



Share Buybacks: Tax Planning and Pitfalls

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Why?

- / Retirement?
- / Dispute?
- / Cash extraction?

Tax treatment

- / Distribution
- / Not a distribution (“capital”)

Distribution?

BKL Property Investments (2019) Ltd	
Share capital £100	Investment property £1m
Share premium £1m	Cash £100

50 shares being bought back for £500,000
Income or capital distribution?

Distribution – basic law

Includes (see CTA 2010 s1000(1)A(b))

“any other distribution out of assets of the company in respect of shares in the company, **except however much (if any) of the distribution... represents repayment of capital on the shares...**

Purchase of own shares

A payment [that would otherwise be a distribution and is] made by a company on the redemption, repayment or purchase of its own shares is not a distribution if

- / The company is an unquoted trading company (or the unquoted holding company of a trading group) and

- / Either Condition A or Condition B is met

“Trading company” / “Trading group

- / Business of the company / group consists wholly or mainly of carrying on a trade or trades

- / “Trade” doesn’t include dealing in shares, securities, land or futures

- / Contrast definition for Entrepreneurs’ Relief purposes (activities do not include “to a substantial extent” non-trading activities)

Clearance brings clarity

- / Company may apply for clearance
- / Before making payment
- / Not compulsory
- / Clearance is “either way” (i.e., income or capital)
- / Clearance is “full” (not merely on whether tax avoidance is involved: contrast TCGA s138)

Condition B: Paying an IHT bill

The whole or substantially the whole of the payment (apart from any sum applied in paying CGT on the redemption, repayment or purchase):

- / Is applied by the person to whom it is made in discharging a liability of that person for IHT charged on a death and
- / Is applied in that way within two years after the death and
- / The liability could not have been discharged otherwise than through the redemption (etc) of shares in the company or in another unquoted trading company (or holding company of a trading group)

Condition A: Trade benefit route

- / The redemption etc is made wholly or mainly for the purpose of benefiting a trade carried on by the company or any of its 75% subsidiaries; and
- / The redemption etc doesn't form part of a scheme or arrangement to avoid tax; and
- / The objective requirements in s1034 to s1043 are met
 - / Residence
 - / Period of ownership
 - / Substantial reduction
 - / Lack of post-transaction connection

Benefiting the trade

- / Retirement
- / Death
- / Withdrawal of finance
- / Falling-out
- / Implications of
 - / Continued directorship
 - / Retention of shares
 - / Consultancy

The objective conditions: residence, period of ownership

- / The seller must be UK resident
- / Any nominee must also be UK resident
- / The shares being sold must have been held for at least five years
 - / Shares acquired earlier are taken into account before shares acquired later
 - / Any previous disposal is assumed to be of shares acquired later rather than of shares acquired earlier
- / CGT “no-disposal” fiction on reorganisations applies (except rights issues or stock dividends)
- / Shares acquired from spouse treated as acquired when spouse acquired them (unless separated in the interim)
- / Inherited shares treated as acquired when deceased acquired them (and only three years’ ownership required)

The objective conditions: substantial reduction

- / There must be a “substantial reduction” in
 - / Seller’s interest
 - / Aggregate interest of sellers and associates
- / Substantial reduction if “subsequent interest” does not exceed 75% of “prior interest”
- / Interest (subsequent or prior) =
$$\frac{\textit{Total nominal value of shares owned}}{\textit{Issued share capital of company}}$$
- / NB alternative test by reference to fractional entitlement if the company were to distribute all its profits
- / No test of votes but retention of significant voting influence would be likely to fail trade benefit test

The objective conditions: substantial reduction

- / Vendor owns 50 out of 100 shares
- / Sells 30% of his holding (15 shares)
- / Prior interest = $\frac{50}{100} = 50\%$
- / Subsequent interest = $\frac{35}{85} = 41.18\%$
- / Not a “substantial reduction” as $\frac{41.18}{50} = 82.35\%$

The objective conditions: no connectedness

- / Immediately post-sale, must not be “connected” with company or a group company
 - / Over 30% of issued share capital (by nominal value)
 - / Over 30% of loan capital plus ISC
 - / Over 30% of voting power
 - / Rights entitling you to more than 30% of assets available to “equity-holders” on winding-up or any other circumstances
 - / Rights and powers of “associates” are attributed
- / No scheme or arrangement in place for seller or associate to have disqualifying interests
- / Anything occurring within a year of repurchase is deemed to be part of a scheme or arrangement existing at the time of the repurchase

The objective conditions: relaxation

/ Special rule for a seller

/ For whom the substantial reduction test or the connectedness test is not in fact met but

/ Who agreed to the repurchase in order that the test(s) could be met in regard to a repurchase from an associate

/ Share capital 100

/ Vendor holds 50

/ Associate holds 20

/ Others hold 30

/ Buybacks

/ 50 from Vendor – would leave associate with $\frac{20}{50} = 40\%$, leading Vendor to fail connectedness test

/ So Associate sells 8, to reduce shareholding to $\frac{12}{42} = 28.57\%$

/ Associate gets capital treatment despite himself failing substantial reduction test (in fact Associate has increased from 20% to 28.57%!)

Post-transaction notification

- / Where “capital” payment made, company must notify HMRC
 - / Within 60 days
 - / Regardless of whether clearance sought
- / Max penalty £300 for failure or £3,000 for getting it wrong

Company law

- / Leaving the proceeds outstanding
 - / Companies Act 2006 s691(2):
 - / “Where a limited company purchases its own shares, the shares must be paid for on purchase.”
- / Getting it wrong
- / Baker [2013] UKFTT 394 (TC)

Alternative

- / Acquisition by Newco
 - / Share for share for “staying” shareholders
 - / Cash / loan for leaving shareholders
- / Advantages
 - / No restriction to trading companies
 - / No minimum ownership period
 - / No “substantial reduction” requirement
 - / No “connectedness” requirement
- / Why not?
 - / Transaction in securities
 - / Potential for charge on “loan to participators”