Institution **CIOT - CTA**
Course **APS Owner-Managed Businesses**

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Section 1	**2836**	**13300**	**16293**
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Answer-to-Question-_1_

REPORT

To:Directors of Briggs LTD

From:Danny Pine, AD Accounting

Date:14th November 2024

Subject:Removal of Dianna and Pedro as minority shareholders of Briggs LTD

<u>Introduction</u>

This report has been prepared following the shareholder's meeting held on 19th October 24 and following Michael's email on 20th October 24.

It is for the use of the directors of Briggs LTD and can not be relied upon by any third parties.

The rates of tax used in the reports are today's rates, should there be delay in any actions advised upon, the advice may need to be reviewed.

The exiting shareholders have acknowleged that they may need to obtain independent advice.

Where there is reference to 'the company', this is Briggs LTD.

The report is made up of the following three key areas:

1) Exit of Pedro Hellas

2) Exit routes for Dianna Peach

3) Increased shareholding for Henry Fall

Executive Summary

1) Exit Of Pedro Hellas

The company should purchase Pedro's shares, obtaining capital treatment.

This will result in a gain for Pedro, to which Business Asset Disposal Releif (BADR) can be claimed.

The gain of will be payable by 31st January 2026.

2) Exit Route for Dainna Peach

Given that Dianna is not eligible for BADR, an purchase of all shares would not be faourable.

The comapny should purchase the shares back from Dianna, having disppalying any capital treatment.

This should be done in a staged approach utilising her basic rate of tax avaiable attracting tax on dividend income at 8.75% or relevant dividend tax in future years.

3)Share issue to Henry

Issue shares to Henry and claim a joint election for income tax to be charged on the unrestircted value.

This election is irrevocable and must be made within 14 days of acquisition.

1)Exit of Pedro Hellas

There are two options to explore for Pedro's exit from Briggs LTD, it has been confirmed that a sale to a third party is not an option.

Michael could directly purchase the shares from Pedro or the comapny could purchase these shares from Pedro.

These options have been discussed in more detail below.

1a) Direct Sale

The sale to Michael would be at the market value of £275 per share as confirmed in your letter, HMRC may request formal valuation for this but for the purpose of this report I have assumed this value.

The proceeds will be £550,000 for the 2000 shares.

Implications for Pedro

The sale will realise a gain chareable to capital gains tax(CGT)for Pedro.

Pedro's cost **(Appendix A)** will be offset from the proceeds realising a gain of £350,000.

Assuming Pedro has no other chargeable gains in the year, he will be able to offset the annual exempt amount of £6,000, reducing his gain to £344,000.

A gain on shares is normally taxed at 20% (for higher rate tax payers) however Pedro will qualify for Business Assset Disposal Relif (BADR)**(Appendix B**), meaning his gain will be taxable at 10% instead.

The total amount of CGT payable will be £34,400, assuming the sale happens within this tax year (24/25) the CGT will be reported and payable to HMRC by 31st January 2026.

Implications for Michael

Michael this would mean that you have acquired a further 2000 shares in the company, the base cost for these shares would be £550,000.

This could be offset from your proceeds on a subsequent sale of the shares.

I have discsused further things for you to consider below.

Michael you have confirmed that your personal resources are limited and therefore you would be required to borrow the funds in order to fund the purchase.

Loan from the company

It would be possible for your to borrow from the company as there are suitable funds available, however there are certain comapny implications that you would need to be aware of, given that the company is a close company (less than 5 shareholders).

A tax penalty is added to the comapny when a loan to a shareholder with more than 5% holding, is outstanding at the companies normal due date for corporation tax.

Assuming the loan will be lent to you very soon we will assume it will be made with in 30th June 2025 period of account and any tax charge will be applied and payable at 1st April 26.

If the balance of the loan that is outstanding at this point attracts tax at 33.75%, on £550,000 this would be £185,625. This is payable with the normal corporation tax due.

Upon repaying the loan, the tax charge can be refunded, however it will only be refunded at the normal due date for corporation tax. If you repaid the loan before 30th June 27 the tax would be refunded by 1st April 27.

If you are not in position to repay the loan the comapny could write this off, however the amount outstanding would then be treated as a dividend to you, likely at higher rate of tax as it would be in top of your other earning.

External Lenders

You could borrow from an external lender, the interest on the loan would be qualifying interest as it is for the purcahse of shares in a unquoted trading comapny and you would be able to deduct the interest from your income to obtain tax releif.

However, I expect to pay the loan, you will need to etract further income from the comapny, again attracting high dividend rates of tax.

If you are able to borrow the money and have it repaid by 1st April 2026, it would be advisable to borrow from the company rather than external investment.

SDLT

You would need to pay Stamp Duty Land Tax (SDLT) on the purchase of the shares, this is 0.5 %, £2,750.

1b) Company purchase of own shares

The other option that could be explored is the company purchasing the shares from Pedro. The company would buy the shares and then the shares are noramlly cancelled reducing the existing sharehodling from 10,300 to 8,300.

In order for the company to purchase the shares the comapny will need to have suitable cash avaialble and resesrves. I see no isse with this from the reserves avialble at June 24.

You will need to consider the commercial impact on the company as these reserves will deplete following the share purchase.

Defualt Position

The defualt position on this is that purchase will be treated as a income distribution to Pedro.

The distibution is calcualted as the market value of the shares less the orginal subscription price.

This would be £550,000 less £2000, therefore £548,000 in dividends to Pedro.

Assuming Pedro leaves at the end of October, he will have salary for 6 months of £60,000, plus his termination payment, taking his income up to £180,000 for the year.

There will be an exempt element of £30,000 for the exgratia payment reducing his income to the region of £150,000 **(Appendix D)**

Therefore this distribution will be chargeable to a dividend rate of 39.35%, £215,638.

There will also be a disposal for CGT, which will be subscription price less actual price.

This will give rise to a loss of £198,000. This loss will be available to offset against Pedro's other income in the year (the additional dividend).

REducing thethe additional dividend tax to, £137,725, on £350,000.

It is possible, if certain criterias are met that the a capital treatment can be appplied, please see below.

Capital Treatment

The capital treatement can be applied if one of two conditions are met :

Condition A - that the purchase of shares is wholly for the benefit of the trade
Condition B - that the purchase of shares is to enable the shareholder to pay an IHT liabilty

As you can see condition B is not relevant but consdition A can be considered.

HMRC accept that if the purchase of shares is for the exit of a dissenting shareholder, due to fallout that this will be deeemed benefit of the trade and capital treatment can be considered.

Pedro then has to also meet the following criteria:
- UK resident
- Has owned the shares for 5 years at the date of purchase
- Reduces interest by 25%
- Does not maintain any controlling shareholding following purchase.

Pedro will meet all of the above and therefore capital treatement can be applied.

The capital treatment will be dealt with in the same way as detailed on the direct sale to Michael as above, therefore only tax at £34,400.

The comapny will have to pay SDLT at the same rate.

Conclusion

Following Pedro's termination package and purchase of own shares this will eat into potetnial cash avaialble in the business. If you borrow the money from the comapny or the company purchases the shares this will have a large impact on cash balance.

It would be possible for you to get an external loan but as mentioned this will mean that would have to take out increased amounts to meet the loan repayments.

Commerical impacts must be consdiere but given the large reserves in the business and the fact that there is substatial work in progress and debtors bought forward from 30th June 2024, I feel that this is not an issue.

I feel that it is acceptable to take this route.

The comapny purchase of Pedro's shares creates the lowest amount of tax liabilty for all and therefore is the favourable route for Pedro's exit.

2)Exit routes for Dianna Peach

The same considerations can be made for Dianna exit, a direct sale to Michael or a purchase of own shares by the company. The gain is calculated in **Appedix C**.

It is also possible that HMRC will question whether the capital treatment could apply as benefit of trade as Dianna is already retired and does not have direct impact in the business.

She also has a minorirty shareholding and therefore does not have much say in the overall business.

That said there still may be a case to present in that it is holding back the future direction of the comapny as she is no longer involved nor required.

If that were the case I would advise that we seek advance clearance from HMRC in order to obtain capital treatment.

It is worth noting however, that Dianna will not be eligible for BADR **(Appendix A**)and therefore any gain in excess of her basic rate will be chargeable at 20% instead .

Capital treatment could be applied with staged purchases, however, Diana would risk not meeting the substational reduction test.

In the tax year of 23/24 she had £31,074 left avaialble of her basic rate. If we use the market value of £275, Dianna could look to sell in the region of 110 shares a year.

She would not meet the substatial reduction test and therefore income treatment would be applied.

Income Distribution with staged purchase

Michael, you had mentioned that you do not wish to give Dianna any addtional dividends to assist with her situation but it would be an option to follow the route of purchase of own shares and request that the capital treatment is not applied.

This would then mean that any purchase of shares are treated as a distibution of income (dividends). Although this is providing DIanna with dividends, it is also disposing of her shares from the company.

Given that you wish to help Dianna's position the comapny could stagger the purchase of her shares over multiple tax years utlising the lower rate of dividend tax at 8.75% on her avaialbe basic rate band.

This would give Dianna a substatial amount more money in the year without attracting addtional tax for the company and any higher rate for Dianna.

Given Dianna's age, we should consider the situation in which she still owned any shares upon her death.

Dianna could have these left to her children in her will at would attract Business Property Releif for Inheritiance tax (IHT), meaning no IHT woudl be due.

Conclusion

I would recommend that you take the route of purchase of Dianna's shares by the comapny.

If capital treatment is applied, we can disapply for this and have the purchase to be treated as an income distibution staggered over future tax years.

In turn utulising Dianna's avialable basic rate of income.

3) Increase to Henry Fall Shareholding

Defualt Position

It would be possible to give Henry the additional shares.

The additonal shares would be treated restricted securties as you are providing them with restrictions depending on his performance.

The shares will have a market value now and a retircted market value.

Given that you are giving Henry the shares at par value, this is under market value.

There will be no charge at the acquisition as there are restictions on Henry obtaining these shares depeding on the performance of the company in coming years.

The restriction is deemed to of lifted when the performance creiteria is met.

Income tax will be chargeable at point as this will be a chargeable event.

It will be chargeable at the unresticted market value as Henry will have not paid anything now.

Claim election

Henry and yourself can elect for him to pay income tax on the market value now on the on the market value of the unrestricted value now however this election is irrevocable.

This could be risky if the target given is not likely to be met.

If the election is made then Henry would have no further income tax to pay when the restirctions are lifted.

If there is a significant increase in value of the shares this would be beenfitcal for Henry as he would not pay income tax on the increased value.

This does however mean that his base cost for CGT would be lower, but given his increased in shareholding to above 5% he would then be eligible for BADR on a subsequest sale so long as all other criterias are met.

Conclusion

If the target is met, it would assue that the company position has improved and that the value of shares would be better.

Assuming the target provided is reasonable it would be best for a joint election to be made for the income tax to be charged on the unresticted market value of the shares.

APPENDIX A - Pedro Base Cost

Pedro's base is calculated as £100 (market value at purchase) as when he purcahsed them at undervalue, he will have paid income tax on the difference in value as employment related security.

This means his base cost would be £60 actaully paid plus £40 for amount charged to income tax.

APPENDIX B - Business Asset Disposal Releif (BADR)

BADR is a capital gains tax releif that is avialble for indivuals selling business assets. The releif is given by reducing the standard rate of 20% to 10% on gains up to a lifetime limit of £1 million.

The comapny must be a trading comapny and the indivual must:
- Have owned the shares for at least two years
- Have 5% shareholding, voting rights and right to assets on wind up
- Be an employee or director

APPENDIX C - Dianna gain on direct sale of shares

Diana Gain

Proceeds	220,000
Cost	(800)
Gain	219,200

APPENDIX D - Termination Package for Pedro

You have confirmed that Pedro will recevie a non contractual termination payment of £120,000 on top of his annual salary.

You have mentioned that you would like Pedro to leave as as soon as possible, however he has a 6 month notice period.

It is possible for Pedro to resign and leave, of the £120,000 termination package you have confirmed that £24,234 is reducnacy and then the balance is ex gratia.

AS you are requesting that Pedro is leaving before his notice period an element will be taxable as post employment notice pay, he will be paid it in order for his employement to cease.

The rest will be ex gratia. THe amount in excess of £30,000 will not be exempt from income tax.

FOr the purpose of the report above £150,000 has been used but seperate advice can be provided for Pedro on his tax implications for termination package.

END OF REPORT

<u>PLANNING SECTION (DOES NOT MAKE UP PART OF ANSWER)</u>

Pedro Gain

Proceeds	550,000
Cost (MV)	(200,000)
Gain	350,000

AEA if no other dispoals

AEA	(6,000)
Gain	344,000

BADR @10% 34,400

Pedro Termination Package

Statutory Redundancy 24,234

PENP Ex gratia 60,000

£60,000 PENP taxable to employment income as normal

£60,000 ex gratia

PILON

Diana Gain

Proceeds 220,000

Cost (800)

Gain 219,200

AEA if not other disposal

AEA (6,000)

Not qualifying for BADR as not employee

Purchase of own shares potential as no longer contributing to business but would require HMRC clearance to accept.

As Diana does not have BADR avialable may not be favourable either.

Could stage disposal in way of dividends but be aware that not favourable to Michael as no more dividends but could be option as reducing her shareholding

Henry Fall

Resticted Securities with contingency

6.5% increase

Cash At Bank:
611,200

(120,000)
(550,000)