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Count(s)	Word(s)	Char(s)	Char(s) (WS)
Section 1	**2902**	**13393**	**16953**
Total	**2902**	**13393**	**16953**

Answer-to-Question-_1_

Ms Phoebe Tanner
Hack Marketing Ltd
West Lane
Big Town
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AC Accounts LLP

8 November 2021

Dear Phoebe,

I am writing to you in response to your letter dated 30 October 2021.

In this letter I have outlined the implications of disposing Hack Marketing Ltd (HML)to Market International Ltd (MIL) via a sale of trade and assets or sale of shares, and the implications of starting your own company with Dean.

The letter will cover the following areas.

1 - The transfer of La Mabelle

2 - Sale of trade and assets to Market International Ltd

3 - Sale of shares to Market International Ltd

4 - Extraction of funds

5 - Sale of Hack House

6 - Implications of New company with Dean

This letter is intended for the use of the directors at Hack Marketing Ltd (HML) only and liability is not accepted to others who rely on this letter.

1. Transfer of La Mabelle

There are a few options on how you could extract La Mabelle from the company. You could purchase the property from HML or HML could transfer the property to you. There would be no stamp duty land tax on the property due to the property being located in Switzerland and the market value.

Purchase the property from HML

If you purchase the property from the company for £117,000 you may need to raise capital to purchase the property. This may only be a short term loan as you will be receiving income on the sale of the business.

If your purchase the property from HML, then there will be a chargeable gain. As HML purchased the property before December 2017 the gain is reduced by indexation allowance, therefore the gain would be £48,351 (see appendix 1). This would be taxable to corporation tax at 19%, which would create a liability of £9,187.

Transfer the property to you

If HML transferred the property to you, then this would be treated as a dividend in specie. This means the market value of the property (£117,000) would be treated as a dividend to you. You would then be taxed on the dividend at 32.5% and then 38.1%. This is a cheaper option compared to purchasing the property from HML. The distribution would not be eligible for a deduction for corporation tax for HML.

If the transfer is treated as a dividend in specie then the other shareholders would be entitled to a dividend of the same value. This means Mary and Phil would be entitled to a dividend, however they could waive their rights to a dividend. Mary and Phil may feel they should be compensated if you are receiving the property. The property could be distributed a dividend in specie to all 3 of you, which would be the fair option and the property can remain in the family.

HML could transfer you the property as part of your employment income instead of voting for a dividend in specie. You would therefore be receiving a taxable employment benefit and this would be reported on your P11D for the tax year. You would then need to report this on your self assessment and would pay 40% and 45% tax on the benefit of £117,000. HML would then need to pay class 1A NIC on the this benefit at 13.8%, which would be £16,146.
This option would be quiet expensive as the income rates are higher than the dividend rates and the company would need to pay class 1A NIC.

Recommendation

I would suggest HML either transfers the property to yourself and Mary and Phil waive their right to a dividend, or transfer the property to all 3 of you equally.

This would mean the company would not get a corporation tax deduction for the dividend, however there would be no NIC on the dividend. The dividend would be taxed at the lower dividend rates compared to the income rates.

I would suggest you transfer this property as soon as possible this would mean the market value would not increase and it reduces the amount of non trading assets which are held in the company.

For the purpose of this letter I will assume the property has been transferred out of the company before the sale of either the trade and assets or shares.

2. Sale of trade and assets

If Market International Ltd purchased the trade and assets for £2,174,000 then HML would be chargeable to corporation tax at 19% on the income and gains.
After the other liabilities are paid and the debtors are collected then the remaining amount could be distributed to the shareholders.

Goodwill
The goodwill would be purchased for £1,200,000 and there is a nil base cost for the goodwill, so the gain is £1,200,000. There is no indexation allowance on this disposal as the cost is nil.

This gain would then be taxed at 19% for corporation tax.

<u>11-13 Rose Road</u>
When the warehouse was purchased a gain from the previous premises had been rolled over so the base cost of the warehouse is £240,000. If the property is sold for £625,000 then HML can claim indexation allowance up to December 2017. This means the gain on the disposal is £270,280 (see appendix 2).

There will be no VAT due on the disposal of the warehouse as the property is not new commercial property, which means it is older than 3 years old. Market International Ltd would need to pay stamp duty (SDLT) on the property, however as the seller you would not need to pay any SDLT

<u>Stock</u>
If the stock is purchased for £324,000 then it is being purchased for same as the cost of the stock. This means there is nil income from the disposal of the stock. So there is no tax on the sale of the stock.

<u>Plant and machinery</u>

As there is a tax written down value of £6,400 at 1 October 2021 and Market international are purchasing this for £25,000 there is a capital allowances charge of £18,600. There will be no written down allowances in the final period, so this capital allowance charge is taxable to corporation tax.

<u>Hack House</u>
This property is owned solely by Mary which means she will pay capital gains tax on the disposal and the company will not pay corporation tax on this disposal. I have discussed the amount of

capital gains tax due on this disposal later in the letter (see section 5).

Distributable amount and liquidation of HML

This means £1,488,880 would be subject to corporation tax due to the sale of the trade and assets of £282,887.

HML would then need to wind up the company, which there are two options for.

HML could be struck of the companies house list, which means when the distributable amounts after paying creditors and collecting money from debtors is over £25,000 then it will be treated as a income distribution. This would be taxable as a dividend and would be taxed at 32.5% and 38.1%. This would not be recommended as the dividend rates are higher than the capital gains tax rates.

The other option is to pay a liquidator to formally wind up the company. A qualified liquidator may cost around £5,000 which would be a deductible cost. The liquidator would collect the debts from your creditors and collect any amounts owed by debtors. Then this would be treated as a capital distribution.

VAT and other issues

As HML would no longer be making taxable supplies,it should deregister for VAT within 30 days of ceasing to trade.

HML will need to inform HMRC that the company is ceasing and will no long need to file a tax return.

We can assist you with both of the above issues if you do sell the trade and assets.

Recommendation

There would be corporation tax due on the income and gains on the disposal of trade and assets. I would suggest you hire a qualified liquidator to wind up the company so the distribution is treated as capital distribution instead of a dividend, as it will be taxed at lower tax rates.

3. Sale of share capital

Market International Ltd has suggested if La Mabelle is extracted out of the company then they may purchase the share capital instead of the trade and assets.

If Market international Ltd purchases the share capital they would offer a lower price of approximately £1,728,813. This is due to the company paying the corporation tax due on the transfer of La Mabelle and paying the creditors and bank loans. (see appendix 3)

This gain would then be taxed on the individual shareholders, after deducting their base cost. This would mean a higher amount of money which could be distributed to the shareholders.

VAT

As the transfer is of the whole business then this would be treated as a transfer of a going concern which is outside the scope of VAT. This is on the basis that there is no significant break in trading, the same kind of business is being carried out and the purchasers are VAT registered.

Therefore no VAT would be chargeable on the disposal of the shares.

Recommendation

I would recommend selling the share capital instead of the trade and assets if possible. This is because there will be a higher amount of funds which can be distributed and you will not need to hire a liquidator.

This would be the simplest option for all the shareholders.

4. Extraction of funds

When HML is sold then Dean is eligible to exercise his EMI options. This means he will become a shareholder and own 35 shares. I assume the shares are newly issued shares and not shares from another shareholder.

I means the shareholders will receive approximately £1,670 per share. This will be taxable to capital gains tax.

Mary

Mary would make a chargeable gain of £882,050 (£1,670@650 shares) on the disposal of her shares. As HML is a trading company, then Mary would be eligible for business asset disposal relief (BADR) if the following conditions are met, i) for at least 2 years before disposal she had worked for HML and ii) owned at least 5% of the shareholding (and voting rights).

As Mary meets the conditions for BADR, then she can claim this on the gain of her shares. This will mean her gains of up to £1 million will be taxed at 10%.

Phoebe

You would also be eligible for BADR on the disposal of your shares as you have worked for the company and owned at least 5% of the shareholding for at least 2 years.

This means after your annual exempt amount of £12,300 then your gain would be taxed at 10%.

Dean

When Dean exercises his options he will be subject to income tax as his options were offered to him at a discount. The employment income subject to income tax is the lower of the market value at the grant of the option and exercise less the amount he paid for the shares. This means £624 would be treated as employment income and would be taxed via PAYE. Class 1 NIC would be due on this amount from both Dean and HML.

This means the base cost of Dean's shares are the cost of the shares (£35) plus the amount subject to employment income (£21,840).

As he holds EMI share options they would be eligible for BADR even if he doesn't hold 5% of the shareholding if he has held the share options for over 2 years. This means if the company is sold and he exercises is options before 7 January 2022 he would not have held his options for 2 years and he would not be eligible for BADR.

I would therefore suggest if possible that the company is sold after 7th January 2022, so Dean can claim BADR on his gain.

5.Sale of Hack House

Hack House was purchased for £345,000 therefore the gain on the disposal is £340,000. This would be subject to capital gains tax at 20% due to Mary being a higher rate taxpayer.

As explained above Mary is selling her personal trading company so she would be eligible to claim BADR on her gain from her shares.

Hack House would be treated as an associated disposal for BADR, as Mary has sold her shares in HML, and as part of that disposal has sold an asset which is used in the business for at least the last 2 years and has been owned for 3 years prior to the disposal.

This means Hack House would be eligible for BADR at 10%, however this is restricted to the period when it was used in the business. As the property was owned since December 2001, then the period from 1 December 2012 until disposal would be eligible for BADR.

For the purposes of this letter if the sale takes place on 1 December 2021, then 9 years out of the 20 years would be eligible for BADR, which would be £153,000. The remaining gain of £187,000 would not be eligible for BADR and would be taxed at 20%.

I would therefore recommend that Mary claims BADR on the disposal of Hack House. She would need to claim this by 31st January 2024 if the disposal took place in December 2021. We would be able to assist her in doing this on her self- assessment return.

6. New company with Dean

If you start a new company with Dean in the sports marketing sector this is a similar sector that HML used to operate in.

There are specific anti avoidances rules which apply when an individual winds up a close company and was entitled to at least 5% of the shares and then within 2 years of the distribution owns at least 5% of shares in close company which carries out the same or similar trade.

The rules apply if it is reasonable to assume the main purchase of winding up the first company was the avoid tax and pay tax at the lower CGT rates instead of the income tax rates.

Based on the disposal of HML being due to your Mum wanting to retire and Phil no longer being involved in the business it seems unlikely that you would be caught by the rules. However you can get clearance from HMRC on this to ensure you are not caught by these rules.

Summary

I would suggest you firstly transfer La Mabelle to yourself. This would be treated as a dividend in specie, Mary and Phil will need to waive their right to a divined.

This dividend in specie would be taxed at the lower dividend rates. HML would not get a deduction for the dividend but would be taxed on the gain of £48,351.

I would then suggest that you sell the share capital to Market International Ltd instead of the trade and assets as this would lead to a higher amount being distributed the shareholders.

On the sale of the company Dean will become a shareholders as his options can be exercised, if the sale of shares occurs before 7 January 2022 then he would not be eligible for BADR on his disposal.

Mary and yourself would be eligible for BADR on the disposal of your shares and would be taxed at 10%. When Mary disposes of Hack House this will also be eligible for BADR.

The new company with Dean is in a similar trade to what HML used to operate however it appears unlikely you will be caught by the anti-avoidance rules.

Your sincerely,

Paul Links
Tax Partner, AC Accounts LLP

Appendix 1

Gains

Goodwill

Sale proceeds	£1,200,000
Less cost	nil
Gain	£1,200,000

11-13 Rose Road

Base cost = £325,000-£85,000= £240,000

Sale proceeds	£625,000
Less cost	(£240,000)
Less indexation:	
(240,000*(278.1-188.1/188.1)	
(240,000*0.478)	
	(114,720)
Gain	£270,280

Hack House

Sale proceeds	£585,000
Less cost	(£245,000)
Gain	£340,000

Business use for 9 out of 20 years of ownership.

£305,000*9/20 years= £153,000 gain is elgible for BADR.

La Mabelle

Sale proceeds £117,000

Less cost	(£49,000)
Less indexation:	
(49,000*(278.1-198.5/198.5))	
(49,000*0.401)	(19,649)
Gain	£48,351

Stock

Sale proceeds	£324,000
Less cost	(£324,000)
Income	nil

Plant and machinery

Tax WDV	6,400
Proceeds	25,000
CA charge	18,600

Appendix 2

Corporation tax

Goodwill	£1,200,000
11-13 Rose Road	£270,280
Stock	nil
Plant and machinery	£18,600
Profits suject to CT	£1,488,880

corporation tax@19%	£282,887

Proceeds	£2,174,000
Less corporation tax	(£282,887)
Less other liabilities	(£436,000)
Plus cash balance	£87,000
Plus debtors	£173,000
	£1,715,113

Appendix 3

Sale of shares

gain La Mabelle	£48,351
CT @19%	£9,187

Proceeds	£2,174,000
Less corporation tax	(£9,187)
Less other liabilities	(£436,000)
Proceeds for share sale	£1,728,813

£1,728,813 for 1,035 shares =£1,670 per share

Appendix 4

Base cost of shares

Mary
(£1*325)+(£625*325) =£203,450

Phoebe
(£1*175)=£175

Phil
(£1*175)=£175

Dean
Paid £1 for 35 shares
employment income
lower of

market value at grant and exericse	£625
Less cost	£1
Taxable	£624 per share
Total	£21,875

Appendix 5

gains

Mary
Shares -

650 *£1,670	=£1,085,500
Less cost	(203,450)
Gain	£882,050

Property-

gain	£340,000
Total	1,222,050

Less AEA	(12,300)
Taxable	1,209,750

Tax
£1,000,000@10%=100,000
209,750@20%=41,950
total 141,950

Phoebe
Shares -

175 *£1,670	=£292,250
Less cost	(175)
Gain	£292,075
Less AEA	(12,300)
Taxable	279,775

tax@10% =27,978

Phil
Shares -

175 *£1,670	=£292,250
Less cost	(175)
Gain	£292,075

not taxable as non resident.

Dean
Shares -

35 *£1,670	=£58,450
Less cost	(35)
less employment income	(21,840)
Gain	£36,575

less AEA	(12,300)
Taxable	£24,275