

A FAIR AND EFFECTIVE SOLUTION - IMPLEMENTING A MINORITY SHAREHOLDER EXIT

The JDC Practical Solutions series



JDC Corporate Finance



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ISSUE OPPORTUNITY SOLUTION

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About JDC Corporate Finance

JDC is a leading independent corporate finance and advisory firm, with an impressive reputation as experts in our field, providing transaction and related corporate advisory and tax planning services to owner managed businesses.

Our team combines a wealth of corporate finance, corporate advisory and taxation experience, offering our clients a range of services to suit their needs and the needs of their company at all stages of its evolution and development.

We are instructed as advisers for both sell-side and buy-side clients in corporate transactions, including outright and partial disposals to trade and private equity purchasers; acquisition mandates to achieve growth objectives; MBOs/MBIs and minority shareholder exits.

We are also specialist advisers in succession solutions and related planning matters and by offering a tailored approach and working with clients for the long term, we remain the retained advisers of choice to many growing and enterprising businesses.

Our specialist skills, experience and ability to deliver integrated advice in a clear, concise, hands-on and cost-effective manner are the primary differentiators that set us apart from the competition.

About the Practical Solutions series

In this series of guides, Jon Dodge and Tony Longman have reflected on the tax aspects of certain key issues that they have, in their combined professional experience of over 50 years, encountered again and again and know to be of particular concern to owner managers.

This series (by reference to tax legislation current at May 2016) focuses on capital value extraction (with or without a 'third party' sale) from a privately owned business; key planning considerations in securing Entrepreneurs' Relief; issues that might arise on the departure from a business of a retiring or dissenting shareholder; the attraction, retention and reward of key people in a tax effective way and inheritance tax planning in relation to the value of a privately owned company.

We hope that the series will be of value to you and would be delighted to discuss any of the issues raised with you in more detail, on an entirely confidential and no obligation basis.

Achieving a mutually agreeable exit for a minority shareholder can be one of the most difficult problems a private company can encounter.

Whether in the context of an established multi-generational family business, a parting of the ways for original founding shareholders, the need to ensure succession from within the management team or a complete breakdown of shareholder relations the need to find a fair and effective solution is paramount.

The simple solution is for the continuing shareholder(s) to offer to purchase the shares of the departing shareholder. Simple – but not very tax efficient. Where a private purchase of shares is not possible, an alternative resolution needs to be found.

In most cases, to facilitate a minority shareholder exit it is desirable if the company itself funds the acquisition. This can be achieved in two ways:

- A company share repurchase, or
- Using a new company.

In both cases, the purchase funds are derived from the company itself with no tax charge associated with extracting the funds.

With the correct structure the selling shareholder achieves a low tax rate on the sale making it easier and cheaper for both parties to negotiate an acceptable deal.

JDC Corporate Finance is a specialist East Anglian based corporate advisory and transaction practice with particular expertise in designing and implementing tax effective strategic plans for businesses and balancing these plans with the personal objectives of the shareholders.

In this guide we have summarised two tax efficient solutions to deal with the problem of a departing minority shareholder and would be delighted to discuss these with you in more detail if the circumstances we have described might be relevant to your situation.

IMPLEMENTING A MINORITY SHAREHOLDER EXIT: THE TECHNICAL ANALYSIS

Company Share Repurchase

On a company share repurchase, the shares being bought are cancelled and cease to exist, so the continuing shareholders benefit from a consolidation of the issued share capital on a 'pro-rata' basis to one another.

A company share repurchase is cost-effective and straightforward but has the following risks/requirements:

- The company must have sufficient profit reserves to undertake the repurchase.*
- The company must (usually) pay for the shares in full at the time of the repurchase.*
- In limited circumstances it is possible to undertake a phased repurchase although the terms (including the price) must be fixed at the outset.*
- The balance sheet value of the company will reduce as a consequence of the repurchase.*
- After the repurchase the outgoing shareholder must not be 'connected' (as defined by legislation) with the company.*

The Tax Analysis

• No tax liabilities or negative tax consequences arise for the continuing shareholders.

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• The receipt is taxed on the selling shareholder at dividend income tax rates unless the stringent tax conditions for capital treatment are met. If capital treatment is achievable then providing the conditions for Entrepreneurs' Relief are met, the potential tax rate reduces to 10%.

• If the receipt is taxed as a dividend, unless the shares were acquired by way of subscription for new shares, it is typically the case that the selling shareholder is taxed on an amount which exceeds his gain on the shares.

• There is a tax clearance procedure to give certainty in respect of the seller's tax position. This is particularly advisable if capital tax treatment is required.

• There is a more relaxed tax regime where shares are repurchased after the death of a shareholder.

• Stamp duty is payable on the cash consideration (at 0.5% of the consideration).

Using a New Company ("Newco")

If the conditions for a tax efficient company share repurchase are unachievable (for example, one of the conditions necessary to achieve capital treatment, but which cannot be met in many cases, is a five year ownership condition) or is commercially undesirable, it is possible to achieve a tax efficient outcome by undertaking the following steps:

- Set up a new company ("Newco") with founder shares.*
- Newco acquires all the shares in the existing company.*
- Consideration is paid in cash to the exiting minority shareholder(s).*
- Consideration is paid in the form of an issue of Newco shares to the continuing shareholder(s).*

This leaves the continuing shareholders with a proportionate shareholding in Newco which now owns 100% of the original company. The cash to fund the purchase can be provided by the original company by way of loan to Newco or by way of external borrowings by either company.

Because of the use of an additional company and the complexity of the share exchange, the costs are higher than for a company share repurchase. Tax clearance from HMRC is essential.

The Tax Analysis

The Newco solution has the following advantages/disadvantages:

- No tax liabilities or negative tax consequences for the continuing shareholders.*
- It is usually straightforward to achieve capital treatment for the selling shareholder, thus resulting in a 10% tax rate where the conditions for Entrepreneurs' Relief are met.*

The terms for the share purchase are very flexible and can include deferred consideration, and/or additional consideration payable by reference to future company performance - an "earn out".

It is possible to acquire the dissenting shareholders' shares in tranches.

The transaction can take place regardless as to the availability of reserves and the balance sheet of the original company is unaffected.

Statutory tax clearances are necessary to ensure that the tax outcome is certain.

Stamp duty is payable on the value of all the consideration (the cash and the Newco shares) at a rate of 0.5%.

Interested? Please call or email us to find out more.

OUR SPECIALIST SERVICES

Acquisitions

Whether a first time purchaser, a serial acquirer or an MBO/MBI team, we have the knowledge and experience to assist in all aspects of the acquisition process including:

target searches • target appraisal • valuations • funding • due diligence • negotiation • deal structuring • integration strategy.

Business Growth

Through our business growth services we provide external advice or hands-on interim management support to a wide range of clients. Our services include:

business plans • financial projections • refinancing • tailored MI • non-exec services • cash flow management • development strategy • turnaround.

Disposals

We specialise in advising on full, partial or structured exits, retirement sales, divestments and equity release. Our services include:

pre-sale advice and preparation • information memoranda • contacting targets • negotiating and structuring the deal • advising on post deal issues • accelerated M&A.

Reorganisations

The restructuring of a company or a group of companies involves financial, structural, strategic and tax based considerations. We are specialists in:

financial restructuring and refinancing • de-mergers • divestments • succession planning • capital extraction including company purchase of own shares.

Private Equity

We are very well connected to many private equity and venture capital funds and focus on matching the best placed investor to the right deal. We can help with:

pre-investment preparation • deliverable deal structures and IRR models • investor profiling • business plans and sensitised financial models • leading management presentations • negotiating the deal • project management • advising on post deal issues.

Specialist Tax

Understanding the tax planning opportunities and avoiding tax traps and pitfalls is at the core of all our planning work. We are specialists in:

all aspects of transaction tax • corporate reconstruction • share option arrangements • investment and reinvestment relief • tax effective income extraction • tax effective capital extraction • inheritance tax planning • specialist tax clearances.

CONTACT US

Talk directly with any of our senior team:



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