Irish Life

Case study for Retirement Relief
– Life Advisory Services

This document is based on Irish Life's understanding of Revenue law and practice at February 2012. This is a specialised area and specialist tax advice should be sought, in advance, if Retirement Relief is to be availed of.

When looking at the possibility of a Share Buy Back (i.e. where a private limited company buys back its own shares from a shareholder) there are two main issues:

1. Company Law

- the provisions of the Companies Act 1990 must be complied with.

Part XI of the Companies Act 1990 allows a private company to buy back its own shares in certain circumstances and subject to certain conditions.

2. Taxation

- can the proceeds of the sale of the shares be received in a tax efficient manner?

Two hurdles here:

- where a company buys back its own shares this will be treated as a distribution and subject to income tax in the hands of the seller, unless the relevant conditions can be met to allow the buy / back of shares by the company be treated as a disposal for Capital Gains Tax purposes, and if they are,
- will Retirement Relief apply.

If Retirement Relief applies, the disposal will be exempt from Capital Gains Tax, where the value of the shares sold to the company does not exceed €750,000.

Where shares are being transferred to someone other than the company, for example, a child, the transfer is always treated as a disposal for Capital Gains Tax purposes regardless of the value of the shares.

Where Retirement Relief is being availed of on the transfer of shares to a child, either on sale or as a lifetime gift, the limit of €750,000 does not apply.

The value of the shares transferred would be liable to Stamp Duty of 1%. (Consanguinity relief does not apply to the transfer of shares)

So with the above issues in mind, is it possible to use Retirement Relief from Capital Gains Tax to take a tax-free lump sum of €750,000 out of a company by selling shares worth €750,000 back to that company?

Lets take the following example:

Mr Jones owns 65% of a private Irish trading company valued at €1,500,000. His son owns the remaining 35%.

His son will ultimately take over the business, perhaps on the death of his parents / father or, during the parents' lifetime on his father's retirement.

There are two options available to Mr Jones on the disposal of his shares:

Option 1 – Mr Jones sells some of his shares to the value of €750,000 back to the company

Or

Option 2 – Mr Jones gifts some shares to his son, and then sells the remainder of his shares back to the company.

In the following pages we will show you the practical issues to think of in both options.

<u>Option 1 –</u>
Mr Jones sells some of his shares to the value of €750,000 back to the company

- **Company Law**

Part XI of the 1990 Companies Act allows a private company to buy back its own shares in certain circumstances. These company law conditions must be met if the buy / back is to take place.
We are assuming in this instance that these requirements can be met i.e. the required special resolutions to change Articles, and to authorise the buy / back agreement will be put in place, the company will have sufficient "funds available for distribution" to effect the purchase etc.

- **Taxation**

Several conditions must be met in order that the proceeds of the sale of shares to the company will not be treated as a distribution subject to income tax but instead be treated as a capital gain and thus the vendor will be subject to Capital Gains Tax.

A list of the conditions for Capital Gains Tax treatment is available, but broadly:

1. **The company must be an unquoted trading company**
   – let's assume it is
2. **The seller must be resident and ordinarily resident in Ireland and must have owned the shares for 5 years**
   – we presume this is ok.

3. **The seller and his associates must reduce their shareholding by at least 25% and after the buy / back must have less than 30% of the equity of the company.**
   – *a sale of shares worth €750,000 of a holding worth €975,000 in a company worth €1.5m would leave Mr Jones with 15% of the company and he would have reduced his shareholding by over 70%*

4. **The purchase must be for the benefit of the trade and not part of any scheme to enable shareholders to take profits from the company without taking a dividend.** The Revenue will give an advance opinion on particular circumstances.
   Based on previous Revenue notes on this issue ***we are not convinced that the sale would meet with Revenue approval***. *In previous guidance they outline circumstances where the entire shareholding is being sold, which would be likely to meet the test. They also point out one or two circumstances where although all the shares are not being disposed of* ***the company may be able to prove that the transaction is for the benefit of the trade.***

   - ***Where a retiring director maintains a small shareholding for sentimental reasons.***
     – would 15% be considered small?

   - ***A sale by a controlling director to allow control to pass to his children, but remains on for a specified period for commercial reasons.***

Retirement Relief
Retirement Relief can only apply if the buy / back is treated as being liable to Capital Gains Tax in the first place.

Based on the points made in Point 4 above we could not be guaranteed that Capital Gains Tax treatment would apply in the scenario outlined without Revenue opinion, based on convincing them the sale is for the benefit of the trade.

The shareholder would obviously be in a better position to comply with Point 4 if he sold his entire shareholding valued at €975,000 (*assuming the company could afford this*).

However while this might help meet the conditions for Capital Gains Tax treatment, it would put the disposal outside the €750,000 limit for Retirement Relief.

Option 2 –
a) Mr Jones gifts some shares to his son, and b) then sells the remainder of his shares back to the company

a) Mr Jones gifts a further 15% (€225,000) of the company to his son.

♦ Taxation

Capital Gains Tax
Mr Jones will be deemed to have made a disposal of the shares at market value to his son.
No Capital Gains Tax liability will be payable by Mr Jones if Retirement Relief applies.

Retirement Relief

- Mr Jones is over age 55. (There is no actual requirement to 'retire' as such, simply to be over age 55).
- The shares relate to a trading company and have been owned by Mr Jones for at least 10 years.
- Mr Jones has been a working director of the company for at least 10 years and full time working directors for at least 5 years.
- Mr Jones must own at least 25% of the voting rights in the company.
- Relief will only apply to the value of shares applicable to "qualifying business assets". The value of shares treated as being applicable to "qualifying business assets" is related to the value of the company's chargeable business assets plus cash as a portion of the company's total assets. A Company's chargeable business assets are those assets used in the course of the trade, including goodwill but excluding assets held by the company as investments.

The limit of €750,000 for Retirement Relief does not apply in relation to disposals to children. However the Capital Gains tax, which would have been payable, becomes due immediately if the child disposes of the shares within 6 years.

Gift Tax
Mr Jones's son will have received a gift of shares valued at €225,000. For CAT purposes this will be aggreg with any previous Gift / Inheritance since 5th December 1991.

Assuming the value of the gift of 35% of company previously (at current market value), this gives a potentia aggregate value of €750,000.

If Business Relief (90% reduction in taxable value) for Capital Acquisitions Tax applies this could reduce the aggregate taxable value to €75,000.

Assuming the full child threshold of €250,000 (2012) is available, no Capital Acquisitions Tax liability arises for Mr Jones' son.

Stamp Duty
The transfer of shares is liable to 1% Stamp Duty. This would be €2,250.

b) **Mr Jones sells the balance of his shares 50% (€750,000) back to the company.**

- **Company Law**

Part XI of the 1990 Companies Act allows a private company to buy back its own shares in certain circumstances. These company law conditions must be met if the buy / back is to take place.
We are assuming in this instance that these requirements can be met i.e. the required special resolutions to change Articles, and to authorise the buy / back agreement will be put in place, the company will have sufficient "funds available for distribution" to effect the purchase etc.

- **Taxation**

In order for the sale of shares back to the company to qualify for Capital Gains Tax treatment the conditions outlined previously must be met:

1. **The company must be an unquoted trading company**
   – *let's assume it is*

2. **The seller must be resident and ordinarily resident in Ireland and must have owned the shares for 5 years**
   – *we presume this is ok*.

3. **The seller and his associates must reduce their shareholding by at least 25% and after the buy/back must have less than 30% of the equity of the company**.
   – *this time Mr Jones is disposing of his entire shareholding.*

4. **The purchase must be for the benefit of the trade and not part of any scheme to enable shareholders to take profits from the company without taking a dividend**.
   – Based on the Revenue note ***we feel that the sale of all remaining shares is more likely to meet the Revenue requirement of benefiting the trade – again advance opinion should be sought.***

Retirement Relief

Retirement Relief can only apply if the buy / back is treated as being liable to Capital Gains Tax in the first place. The same conditions as outlined earlier apply.

The relief will only apply where the total consideration does not exceed €750,000 where the disposal is to someone other than a child, in this case the relief therefore should apply.

So back to the original question.

Is it possible to use Retirement Relief from Capital Gains Tax to take a tax-free lump sum of €750,000 out of a company by selling shares worth €750,000 back to that company?

We have shown you the two options available.

In option 1 we are not sure that Capital Gains Tax treatment will apply if only €750,000 worth of shares are sold back to the company. This is because we are not convinced that this sale would meet Revenue approval in view of the amount of shares being retained by Mr Jones. However Revenue will give an advance opinion in particular circumstances.

If Capital Gains Tax treatment does not apply to this disposal then the sale will be treated as a distribution and will be subject to income tax.

Alternatively, if all his shares are sold, thus meeting the conditions for Capital Gains Tax treatment, this will put the disposal outside the €750,000 limit for Retirement Relief.

In option 2 we can see that, assuming all the relevant conditions are met, Retirement Relief can be claimed on both the sale of shares to the company and on the gift of the shares to Mr Jones' son. Assuming Mr Jones' son can avail of Business Relief from Capital Acquisitions Tax then no tax liability will arise for him on this gift of shares.

The value of the shares transferred however would be liable to Stamp Duty of 1%.

Each client's situation is different and this document provides just a brief outline of the issues involved in the areas of both company share buy backs and Retirement Relief.

We advise that your client seeks professional tax and legal advice as the information given is a guideline only and does not take into account your client's particular circumstances. More detailed information on Retirement Relief can be located on bline.

The changes proposed to Retirement Relief in Finance Bill 2012 are not included in this document because, even if they are enacted as they are currently proposed, the changes will not come into effect until 2014.

Information is correct as at 1 February 2012 but is subject to change.