

Estate planning for business owners - Part 1

Paul

My name is Paul Bradshaw, I'm joined today by Karina Challons. Both of us work in the UK wealth planning and advisory team and we're going to be discussing succession planning for business owners and some of the planning that we see our clients implement on a reasonably frequent basis. It's important to note that we're unable to provide you with tax advice and that prior to taking any action you should of course speak to your usual tax advisors.

What are the key considerations when selling a business?

Karina

So, there are principally four main considerations for a business owner. I mean, you're going to start off being really focused on driving value of the business, but the other things you need to consider is what's the purpose of the exit?

After that you might be, you might be considering what am I going to be doing post exit? What's my life going to look like then? And then thirdly taxes generally, pre and post as well. And then the last one, which a lot of business owners don't think about, is the impact on the children on the next generation. And if you don't focus on that you can find you have issues that you need to deal with, so preparing for that, that point is very important.

What would a business owner focus on?

Paul

In the run up to a business sale and the business, the business owners are typically focused on two things. They're obviously concentrating on running the business, making sure that continues to function properly and then also driving value ahead of any transaction. And the transactions can take different forms, they could be in the way of a clean break, where all ties are severed with the business, or it could be a partial exit where there's ongoing involvement either for you know,

relatively short or even a longer period of time sometimes spanning many years. And I think business owners need to kind of carefully consider which option is best suited to them and their personality type. Assuming that both options are available because it's quite hard to go from a position of absolute control to one where you're stepping back and might not be, you know, the only party making a decision. And as you know, we know from experience, it's also really important to choose the right partner for the exit.

Karina

Yes, I don't if you remember a number of years ago a client, who had reached a certain age, decided to sell the business, really built up the value, but then decided that you know, he wanted to stay involved in some form. So, he rolled over some shares, it was an earn out and not long after the sale had gone through, he found that giving up control to the new owners was just impossible for him. So, after a few weeks, he stepped away and lost a significant amount of money, but he said, you know, it was worth losing the money because he couldn't envisage carrying on as he was in this newfound business.

Paul

It's a difficult transition.

Karina

Absolutely.

How much Capital Gains Tax might business owners expect to pay?

Paul

So, when we're thinking about capital gains tax and how much clients will pay, there are two headline rates for clients to consider. For those who haven't previously sold a business, they might benefit from what we used to call entrepreneurs relief, which is now called Business Asset Disposal Relief. And that's a rate of 10% on the first million of gain. And thereafter the vast majority of gains are going to be taxed at 20%. If clients, if they plan in advance, are able to think about utilising capital gains tax deferral. But utilising that type of planning can't be left until the last minute, it's got to be, you know, well considered and well in advance with your tax advisors.

Karina

And some of it it's 18 months to two years. So, you need to think about it very early.

Paul

Absolutely.

What is the position with Inheritance Tax pre-sale of the business?

Karina

So the position with inheritance tax pre-sale of the business is that if you as the business owner own shares in the company that qualify for what is known as business relief or what we, do you remember, used to be called business property relief, then as long as you held them for two years if you died say, unexpectedly, and wanted to pass them to your children, there'd be no inheritance tax to pay.

So, when business owners are looking at a sale, then business property relief is very useful. And they may look at transferring some or all, probably not all into a trust pre-sale, so that if they died, say eight years later, the value of the trust would be outside their estate for inheritance tax purposes.

What is the Inheritance Tax position post-sale of the business?

Paul

Right, so the inheritance tax position post-sale of the business is quite different to pre-sale and I think as with all things in life, it's important to compare and contrast. So you know our clients who have exited a business go from a position where they have been a business-owning family, and hold shares in a business that will qualify as you say for business relief so, get an exemption from inheritance tax to post liquidity event holding cash. And that's often, you know for a short period of time but quite frequently for very long periods of time and it's important to recognise that that cash doesn't get the same reliefs that the shares in the business will have done and actually it would be exposed to inheritance tax at 40% if it's left to anybody, really other than your spouse. There are some quirks around domicile, but they can be quite complicated.

We often find clients thinking about, if you like, post-event planning and you know, a bit like closing the door after the horse has bolted, and wanting to do inheritance tax planning when there's this

realisation that there's this large amount of wealth in the estate. And if they were to add assets to a trust that had been derived from a business, so just putting cash into a trust then there'd be an immediate charge to the lifetime rate of inheritance tax at 20 percent above the no rate band of that's a very small amount, which is £325,000.