HSBC Private Banking

Video Transcript

Estate planning for business owners - Part 2

Should you consider putting money in a trust?

Karina Challons:

The planning involves considering really estate planning, pre-sale. So, if the business owner wants to put some money in trust and we've touched on it, as long as the shares qualify for business relief - and it's essential to have that confirmed by their professionals - but there are restrictions, so you can't just put everything in it because then you and your spouse would be excluded, and children under the age of 18 would also be excluded. So, you've got to think about what do you need to support your lifestyle and other funding that you will need for other purposes, so it's important to consider that before looking at the level of funding you're going to be doing.

So, the other purpose of a trust is control and a lot of people don't want to give up control so they don't want to give huge sums of money to their children, particularly if they're young, and so by having a trust they can be appointed as trustees: they can control when and how much they want to distribute to the trustees over the many years in the future. So, that planning needs to be carefully thought out and the level of funding they'll need.

Paul Bradshaw:

There certainly can be broader benefits as well in terms of legacy protection.

Karina

Absolutely, if you want to benefit your grandchildren, you want to lend funds or you want the trust to own it for future generations, all this needs to be considered. And if you do it pre-sale and you are lucky enough to have assets, or shares that qualify for business relief, then it's not something you want to discount too quickly.

Paul

No, absolutely not.

There are a variety of reasons why things need to be considered well in advance of a sale. It might be that following advice from your tax advisors, it's anticipated there’s going to be a split of assets across a variety of structures, which will each seek to serve a different purpose; some legacy planning, some income planning and it could well be, as is often the case with our clients who exit a business when they transition from being a business-owning family to a family who is effectively managing wealth, that there’s this realisation that actually there's much more liquidity than was ever expected.

And actually with that comes some issues, for example, inheritance tax, and that often gives rise to, not knee-jerk reactions, but clients thinking about how they can address the inheritance tax exposure that they didn't have previously, and we see people wanting to give away large sums of money.

What we typically say is let's stop and take a deep breath before you do anything, and in fact preferably in the run-up to the sale once there's an idea of what the final earn out will be, whether that's an immediate clean break or a partial exit, that we do some form of cash flow planning to see what the income profile will look like, if the assets will support the lifestyle the clients want, whether that's, you know, modest or extravagant, and if off the back of that they are able to give away assets, or if they should retain what they've realised for their own use and then do some side planning around making sure wills are relevant, up-to-date, lasting powers of attorney and something basic, like life insurance.

Karina
The other thing is we found that when we've looked at the cash flow, sometimes people have been able to sell for less than they thought they needed, or they needed to actually, or they couldn't gift as much as they wanted to. So, by preparing them for that, it's remarkable how you've been able to shape people's decisions, before they've actually signed on the dotted line.

Paul
It's quite a powerful thing.

<u>Why is it important to consider what your plans for the future are, ahead of sale?</u>

Karina
So post-exit, a lot of people might be exiting their business so they can travel and see countries that they've never seen before, and never had time to, or play golf or just relax. But that's not right for everyone. For example, we had a client a few years ago who decided to sell his business; he drove the price up and sold it for top dollar, only to realise, post-sale, that this was a terrible mistake and he regretted it because he had no purpose in life - work was everything to him. He then spent four years trying to buy this business back and, luckily for him, he managed to buy it back at a decent discount and now he's happy again because he's got his purpose back.

Planning for the next phase is absolutely critical because selling a business is a major change in your life and people don't realise that you spend years building up a business and then day two you sell, and that's it. If you've got a clean break, you're out of it. So, preparing for that is important; think about what you're going to be doing in phase two. Are you going to be involved in helping your children develop a business? Or are you going to be involved in philanthropic purposes? Or do you just want to manage your money and enjoy your hobbies?

We find that clients who take the time to think about phase two don't suffer the anxieties of people who don't plan, and so it's important to think through not just the sale but what you're going to be doing later.

Have you considered the impact of the sale on your family and future generations?

Paul

When we think about, or when we see our clients all the time, and you often see what the impact of a sale of a business is, it's not only that psychological shift of you being in a family that own a business - and that might not have been just you, it might have been something generations ago that was started by the family, or it could have been something that you founded - you move from that transition to being a family that manages wealth.

There’s a realisation, I suppose, well sometimes there’s a realisation, that actually people aren't prepared for that change, and that’s not just the kids, it could be the whole family. And there’s often this shift where people suddenly think about inheritance tax is often a consideration where the amounts are significant, and also a realisation that actually if no one's prepared, how do we go about managing the wealth?

The starting point, as we've discussed in the past, is that we need to think about succession planning generally; start with the basics that is a will and how do you want the estate to pass to the next generation, assuming you’ve got children? And do you want them to enjoy the wealth, go and party, or do you want them to grow it? Off the back of that; if the wealth is significant, is this to be dynastic, is it for successive generations, not just for the next generation or actually don't you care?

Karina

Also, it takes them time to think through this because having gone through all the process of the sale, their thought process has evolved over time so, they need to think about are the family ready.

If, for instance, the business owner suddenly dies unexpectedly, does the rest of the family have the knowledge and experience to oversee, say, the management by third party advisors? Do they have the infrastructures in place, ready for that family? And for different families, there’s different set-ups.

All of this needs to be thought through, it takes time and often it's forgotten and dealt with at a very late stage.

Paul

An afterthought.

Karina

Absolutely.

Paul

There's no such thing as best practice here, rather like all families are different as we all know.

Karina

Yes, quite right.

What could be some other issues you need to consider?

Paul

Other issues to consider; I suppose the unexpected aspect of this is the impact on your health, like the runup to the sale, you know, clean break or partial exit - it's intense, long hours.

Karina

Very stressful**.**

Paul

Super stressful. So if you're able to relax afterwards, try to, don't make decisions quickly and actually, irrespective of type of exit, I suppose there are some other – well, we see reasonably frequently - other unexpected consequences, something as extreme as sudden concerns around family security, what the kids are doing on social media, people are sometimes not knowingly sharing too much information which can put other family members at risk, or it might be something that's pretty straightforward as just learning about what to do with money, educating yourself and the next generation for the responsibilities it involves.

Karina

What we find often is that, post-sale, people are very quick: they think they need to make decisions, because they've been making decisions all their life. And so, they decide 'oh, we're going to give lots of money to the children' and then regret it, because a lot of the children are young and not ready for the money. So it's important to take that time to think it through, do the planning, look at when you want to pass wealth - if you do - but not to make that decision quickly because, once you've given it, you can't take it back.

It's important if we look back at the beginning of this session that you consider the four points we were talking about:

One is your purpose for the exit. Having built the value, **what is your purpose for the exit?**

The other one is **what's your life going to be like in phase two?** Have you planned for that? Have you thought that through?

Thirdly, taxes generally and the **impact pre and post-sale**.

Then lastly, **the impact on the family** because some lose their purpose. So, it's important to look at the next generation.

You have options and the earlier you start talking to your advisors and consider which ones are appropriate for you, and they're not going to be the same for everyone, but at least you then have the ones that you want to pursue and so taking time to do that, just as you plan for your business, plan for your own affairs as well.