An alternative to dead man’s shoes?

In a discussion about the tax implications of the sale of a family company, the controlling shareholder muttered, “The most effective tax planning is for me to die.”

This gloomy verdict is typical of the approach of many taxpayers in a similar position. A large potential capital gains tax (CGT) liability on the sale of a company held in the same ownership for many years, often deters a substantial shareholder from making a disposal during their lifetime.

If, however, the stake is retained until the shareholder’s death, there is no CGT on its transfer or sale, and business property relief should ensure that there is no inheritance tax liability. This can lead to inertia where, from a purely commercial perspective, a business could have benefited from a change in ownership sooner rather than later.

An opportunity has arisen however, which provides an attractive alternative to such ‘death-bed’ tax planning. The Finance Act 2014 contains a new statutory tax relief which introduces a 0 per cent CGT rate for certain types of business disposals.

The intention behind this tax relief is to encourage more companies to become employee-owned and is likely to be of particular relevance to businesses whose owners are approaching retirement. Disposing of the business to employees who have been involved in its growth and who are more likely to share the same ethos as the current owners might have greater appeal than a sale to a third party, especially if this can be achieved on a tax-efficient basis. Research shows that employee-owned companies outperform other companies in several ways, and the government wants to encourage more employee ownership.

The 100 per cent relief operates where a controlling interest in a company is sold to an employee ownership trust (EOT), which must meet certain conditions. The key conditions are, broadly, that the company must be trading, and that all employees must benefit on the same terms. The EOT cannot confer disproportionate benefits to the advantage of particular employees, although it can allocate benefits of differing amounts by reference to objective factors such as salary, length of service or hours worked.

While there have recently been more sales to an employee trust as a means of ownership succession, this approach is not yet widely understood. However, it is generally no more complex than a trade sale and is usually simpler. One important practical point is that a seller or sellers wishing to benefit from full CGT relief on the sale of 100 per cent of their company will need to ensure that the EOT buys the entire holding in a single tax year.

When the only other alternative to completely escape CGT is to wait until your death, this seems a small price to pay.