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

Event **NA**

Exam Mode **OPEN LAPTOP + NETWORK**

Exam ID

Count(s)	Word(s)	Char(s)	Char(s) (WS)
Section 1	**4870**	**23395**	**28175**
Total	**4870**	**23395**	**28175**

Answer-to-Question-_1_

NOTES - START OF ANSWER DENOTED BELOW

Report!

Exec summary:

- Company repurchases the shares off Pedro
- Company repurchases half of Diana's shares, giving an initial injection of proceeds, as well as continued dividends.
- Assign 2,000 restricted EMI shares to Henry on the back of the disposal of Pedro's shares.

Assumptions:

- Open value of £275 (would need to be agreed with HMRC)
- No changes to draft accounts

Sections:

- Removal of Pedro
- Removal of Diana
- Increasing shareholding of Henry Fall

Removal of Pedro:

- Three ways:
    - Sell shares to third party (not desired so not considered)
    - Company purchases the shares
    - Michael to purchase the shares

<u>Company purchase:</u>

- Capital treatment if conditions are met (should be met given that it'll be for the benefit of trade)
- Seek advanced clearance from HMRC
- Avoids double layer of taxation

Other matters:
- Income tax consequences for Pedro
    - Will have a deemed capital gain/loss of **£xxx(?)**
    - Income tax charge as a dividend.
    - Salary of £120,000 suggests HR, maybe treat as AR for the purposes of this (consider that Pedro has other income).
- Remuneration package
    - The termination packaged would also have consequences for the income tax liability for Pedro.
    - The £120,000 ex-gratia payment would fall under the 's.104 pool' of which the first £30,000 is exempt from income tax (and Class 1a NICs).
    - However, there are elements of this amount that includes PILON, PENP and SRP matters which must be considered.
    - PENP = £120,000 x 6/12 = £60,000 (will be PILON if terminated immediately)
    - SRP = £24,234
    - Ex-gratia payment = £120,000 - £60,000 - £24,324 = £35,676
        - Could be paid into a private pension to be an exempt benefit?
        - Consider NICs, PAYE, and CT deductibility.
- CGT consequences for Pedro
    - Disposal of shares is a chargeable event for CGT purposes
    - As set out, this would assume the share buy-back falls under the capital treatment.
    - Pedro has worked there and owns more than 5% of the shares for the past two years.
    - Consider the trading company status, but keep it brief.

- Therefore qualifies for BADR on the disposal.
- Gain = (£275 x 2,000) - (£40 x 2,000) - (£60 x 2,000) = £350,000 - £6,000 = £344,000.
- Assume full BADR lifetime limit remains then CGT would be payable at 10% so £34,400.
- If sold in the 2024/25 tax year, this would be payable on 31 January 2026.

- Stamp duty on sale of shares at 0.5% as proceeds exceed £1,000.

<u>Michael purchase:</u>
- Take out a loan (personal funds not available)
- If loan is taken out from the company then s.455 tax (explain conditions and consequences).
    - Likely to be expensive so not advisable.
- The taking out of a loan to purchase shares is qualifying and the interest payments can be deducted against Michael's total income in the tax year.

<u>Recommendation</u>
Company purchases shares using excess funds which will then also help entitlement for GR and BPR as cash is an excepted or non-chargeable asset.
Indirectly increase the shareholding percentage of Henry.

Removal of Diana:
- Gift shares to children (no proceeds so not worth considering - also doesn't dilute ownership). Is there a Will?
- Purchase of own shares - would be income treatment. Whilst subject to lower dividend

rates, would still be quite expensive overall.

- Husband died in March, is there a IHT liability? If so, POS could fall under the capital treatment if the proceeds were sought to be used to pay off an IHT liability.
- Do not want to increase dividend payments so not worth considering a different class of shares.
- Value of shares may be different from Pedro's given the smaller holding, so £275 might not be a completely accurate valuation.
- BPR/IHT?
- Chargeable gain of (£275 x 800) - (£1 x 800) = £219,200 - £6,000 = £213,200.
- Sell half of shares to maintain some dividend payment, whilst also giving a reduced CGT liability.

<u>Recommendation:</u> Sell half of shares to maintain some dividend payment, whilst also giving a reduced CGT liability.
Create Will to leave remaining shares to children - entitled to BPR.

Increasing shareholding of Henry:

- Increase if the company repurchased the shares of Pedro/Diana (as recommended)
- Values used throughout could be the amount of shares sold by Pedro (2,000)
- Share incentives
    - Non-tax advantaged share schemes
    - CSOP
    - EMI
    - SIP
- Non-tax advantaged

- Not really considered due to lack of tax benefits for Henry.

- SIP
    -
- CSOP
    - Grant CSOPs and no charge on the grant of an option
    - Must be held for three years to avoid any charge on grant, sold within 10 years.
    - Grant price must equal market value
    - Proceeds is the market value on exercise
- EMI
    - Charges to IT
    - Ensure BL is a qualifying company!
    - Qualifies for BADR after
    - Must be exercised in 10 years
    - Can be restricted to incorporate contingent element around turnover increase

- Stamp duty on exercise.

<u>Recommendation:</u> Restricted EMI shares on the condition that the company's turnover increases by 35% after 2 years.

Other considerations:

- VAT - does not seem relevant here
- IHT - only really relevant for Diana if at all
- Stamp Duty - covered with Pedro
- SDLT - not considered as no properties
- Election dates

- Payment dates
- NICs

ANSWER

From: Danny Pine, AD Accounting

To: Directors of Briggs Ltd

Date: 14 November 2024

Subject: Report on the removal of Pedro Hellas and Dianna Peach as shareholders of Briggs Ltd, and increasing the shareholding of Henry Fall

Dear Directors,

INTRODUCTION

This report has been prepared in response to the shareholder meeting for Briggs Ltd (BL) held on 19 October 2024, and the subsequent email from Michael Briggs on 20 October 2024. The report is intended for use by the current Directors and shareholders of BL, and liability is not accepted for others who may rely on the report.

The report is split into three sections: removal of Pedro, removal of Dianna, and then increasing the shareholding of Henry Fall. Advice and recommendations are given throughout the report, and summarised below.

The report assumes that the advised actions are taken in the 2024/25 tax year, and any rates/allowances mentioned remain the same in future tax years. It has also been assumed that the open market value of £275 per share for Pedro's holding is a reasonable figure. Other assumptions and limitations of the report will be based on the information provided in the aforementioned meeting and email.

EXECUTIVE SUMMARY

We recommend that the following actions are undertaken:

- We recommend that the company undertakes a share buy-back to purchase Pedro's entire shareholding. The timing of this does not matter, and can be taken with immediate effect if desired. This will help to minimise tax liabilities for all parties given the distribution will be treated as capital.

- We recommend that half of Dianna's shares are repurchased by the company. Whilst this is likely to give rise to an income distribution, it provides Dianna with funds and also retains her entitlement to a dividend in the future.

- It is also recommended that Dianna creates a Will to establish the allocation of the shares on her death. This avoids Capital Gains Tax being paid during a lifetime transfer, and Business Property Relief could be available on death for the recipient.

- Regarding increasing Henry's shareholding, we recommend offering restricted Enterprise Management Incentive scheme shares based on the disposal of the other shareholdings. This results in a highly-incentivising and rewarding outcome for Henry, and is in line with the company's targeted growth.

SECTION I: REMOVAL OF PEDRO HALLAS

Broadly speaking, there are typically three ways that Pedro's shares in BL could be disposed of:

1) Sell the shares to a third party;
2) BL repurchases the shares; or
3) Michael purchases the shares.

Further details around the remuneration package for Pedro has also been considered in part 4).

1) Sell shares to a third party

The first option has been noted as not being desired in Michael's email, so this has not been considered further.

2) Repurchase of the shares by BL

The company could offer to repurchase the shares from Pedro.

As this will be a connected purchase of shares, the disposal will take place at an open market value. A figure of £275 has been provided for this amount, but advanced clearance should be agreed with HMRC to ensure this is a fair open market value and avoid any future disputes. For the purposes of the below, this has been assumed to be a fair open market value.

The buy-back of shares from a director in an unquoted company (which BL meets the definition of by virtue of not being listed on any stock exchange) will typically be treated as a distribution and taxed as a dividend on Pedro.

Given Pedro's salary of £120,000 per annum, and assuming company dividends are also paid to him alongside potential other sources of income, it is likely that Pedro is an additional rate tax-payer. That is to say, his taxable income is above £125,140.

Default treatment

The dividends from this distribution would therefore be taxed at a rate of 39.35% (or 33.75% if there was any of the higher rate band left). This could prove to be very expensive, and as shown in Appendix I, this could result in an income tax liability of £137,332.

If treated as an income distribution, the disposal is may give rise to a capital gain/loss. The capital loss is unable to be offset against other income (such as the dividend distribution) and the losses can only be carried forward and offset against future capital gains. In the event of a chargeable gain arising, the Capital Gains Tax (CGT) arising will be payable by 31 January following the tax year of disposal of the shares (in this case, likely to be 31 January 2026).

Subsequently, there are two charges to tax under this method - one to income tax, and one to CGT, which is not tax-efficient for Pedro.

The distribution would have to be made from the cash reserves of BL, and as this is treated as a dividend, there would be no deduction for the amount paid from the company's trading profit.

Capital treatment

Provided certain conditions are met, for both Pedro and BL, the purchase of the shares by the company may be treated as a capital distribution.

The disposal of shares in this case would be a chargeable event for CGT purposes and would give rise to a chargeable gain or capital loss.

For BL to meet the conditions of a capital distribution, the following criteria must be met. I have also set out where the company does or does not meet this criteria for your reference:

- BL must be an unquoted trading company, which as mentioned above, it is; and
- The main, or one of the main reasons for the repurchase is for the benefit of trade. It is noted that Pedro's shares are being sold as Michael and Pedro are unable to continue working together as a result of the personal and professional disagreements. HMRC consider that disagreements between shareholders which prevent the furtherance of trade as a valid reason for the shares to be sold for these purposes, so this condition will also be met.
- The repurchase must not be for the avoidance of tax, which does not appear to be the case in this situation in light of the disagreement.

Further conditions must be met by Pedro in relation to the proportion of his shares being sold. These conditions, alongside relevant commentary regarding whether they are satisfied, are noted below:

- Pedro must be a UK resident in the tax year of sale, which he is in the 2024/25 tax year. It is unknown whether Pedro will remain UK resident in the future, but this assumes the share disposal happens before the end of the current tax year/as soon as possible.

- The shares must have been held for a period of five years, which has also been satisfied as the shares were purchased in 2016.
- Pedro's shareholding must be 'substantially reduced'. For these purposes, this means that Pedro's shareholding after the share buy-back must be less than 75% of his previous holding (i.e. less than 500 shares held). Given the facts of the matter, the sale of Pedro's entire shareholding will meet this requirement.
- Pedro must not be connected with the company after the share buy-back. This means his shareholding after the buy-back must be less than 30%. Again, assuming all of the shares are to be purchased, this condition will also be met.
- Pedro will also no longer be entitled to any of the profits if all of his shares are sold.

The above therefore shows that the distribution would be treated as a capital distribution for CGT, and not be subject to income tax.

On the disposal of the shares, Pedro may also be entitled to Business Asset Disposal Relief (BADR), which taxes chargeable gains at a rate of 10%, rather than the higher rate of 20%. BADR is available on lifetime gains up to £1 million so this does assume that none of Pedro's BADR lifetime limit has been used previously.

Pedro will meet BADR because he is disposing of a material business asset. The unquoted shares are a business asset for these purposes. In addition, Pedro has both owned more than 5% of the shares and has been an employee for the two years prior to the disposal.

BL will meet the conditions for BADR as it is unquoted and it is stated that the company meets the trading condition for these purposes. There is a slight risk that HMRC may be able to contend that the company is not trading due to the cash balance exceeding 20% of the total assets value. However, the cash does not appear to be generating any interest income, and there is no further information to suggest otherwise.

CGT will therefore be charged at 10%. As shown in Appendix I, this leads to a CGT liability of £34,400. This leaves Pedro with significantly greater after-tax proceeds under the capital distribution treatment.

There are no implications on the timing of this buy-back as the shares have already been held for the required five years.

Advanced Assurance

It is advised that advanced clearance is approved by HMRC in relation to the anti-tax avoidance provisions relating to whether the distribution fully meets the criteria for a capital distribution.

Corporation Tax

As the company has a significant cash balance, it can use these funds to buy the shares from Pedro. Again, no relief would be available via a reduction in the corporation tax profits and subsequent liability.

CGT due date

If the shares are sold in the 2024/25 tax year, the CGT liability would be payable by Pedro on 31 January 2026.

Stamp duty

As there is a purchase of shares, and the proceeds exceed £1,000, stamp duty would be payable by BL of £550,000 x 0.5% = £275. This is due within 14 days of the buy-back

3) Repurchase of shares by Michael

Michael could take out a loan to fund the purchase of Pedro's shares given that he has limited funds for these purposes.

Loan from company

Michael could take a loan from the company to fund the purchase of the shares.

BL meets the definiton of a 'close company' as there are fewer than five participators (shareholders). Given Michael's shareholding, he is also considered to be a participator.

There are special rules applied when a loan is made from a close company to a participator, provided the loan is more than £15,000 - which it will need to be in this case to fund the purchase given the open market value.

In this case, tax will be payable by the company at 33.75% on the amount outstanding on the loan as the usual payment date of corporation tax (nine months and one day after the end of the accounting period - 1 April).

Details of the loan are required to be disclosed on the supplementary page CT600A form within the company's tax return.

This would lead to a significant tax bill for the company of £185,625 (£550,000 x 33.75%) assuming no repayments were made before the due date.

There are also special provisions around 'bed and breakfast' loans which mitigate any loans that are written off before the due date, and then reassigned within 30 days of the due date for corporation tax.

If the loan is waivered or written-off, then this would be treated as dividend for Michael and taxed at his respective rates.

Given the increase in tax to either Michael, the company, or both, this approach would not be recommended.

Loan from unconnected provider

Alternatively, a loan could be sourced from an unconnected provider. This would have the effect of avoiding the above tax liability for BL.

Furthermore, any interest payments arising from the loan will be for a qualifying purpose and the gross amount will be deductible in Michael's income tax computation.

This approach is still particularly expensive for Michael, and would require the loan to be secured against significant assets, so this would not be advisable.

4) <u>Termination package for Pedro</u>

The termination package proposed for Pedro would also have Income Tax consequences.

Broadly speaking, there are three types of treatment for payments made in a termination package: taxable, exempt and the s.104 pool. Under the s.104 pool, the first £30,0000 are exempt, with the remainder taxable and subject to Class 1a National Insurance Contributions (NICs) from BL.

The £120,000 salary payment comprises various payment types which have different impacts and treatments for these purposes.

Part of the payment will be Post-Employment Notice Pay (PENP) which relates to the amounts that are paid to Pedro after notice has been given. If Pedro is terminated immediately, then the amounts would all fall under Payment In Lieu Of Notice (PILON) rather than PENP.

PENP falls under the s.104 pool, and PILON is fully taxable so the distinction is important.

Also, the Statutory Redundancy Pay (SRP) must be deducted from the salary payment and will also be allocated in the s.104 pool.

Assuming Pedro is terminated immediately, the PILON will be £60,000 (£120,000 x 6/12), given the notice period of six months. This also means there will be no PENP.

The PILON will be taxable in full and deemed as earnings so subject to primary and secondary Class 1 NICs.

The remaining amount of £35,676 (£120,000 - £60,000 (PILON) - £24,324 (SRP)) will be the ex-gratia payment. This means the total amount for the s.104 pool will be £60,000 (£24,324 + £35,676).

The first £30,000 of this £60,000 will be exempt from Income Tax/PAYE/NICs, but the excess will be subject to Class 1a NICs as a benefit-in-kind.

Payments to an approved pension provider on behalf of the employee is an exempt benefit. It is recommended that BL considers paying some of the termination payment (£120,000) as a pension contribution to help further minimise the tax liability for both the company and Pedro.

Coproration Tax

The payments outlined above are all deductible for corporation tax, provided the SRP is less than three times the statutory amount.

Where Class 1 secondary NICs are payable, these are also deductible from the company's trading profits.

5) <u>Recommendation</u>

It is recommended that the company repurchases the shares as this will likely give rise to the capital treatment and give the most tax-efficient outcome for the company and for Pedro.

Further consideration of the termination package should be considered to see if a pension contribution would be appropriate to minimise the Income Tax payable.

SECTION II: REMOVAL OF DIANNA

As with Pedro, there are the same three methods apply to the removal of Dianna, and these are considered below. Further considerations are also given to the disposal of the shares given Diana's health conditions throughout.

1) Sell shares to a third party

The first option has been noted as not being desired in Michael's email, so this has not been considered further.

2) Repurchase of the shares by BL

Capital treatment

The same conditions apply for Dianna as they did with Pedro. Similarly, it appears that all conditions remain to be met for Dianna, with the exception of the disposal being for the a benefit of trade. This is because Dianna is said to get on well with the other shareholders, and Dianna is not an employee so does not contribute to operations.

With Dianna's husband passing in March, there may be an Inheritance Tax (IHT) liability to be settled. As Dianna is struggling for cash, the disposal of shares may be required to generate income to pay this liability. In these circumstances, this would give rise to the distribution being treated as capital.

However, as this information has not been given clearly, it is assumed this is not the case and that the income treatment applies.

Income treatment

The same conditions would apply as with Pedro, but this time, the base cost would be £800 (800 x £1).

Dianna has a smaller shareholding than Pedro, so it would be reasonable to assume that the open market value of Dianna's shares are lower than Pedro's. However, given that neither of them have control over the company, or lose control on disposal, the same market value of £275 has been used below.

Again, it is worth seeking advice from HMRC to agree the open market value for these purposes. If an enquiry was opened and a different open market value was determined, penalties and interest may be applied on the potential tax lost.

Disposal of Dianna's entire shareholding would therefore give rise to proceeds of £220,000 (800 x £275), and a chargeable gain of £219,200 (£220,000 - £800).

Whilst Dianna is also likely to have the remaining lifetime BADR allowance available, it will not be applicable under these circumstances. This is because Dianna has not been an employee of BL for the two years prior to disposal, despite owning more than 5% of the shares.

3) <u>Purchase of shares by Michael</u>

The same factors would apply as previously, and despite a smaller loan being required, it would still lead to significant risk and exposure with the loan repayments.

4) <u>Gift of shares</u>

Dianna could gift her shares to Michael, or to her children. This could be done in lifetime and be a Potentially Exempt Transfer (PET), or at death (if this is considered to be in the near future with worsening health conditions).

The shares would qualify for Business Property Relief (BPR) provided they are still held by the donnee on Dianna's death. The rate would be 100% on unquoted shares so there would be no IHT payable.

BPR may be restricted to the extent that BL has 'excepted assets'. Excepted assets for these purposes includes cash and other investments. These activities cannot be more than 50% of total assets, and the company currently meets these conditions.

As this gift affects the donnee by effectively passing on the CGT liability to them (via reduction in the base cost of the shares), the election must be joint.

To be passed over at death, a Will would need to be created by Dianna setting out who the shares would go to. It is recommended to seek legal advice if this option is taken.

5) Recommendation

We would recommend that the company buys half of Dianna's shares, and Dianna creates a Will to gift the remaining shares to Michael or her children in the future.

Selling part of the shares now generates significant proceeds (£109,600 before CGT liability of approximately £20,720), whilst also ensuring consistent income through the remaining dividends.

Without increasing current dividend payments, the current dividend could be maintained on the new holding. If this caused complications, a new subset of 'alphabet' shares could also be created to retain the fixed dividend.

SECTION III: INCREASING SHAREHOLDING OF HENRY

Following the above actions, the repurchasing of Pedro's and some of Dianna's shares will inherently increase the shareholding percentage of Henry.

In addition to this, tax-advantages shares could be offered to Henry in order to incentivise his performance and protect him from leaving the company. These are considered further below:

1) Non-tax advantaged share options

Shares could be offered to Henry at a certain price in the future subject to the turnover of the company increasing. Without following any of the other tax-advantaged schemes (see below), this would not have a direct benefit to Henry in terms of Income Tax/CGT savings on disposal. With this in mind, it has not been considered further.

2) Company Share Option Plans (CSOP)

The company could offer shares under a CSOP, which gives Henry the right to buy shaers in the company in the future at a set price.

There are no Income Tax consequences on the grant of a CSOP.

The shares must be held for three years to avoid any Income Tax and CGT on the exercise of the grant. CGT can be avoided by only exercising the options on the date they are sold as the market value on these dates will be the same.

CSOPs are restricted in value to £60,000 being the maximum that can be offered to an employee. Assuming all of Pedro's shares (2,000) are put towards the CSOP, at their current open market value of £275, this would exceed the amount that can be granted in terms of value.

The shares cannot be hold, or the options be granted for more than 10 years in advance.

It is therefore not recommended to use these as it will not be in line with the target revenue growth across the next two years.

3) Enterprise Management Incentive (EMI)

EMI shares operate similar to CSOP, but they can be held for two years before grant.

There are charges to Income Tax on grant and on exercise if the price offered is less than the market value at this date.

In addition, the eventual disposal of the shares will qualifying for BADR if they are disposed of after two years. This also assumes that BL remains a qualifying company for BADR purposes (it remains trading), Henry owns more than 5% of the shares (he currently does not) and Henry remains an employee throughout this period.

If any of these conditions cease to occur, this is a disqualifying event, and the tax-advantage of the shares will be forfeited.

EMI shares can also be restricted to certain conditions. This will be particularly favourable as the contingent aspect of the turnover increasing can then be incorporated into the EMIs being valid for tax relief. This will ultimately help to retain Henry and incentivise his performance for the next two years.

Unlike CSOP shares, the maximum value that can be granted for EMI shares is £250,000. Although this still would not allow the full allocation of Pedro's sold shares based on current open market value, it would allow for a greater incentive for Henry to increase the value of the shares before disposal.

It is likely that stamp duty would need to be paid on the exercise of the shares as they are likely to be more than £1,000 in value.

5) Recommendation:

It is recommended that restricted EMI shares on the condition that the company's turnover increases by 35% after two years are granted to Henry.

This allows him to benefit from tax relief on grant and on disposal, and the greater value offered by EMI shares (up to £250,000) will be a greater incentive for him to stay at BL.

In addition, these shares will be in line with when the company's targeted revenue increase goal will occur (two years). The EMI shares also provide the potential relief for BADR based on the aforementioned requirements continuing to be held throughout this two year period.

SECTION IV: CONCLUSION

As noted, based on the available information made available, we recommend the company and individuals undertake the actions outlined above and summaries in the Executive Summary.

I trust you find the above information useful and I look forward to hearing from you in due course.

Yours sincerely,

Danny Pine

Appendix I: Purchase of Pedro's shares

	Workings	Income tax treatment (£)		CGT treatment (£)
Proceeds	£275 x 2,000	550,000		550,000
Less: price paid	£60 x 2,000	(120,000)		(120,000)
Less: amount charged to income tax (N1)	£40 x 2,000	(80,000)		(80,000)
Gain		350,000		350,000
Dividend allowance/Annual Exempt Amount		(1,000)		(344,000)
Income tax liability	£349,000 x 39.35%	£137,332		

CGT liability	£344,000 x 10%			34,400

N1: The shares appear to have been granted as a result of Pedro's employment in the company (rather than any connection with the shareholders). As a result, Employee Related Securities (ERS) apply to the acquisition. Given that the shares were purchased for less than the market value (£60 against £100), the difference of £40 per share would have been charged to income tax on purchase.