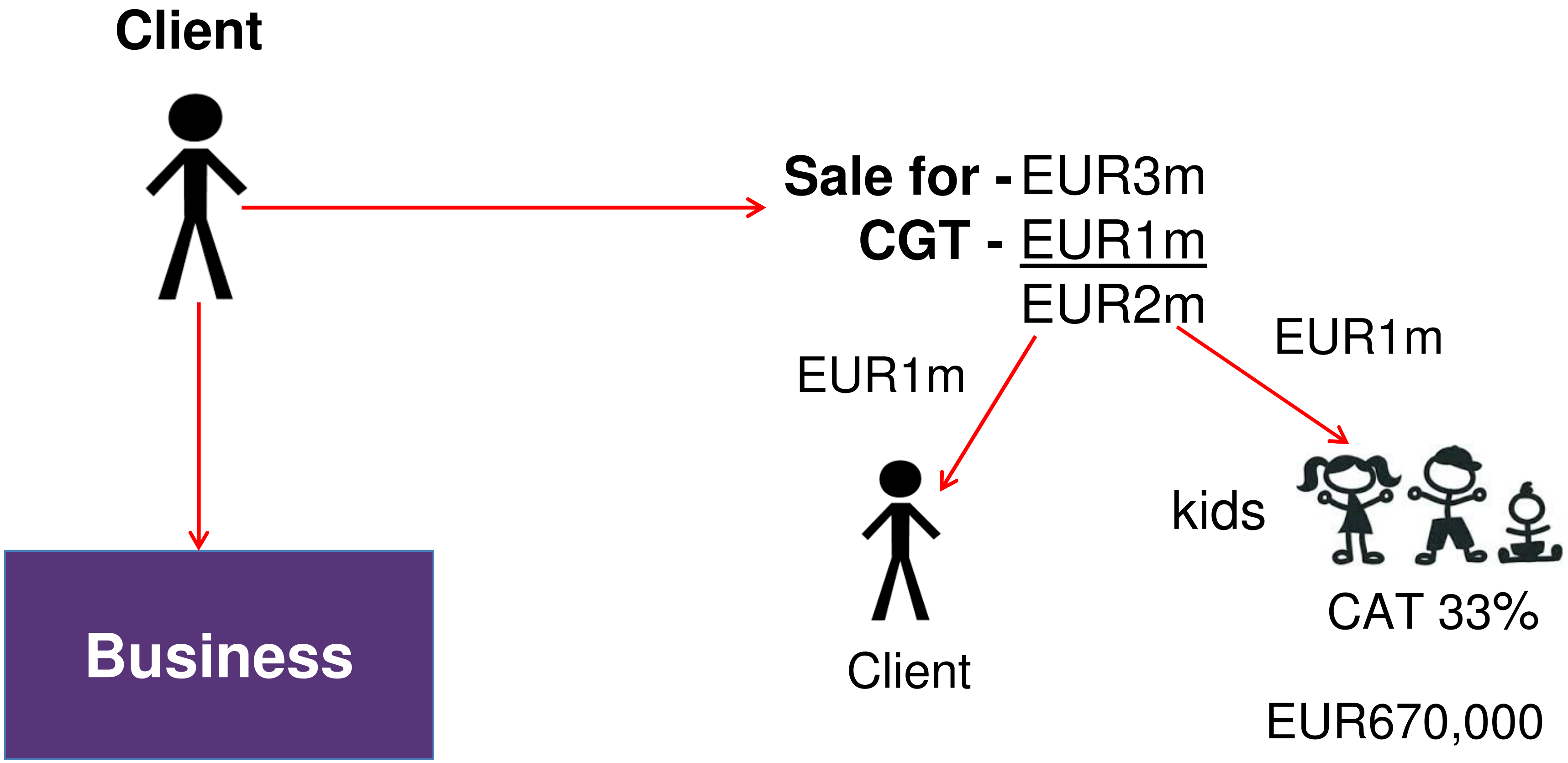
- No tax on sale
- No tax on dividends

Hold Co conditions

- >5% shareholding
- 12 month holding period
- Trading company
- Value not from Irish land
- No requirement to work in business

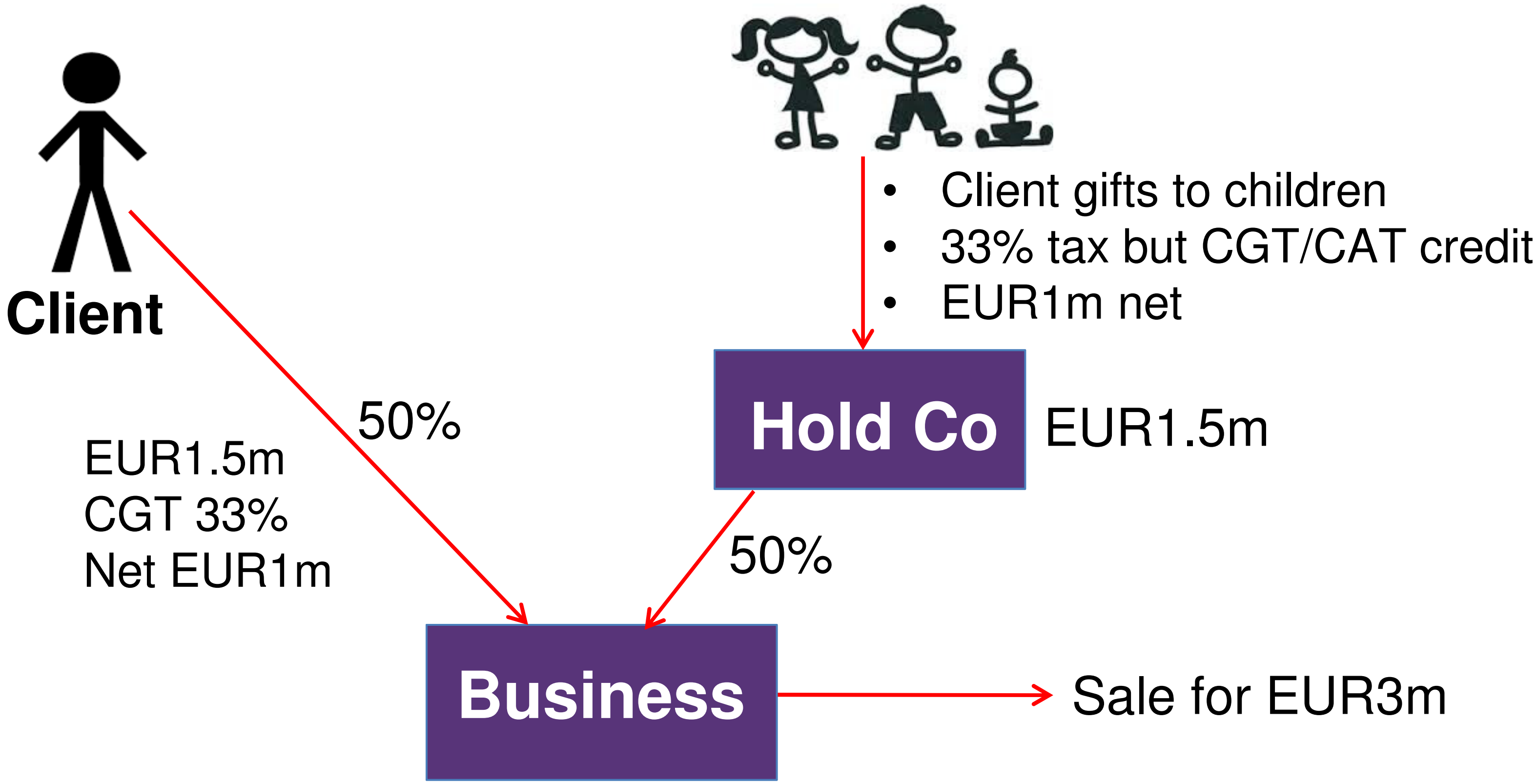
Hold Co sells

- No tax on sale
- Deferral of tax
- Wait until CGT rate reduces
- Become non-resident
- Shares can pass on death without CGT
- If thresholds used up, pass shares to children and avail of CGT/CAT credit



After tax, client has EUR1m and children have EUR670,000

If client held 50% through Hold Co



After tax, client and children have EUR1m each.

Hold Co/Entrepreneurs relief

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- **Hold Co used to be automatic for shareholding >5%. Now, if Hold Co has <51% of trading company, no entrepreneurs relief**
- **Need to consider which is appropriate. Combination?**
- **personal ownership generally best for <50% shareholdings if work in business and sale likely to be less than EUR1m (or EUR2m if husband and wife work in business)**
- **Fianna Fáil manifesto: entrepreneurs relief to 10% on first EUR15m**

Gift and Inheritance tax

Some Irish and International Developments

OECD – Inheritance tax rates

No.	Country	%
1.	Japan	55%
2.	South Korea	50%
3.	France	45%
4.	UK	40%
5.	US	40%
6.	Spain	34%
7.	Ireland	33%

*Top rates to lineal heirs in the OECD 2015

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“UK – 3 times as many estates are expected to pay inheritance tax this year compared with 6 years ago”.

Financial Times, 8 January 2016

Ireland vs UK system

Ireland – inheritance tax

- **If person who has died is Irish resident/ordinarily resident**
- **If person receiving is Irish resident/ordinarily resident**
- **If receiving an Irish asset**
- **Person receiving inheritance pays tax**

Tax in UK is on a completely different basis

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- If person who died is UK domiciled
- Estate pays tax
- 2 different systems – often have tax mismatch or double taxation
- More and more Irish residents are UK domiciled or married to UK domicile
  - Tax planning
  - Deemed domicile UK
  - Long-term residents (15 years)

Potential Irish/UK issues
1. Still there

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- Irish resident daughter
- Father in UK leaves her a property under his Will
- Residue of estate passes to his wife
- UK tax is paid on his estate <u>but</u> paid by estate (out of residue)
- Daughter has tax in Ireland because she is resident here
- Daughter cannot get credit for UK tax because she does not pay it

Potential Irish/UK issues
2. Improved

- **Nil rate band**
- **GBP325,000 in UK**
- **Ireland – 4 children = EUR1.12m**
- **Now can double up to GBP650,000 on second spouse's death**

Potential Irish/UK issues
3. Gone

- Previously, issue in the UK
- Spouse exemption
- UK domicile →UK domicile: exempt
- Irish domicile →Irish domicile: exempt
- UK domicile → Irish domicile: not exempt

Domicile - Example 1

- Irish couple
- She lives in Ireland full-time
- He works in UK during the week
- He has been UK resident for 17+ years so is considered UK domiciled
- He has valuable business interests in UK, leaves everything to wife
- First GBP650,000 tax free, balance taxed at 40%

Domicile - Example 2

- Couple living in Dublin for the last 10 years
- He is originally from Belfast
- She is Republic of Ireland domiciled
- On death, if he is Northern Ireland domiciled, first GBP325,000 tax free, balance taxed at 40%

New provision

- **Irish spouse can elect to be UK domiciled**
- **Must elect within 2 years of death**
- **Inheritance is then exempt <u>BUT</u> if spouse dies within 4 years her estate will be liable to UK tax**

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EU change
Brussels IV

Brussels IV

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- **Approximately 1 EU estate has in 10 has an international element**
- **Differing rules (e.g. forced heirship)**
- **Attempt to harmonise succession law across the EU**
- **Ireland, UK and Denmark have opted out**

BUT

- **Irish testators can elect that Irish rules apply to assets located in any of the signatory states**

Brussels IV – What action is needed?

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- **Anyone with property in a country where forced heirship rules apply should look at revising Wills (e.g. if they want property to pass to spouse)**

- **Can elect in Will for Irish law to apply – and are then free to leave property as they wish**

- **Key countries: France, Spain, Portugal**

Investment portfolios

International inheritance tax

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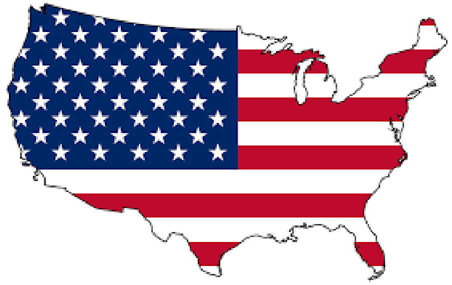
Investment portfolio

- **UK shares**
- **US shares**
- **UK – No longer such an issue as can double up on nil rate band to GBP650,000 and now can elect for inter-spouse exemption**

US inheritance tax

- **Non – US domiciled spouses – USD60,000 exemption**
- **Balance fully taxable**



Trend towards using US ETFs in portfolios

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- **Many European ETFs – funds**
- **US ETFs – CGT (Revenue confirmed):**
  - **SPDR Pharma ETF**
  - **First Trust Nasdaq ETF**
  - **Powershares**
  - **US Vanguard ETFs**
- **Unit investment trusts**
- **Tax is based on location of the issuer – underlying market is not relevant**

Canadian inheritance tax

- Canada – no inheritance tax for non-residents
- Canadian iShares
- Physical gold
- Central Fund of Canada
- Central Gold Trust

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Recent Irish gift/inheritance tax changes

Recent Irish changes

- **Clarification on loans**
- **Parent – child exemptions**

Why lend instead of gift?

- **Problem is still there eventually**
- **No cash to pay gift tax 33%**
- **Hope that thresholds will increase or rates decrease**
- **Possibility of becoming non-resident in future**

Loans

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- Interest-free use of money is a gift
- What rate?
- Revenue have updated example in published material from 12% to 1.5%
- "Best rate a prudent depositor would obtain"
- Arguably lower
- Even at 1.5%, allows 2 parents to give daughter and son-in-law loan of EUR800,000 without an annual tax cost

Parent/child exemptions

- Curtailed for over 18's in December 2014
- Free housing for child attending university (up to 25 only)
- Occupation of family home by child
- Cost of family functions paid for by parent

What exemptions are left?

1. Business relief/agricultural relief.
2. Annual EUR3,000 exemption.
3. Family home exemption.

Annual EUR3,000 exemption

- **2 Grandparents**
- **Son, married with 3 children**
- **Annual gift: EUR6,000 from grandparents to each family member**
  - **=EUR30,000 per year tax free**
- **Son still has EUR280,000 free threshold**
  - **Be careful – certain life assurance products**

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Family home exemption

The family home exemption

- Home in Ireland or abroad
- Includes land up to one acre (excluding the site)
- Only or main residence of recipient
- 100% tax savings
- Act now if qualify

The family home exemption – main conditions

- **3 year occupation before the gift/inheritance**
- **6 year occupation after the gift/inheritance**
  - ***Unless 55 at date of gift/inheritance***
- **Must not own an interest in another residential property at date of gift/inheritance (fixable)**

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The obvious

- One child still lives at home – Will planning
- You own a rental property that your child could move into
- You buy an apartment for a child attending college

The less obvious

1. Child already has house

   – Buy and give back after 3 years
   – Child gets cash now (tax free)
   – Child gets house in 3 years time (some small tax costs)

The less obvious (cont)

2. I don’t want my mother-in-law owning my house

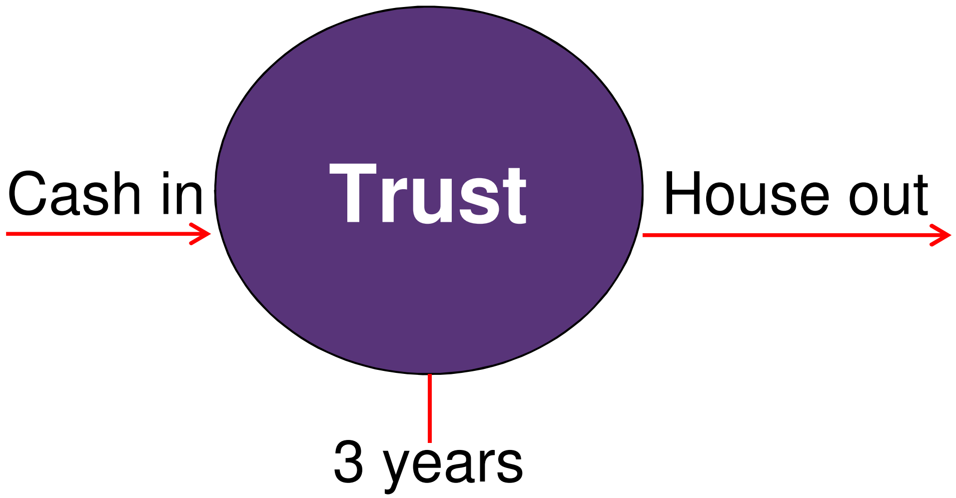
   – Buy 49% of the house and give back after 3 years

   – Or register a charge

The less obvious (cont)

3. **I don't have any property that I could leave to John**

   – **Leave cash into a trust**



Trust planning – as part of Will
Reasons for not qualifying

- The children already own properties
- Other residential property is left under the terms of the Will that knocks them out of the exemption
- 3 years pre occupation period

Will planning

Beforehand the individual cannot qualify for the family home exemption

Funds/assets put into a Trust

House comes out when the family home exemption conditions are satisfied

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Will Trust

- **Is it complicated?**
- **Part of the Will**
- **Executors hold on to assets longer**
- **Same approach for business relief (2 year holding period)**

Summary – Dwelling House Exemption

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- Tax Free and does not affect lifetime thresholds
- Can skip a generation
- Applies to any home anywhere
- Use now if you can
- No limit on value and no limit to the amount of times it can be used

Some generous tax reliefs with wide application

- Dwelling house exemption
- Holding company regime
- Entrepreneurs relief - future

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