

Institution **CIOT - ATT-CTA**

Course **CTA APS Owner-Managed Businesses**

Answer-to-Question-_1_

Plan

Charter Tax Adviser

Report for Julia Tillia

Anne and Robert to retire

Robert now full time again

Ownership to Simon

Want to gift to Simon (PETS?)

Gifted property in 2019. No Gain

Cash is £75k in excess of requirement

WRW not a JV company

Values to increase so earlier transfer the better

Sell warehouse. Should be done with shares so associated disposal for BADR

Only need to consider IHT on gift. Do not need to consider IHT on other points.

10% shareholding so eligible for SSE. Sell shares prior to gift, to receive more BPR?

Rent on investment property low compared to turnover so BADR likely.

Value of shareholdings is £362,500. Reserves > £362,500, so purchase of own shares possible for Anne

Report

From: Tillia Taxation

To: Anne and Robert Simpson

Date: 12 May 2022

Re: Proposed passing of company ownership to Simon

Introduction

As requested in your meeting with Julia Tillia on 22 April 2022, this report considers matters related to the proposal of gifting your respective shareholdings to Simon. In the report, we have considered the current position and what actions can be taken to

mitigate and tax implications.

Executive Summary

Gift to Simon

As Simon is a connected party, the gift of the company shares to Simon would be deemed to take place at market value (£362,500 each). This would therefore result in a taxable gain (Appendix A) and a resultant Capital Gains Tax (CGT) charge.

This CGT charge would be at either 10% or 20%, subject to whether Business Asset Disposal Relief (BADR) is available. I have commented further on this below.

In addition to the CGT implications, there would also be Inheritance Tax (IHT) implications on the share gifts to Simon. I have commented on these below.

Selling warehouse to Company

The proposed sale of the warehouse to the company would be a chargeable disposal for CGT purposes. This means that Robert would have a chargeable gain equal to the difference of the proceeds and the cost of the warehouse (£22,000). There are further implications that I have commented on below.

Gift to Simon without any action

CGT

If you were to both gift your shareholders to Simon, at the current position, you would both have a taxable gain equal to Appendix A.

As referenced above, this taxable gain would be subject to CGT at either 10% or 20% subject to BADR.

BADR is a CGT relief available where there is a material disposal of business assets. For shareholders, this is defined as selling shares in their personal trading company.

In order to qualify for the relief, an individual must have the following for at least 2 years prior to the disposal:

- 1) Ownership of 5% or more of the ordinary share capital
- 2) At least 5% of the voting rights
- 3) Entitlement to at least 5% of the distributable profits and assets on a winding up
- 4) Be an employee or officer of the company

The above conditions are met by both of you, however, whether Simpson Engineering Limited (SEL) is a trading company is more contentious. HMRC define a trading company as one with no more

than 20% of it's turnover and balance sheet being derived from non-trading activities.

The shares in WR Woodturning Ltd (WRW), excess cash reserves and the unit rented by the company would be deemed as non-trading. The income from WRW and the unit equate to £13,000, being less than 20% of the company's total income.

However, the value of the shareholding in WRW, the excess cash reserves and unit equate to 48% of the company assets, per the 2021 balance sheet.

Whilst the income levels are less than 20% of the company's total income, no single indicator is conclusive and my view is that 'in the round' the balance of the indicators points towards trading status.

It is possible to apply to HMRC for an informal clearance to confirm that the company is accepted as a trading company at the time of the clearance. However, I do not think that this is necessary.

Therefore, CGT would be at 10%, resulting in CGT payable of £34,020 for you both.

IHT

A gift of shares from one individual to another will be deemed to be a potentiall exempt transfer (PET) for IHT purposes. As a PET, provided you outlive the gift by 7 years, no IHT will be payable.

Further to the above, as shares in an unquoted trading company, the gifts would also be eligible for Business Property Relief (BPR). Ordinarily, shares in unquoted trading companies, would be subject to 100% IHT relief, provided they have been held for at least 2 years.

However, this relief is restricted if the company holds excepted assets. Excepted assets would include surplus cash and investments. We have calculated that relief would be restricted by 29% (Appendix B).

Given the above and Anne's expected life expectancy, Anne would likely have to pay IHT on a portion of the gift to Simon. As the property gift to Simon was also within the 7 year period, this would also be included as part of the IHT calculation. We have calculated IHT due on these transfers after deduction of your nil rate band (NRB) to be £47,050 (Appendix C).

As the company is due to increase in value, the later the gift is made, the more IHT will be payable on Anne's death.

As you can see from the above, if no action is taken prior to the gifts to Simon, there would be considerable CGT and IHT payable.

As neither of you would have received any consideration for the shares, tax on the gift is not ideal.

Stamp duty

As there is going to be no consideration on the share gifts, I do not expect there to be any stamp duty payable by Simon.

Disposal of Warehouse

In the current position, as the warehouse is used by the company for at least 2 years and no rent has been charged on this use; provided the warehouse is sold to the company in conjunction with the share gift, the warehouse will be treated as an associated disposal for CGT purposes.

This means the taxable gain on the warehouse would be subject to CGT at a rate of 10%, as it is deemed eligible for BADR.

Actions that can be taken

Gift to Simon

At present, the gifts to Simon would be subject to a dry tax charge (tax charge where no proceeds have been received). However, as the company is a trading company for tax purposes, you can both make joint elections with Simon for gift relief (GR)

can be claimed. This election would need to be made within 4 years of the end of the tax year of the gift.

GR is available where shares in an unquoted trading company is gifted. GR defers the gain of the gift, by deducting it from the base cost carried forward by the donee.

This means that there would no CGT payable on the gifts to Simon and Simon's base cost carried forward on the £1,000 shares would be £20,000.

For IHT purposes, it is important to reduce the restriction to BPR. This can be done by selling its's shareholding in WRW and the investment unit.

The gain realised on the investment unit will be subject to Corporation Tax (CT) at 19%, as this is a chargeable asset disposal.

As SEL holds a 10% share of WRW, the substantial shareholding exemption (SSE) will be available. This means, no CGT will be payable by SEL on the share disposal.

These disposals would increase the cash reserves held by the company but this would then be reduced by the proposed fixed asset purchases of the commercial vehicle, lathe equipment and the warehouse held by Robert.

As the company has made £10,000 annual contributions into your pension scheme, you will have unused annual allowance brought forward.

Assuming your income levels were at a similar level in prior years and a further pension contribution of £10,000 in the 2022/23 tax year, you will both have excess annual allowances of £120,000. The lifetime allowance for pension contributions is £1,073,100 so contributions at this level would not exceed this threshold.

Therefore, the company's excess cash reserves can be reduced further (likely to nil) by making up to £120,000 of pension contributions to your respective pension schemes. Should you contribute in excess of this £120,000 you will have a tax charge on the excess at your marginal rate of tax.

Please note that the pension contributions should represent a reasonable commercial level. If the contributions are deemed to be excessive, the company may not receive a deduction for a portion of the costs in its corporation tax return.

Alternatively, instead of pension contributions, the company could declare increased dividends to you both. This would also reduce the company's excess cash reserves. However, in order to reduce the company's cash reserves this would likely take your

respective income levels above £100,000. This would result in a tapered annual allowance and increased income tax charges. Therefore, I would not recommend this approach.

If excess cash reserves are reduced to nil and the investments in the company are sold, I would expect the share gifts to be eligible for BPR at 100%. This would then mean no IHT payable on this gift on Anne's death.

Disposal of Warehouse

The GR claim should not affect the aforementioned CGT position on the warehouse sale. Therefore, provided the warehouse is sold to the company in conjunction with the share gift, the warehouse will be treated as an associated disposal for CGT purposes.

Conclusion

To conclude, a gift of the shares to Simon without any action would result in significant CGT payable for you both. Additionally, due to Anne's life expectancy, there would likely be a IHT tax charge on the gift when she dies.

Therefore, I would recommend that the actions mentioned previously should be implemented, to mitigate the CGT and IHT implications of the gift.

The share gifts should then be finalised once these actions have occurred.

Appendix A - CGT on disposal

| | | | | | |
|------------------------|--|--|--|----------|--|
| | | | | £ | |
| Market value of shares | | | | 362,500 | |
| Less: | | | | | |
| Cost of shares | | | | (10,000) | |
| Chargeable gain | | | | 352,500 | |
| Less Annual Exemption | | | | (12,300) | |
| Taxable Gain | | | | 340,200 | |
| | | | | | |
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Appendix B - Business Property Relief restriction

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|--|--|--|--|---------|--|
| | | | | £ | |
| Excess Cash | | | | 75,000 | |
| Investments | | | | 210,000 | |
| Total | | | | 285,000 | |
| | | | | | |
| Percentage of above compared to total value of company | | | | 29% | |
| | | | | | |
| | | | | | |
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Appendix C- IHT on PET's by Anne

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|----------------|--|--|--|---------|--|
| | | | | £ | |
| Main Residence | | | | 337,500 | |
| Shares in SEL | | | | 362,500 | |

| | | | |
|--------------------|--|--|-----------|
| less BPR available | | | (257,375) |
| Total | | | 442,625 |
| less NRB | | | (325,000) |
| Gifts taxable | | | 117,625 |
| | | | |
| IHT @40% | | | 47,050 |
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