



# Succession planning for the family business

**a UK perspective**

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## Introduction

- The day to day management of private limited companies incorporated in the UK lies with the company's directors who derive their authority from the companies articles of association;
- Ownership of the company is in the hands of its shareholders;
- To ensure continuity regard must be had to succession planning, whether on death or retirement during lifetime.

## Succession planning issues to consider

- In considering succession planning regard must be had to a number of issues:-
  - Taxation;
  - Transfer of shares to family members;
  - Transfer of shares to non-family members; and
  - Ongoing day to day management post death or retirement.

## Taxation – general principles

- The principal taxes to consider with regard to succession planning for UK private limited companies are inheritance tax and capital gains tax:-
  - **Inheritance Tax (IHT)** – is payable on death or on a chargeable lifetime transfer. The rate of tax, subject to exemptions, is 40% on death and 20% during lifetime;
  - **Capital Gains Tax (CGT)** –no CGT liability arises on death. A lifetime transfer of shares can give rise to a CGT liability. The rate of tax, subject to exemptions, on lifetime transfers is 18%.

## IHT issues in relation to private company shares passing on death

- The first issue to consider is whether the deceased shareholder died having made a Will:-
  - If a Will has been made, the deceased's shares will pass in accordance with the provisions of the Will;
  - If no Will has been made the deceased will have died intestate and statutory provisions will dictate how the deceased's assets, including his shares, devolve

## IHT issues in relation to private company shares passing on death where the deceased left a Will

- If shares pass to a non - exempt beneficiary, subject to available reliefs, IHT will be payable at 40% to the extent that the value of such shares exceed the IHT tax free band, currently £325,000;
- If the deceased was UK domiciled and shares pass to a UK domiciled surviving spouse or civil partner there is a spouse exemption and shares will pass free of IHT;
- If the deceased was UK domiciled and shares pass to a non UK domiciled surviving spouse or civil partner the spouse exemption is limited to £55,000 and the balance in excess of £325,000 will be subject to IHT;

## IHT issues in relation to private company shares passing on death where the deceased left a Will

- The shares may qualify for IHT Business Property Relief (BPR). The maximum relief available is 100% where the deceased held the shares for 2 years prior to death;
- In terms of IHT planning on death regard should be had to the availability of BPR. If shares are passed to the surviving spouse or civil partner BPR will be wasted. Consideration should therefore be given to passing shares upon which BPR is available to non-exempt beneficiaries.

## IHT issues in relation to private company shares passing on death where the deceased did not leave a Will

- If a person dies without having made a Will they will have died intestate, as a result of which statutory rules will determine how the deceased's estate devolves. There are many permutations depending on who survived the deceased. If the deceased was survived by a spouse or civil partner with children:-
  - The surviving spouse or civil partner inherits the first £250,000;
  - The surviving spouse or civil partner has a life interest in trust in  $\frac{1}{2}$  of the balance which on their death passes to children;
  - The remaining  $\frac{1}{2}$  passes to children at age 18

## IHT issues in relation to private company shares passing on death where the deceased did not leave a Will

- The operation of the intestacy rules could mean that:-
  - The deceased's shares do not pass in the manner desired;
  - BPR is wasted;
  - If BPR is not available, IHT is payable;
  - Therefore a Will should be prepared to ensure this does not happen.

## Taxation issues in relation to private company shares passing during lifetime

- Shares will generally pass during a person's lifetime either on sale or by way of gift;
- If shares are **sold** for their market value:-
  - No IHT will arise;
  - A CGT liability will arise at the rate of 18% on the increase on the sale price as compared with the cost of the shares. Entrepreneur's Relief can be claimed up to a maximum of £1m of gain if the shares have been held for at least 1 year and this reduces the rate to 10%;
  - Stamp duty will be payable by the purchaser of the shares at the rate of 0.5%

## Taxation issues in relation to private company shares passing during lifetime

- If shares are **gifted** the gift will be deemed to have been made by reference to the market value of the shares at the date of gift. The tax consequences are as follows:-
  - The gift might be subject to IHT.
    - If the gift is made to an individual absolutely, other than to a surviving spouse or civil partner, it will be a Potentially Exempt Transfer and provided the donor survives the gift by 7 years no IHT will be payable;

## Taxation issues in relation to private company shares passing during lifetime

- The gift might be subject to IHT.
  - If the gift is not absolute, for example a gift to trust, it may be subject to IHT at 20%, if 100% BPR is not available, to the extent that the value of the gift exceeds the tax free band, of £325,000.
- The gift will be a deemed disposal for CGT purposes and, subject to the availability of Entrepreneur's Relief, a CGT liability will arise at the rate of 18% on the increase on the market value as compared with the cost of the shares.

## Taxation issues in relation to private company shares passing during lifetime

- The gift will not give rise to a stamp duty liability.
- If a CGT liability will arise on the gift thought should be given to gifting the shares into trust as on a gift to a trust any gain can be held over without any immediate liability to CGT. This could facilitate the tax free transfer of substantial shareholdings where BPR is available.

## Transfer of shares to family members

- The transfer of shares to family members can be:-
  - On death, by Will or under the intestacy provisions; or
  - During lifetime, by sale, or more likely, by way of gift. The gift may be:-
    - Absolute; or
    - On trust – a trust could be useful if the donor wishes to retain control of the shares, as a trustee, during lifetime or to protect the shares from minor children.

## Transfer of shares to non-family members

- It is common for private company shares to be owned by individuals of different families;
- A common problem which arises is how shares will be dealt with if a shareholder dies or retires;
- It is usually the case that the remaining shareholder will not wish to be in business with a retired shareholder or a deceased holder's spouse so will wish to purchase the retiring or deceased holder's shares. The ability to achieve this may be governed by the company's Articles of Association or through a Shareholders Agreement;

## Transfer of shares to non-family members

- A common problem for a remaining shareholder who wishes to purchase the shares of a retired or deceased shareholder is the necessary mechanism to ensure the purchase can be achieved and the availability of personal funds to effect the purchase. This can be achieved by:-
  - The shareholders insuring each others lives for the value of their respective shareholdings;
  - Assigning the insurance policies into a Business Trust for the benefit of surviving shareholders; and
  - Entering into Cross-Option Agreements, binding on the shareholders and their successors, to facilitate the sale and purchase on retirement or death.

## Ongoing day to day management post death or retirement.

- It is often the case that a shareholder is also a director of the company and has day to day management responsibilities in relation to the company's business;
- On the retirement or death of a director there will be a hiatus when the company lacks direction. This may affect profitability in the short term;
- It is common for a company to effect Key Person Insurance to diminish the effects of short term loss of profitability.