Tax Rules Regarding Share Valuations

by Mark Doyle

One of the trends among family businesses during the Covid-19 pandemic has been a renewed interest in succession planning.

This interest has been sparked by business owners taking stock of their own personal circumstances and falling profitability in many businesses. Taxes arising from inter-generational transfer of assets are levied based on the market value of the assets at the point in time of the transfer, reduced asset values result in lower tax bills. Reduced asset values coupled with beneficial tax reliefs that allow succession planning (e.g. retirement relief and business asset relief), now represents a favourable time to undertake such planning.

This article will focus on a high-level basis on the main tax considerations when undertaking the valuation of shares in a family-controlled company; this article will not focus on valuation methodologies.

The purpose of the valuation

The valuation of the shares in a family company will be included in the tax returns filed related to the share transfer, these returns could be for CGT, CAT and stamp duty. It is important that the share valuation be accurate, otherwise the returns filed may be incorrect resulting in potential interest, penalties and possibly surcharges for under-valuation for stamp duty and CAT. The filing of an incorrect return can also allow Revenue to amend assessments even after the 4-year time bar has elapsed.

The date of the valuation

The date of the valuation for tax purposes is driven by the fact pattern of the case and also the legislative provisions pertaining to the tax head in question. For example, the valuation date of an unconditional gift of shares in a company would be the date of the gift for CGT, CAT and stamp duty purposes. On an unconditional inheritance of shares the relevant date for CGT purposes would be the date of death of the disponer, the relevant date for CAT would be the "valuation date" for the inheritance (stamp duty should not apply to an inheritance) and these valuation dates may be different, this may give rise to differing values for the shares for CGT and CAT purposes.

Valuation principles

Undertaking the valuation of shares in a family company is often a difficult exercise, it is not uncommon for two different valuers to be instructed to value a company and for the valuations produced to be markedly different; valuations after all are an art – not a science. However, there are certain concepts and rules that apply to almost all valuations.

Once the valuer has established the correct valuation date for tax purposes it should be regarded as a fixed date and unforeseen future events should not be taken into account. The valuation should reflect the market at the valuation date and the prevailing economic circumstances and uncertainties at that time. For share valuations being undertaken at this time, the economic impact of the Covid-19 pandemic and Britain's exit from the EU should be taken into account if they are likely to impact on the financial performance or asset value of the company.

In the case of shares in a family company, the valuation should be based on the assumed sale of the shares on a hypothetical "open market" at the valuation date.

The open market price is arrived at on the assumption that all the information a prudent prospective purchaser of the shares might reasonably require is available, if the purchaser was buying the shares from a willing seller by private treaty at arm's length. Market value has become accepted as the price a willing buyer would pay a willing seller under open market conditions.

Specific tax rules

Capital Acquisitions Tax (CAT)

For CAT purposes shares in a company are to be valued at open market value as provided by section 26 Capital Acquisitions Tax Consolidation Act 2003 ("CATCA 2003"), generally where a minority shareholding in a company is being sold on the open market a minority discount would apply. The size of the shareholding passing reflects the amount of control that a shareholder can exercise on the running of a company and the value of a particular shareholding is normally discounted to reflect the advantages and disadvantages attaching to same. It is interesting to note that Revenue, for CAT purposes, has published their discount rates as follows (see also discount tables provided in professional valuation books):

Shareholding	Discount
75%+	Nil discount or perhaps 5% at most
50% + 1	10 – 15%
50%	20 – 30%
25% + 1	35 – 40%
25% or lower	50 – 70%

Section 27 CATCA 2003 provides that where a company is controlled by the donee or successor the shares being transferred should be valued on the basis that the beneficiary is deemed to have control of the company. The effect of this provision is that where shares in a company are owned by an individual or by their "relatives" the shares are to be valued as a proportionate part of the entire shareholding in the company so held. The effect of this provision for most family companies is that no minority discount is available for CAT purposes.

Stamp duty

For stamp duty tax purposes, the rules for determining the market value of shares are set out in section 19 Stamp Duties Consolidation Act 1999 which provides that the rules for valuing property under section 26 CATCA 2003 must be used, in this regard the rules of section 27 CATCA 2003 do not apply to stamp duty and a minority discount should be available for stamp duty as appropriate.

Capital Gains Tax (CGT)

The provisions for determining the market value of shares for CGT purposes are contained in section 548 Taxes Consolidation Act 1997 ("TCA 1997"), similarly to CAT and stamp duty one must arrive at the open market sales price.

Minority discounting can apply for CGT purposes, however, there is an anti-fragmentation provision contained in section 550 TCA 1997 that is relevant. This section contains an anti-avoidance measure to prevent schemes whereby shares could be disposed of in tranches so that the value of each tranche (due to minority discounting) is less than what the shares would command as a whole. In such circumstances the amount to be taken as consideration for the tranches is the greater value apportioned rateably over the separate disposals.

Tax	Shareholding	Value €	Discount per Revenue Table	Discount applies to value	Value for Tax €
CGT	20%	400,000	50% - 70%	35% - 40%	250,000
Stamp Duty	20%	400,000	50% - 70%	50% - 70%	160,000
CAT	20%	400,000	N/A	N/A	400,000

Example of applicability of minority discounting

Mr and Mrs Jones each hold 50% of a company valued at €2m. They wish to each gift a 20% shareholding in the company to their child. On the face of it, each 20% shareholding should be valued at €400,000.

However, the value for CGT purposes of a 20% holding after minority discounting (assuming a minority discount was appropriate in the circumstances) would be c€250,000 (taking a mid-point range between 35%-40% from the Revenue discount tables), the provisions of section 550 TCA 1997 would apply and the discount applicable would be for a 40% shareholding rather than a 20% holding. The value of the 20% holding for stamp duty purposes would be c€160,000 (taking a mid-point range between 50%-70% from the Revenue discount tables). The value of the 20% holding for CAT purposes would be €400,000 as minority discounting would not apply by reason of section 27 CATCA 2003.

Conclusion

The valuation of the shares of a family company is a complex matter that brings with it significant tax implications, such valuations should be undertaken with due care and diligence.

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