

Purchase of own shares by non-quoted companies – tax implications for employees selling shares

The Companies Act 2006 (Amendment of Part 18) Regulations 2013 (SI 2013/999), which came into force on 30 April 2013, amended the regulations for purchase of own shares (POS) by a non-quoted company. The text of the regulations can be found at:

<http://www.legislation.gov.uk/ukxi/2013/999/contents/made>

This guidance note highlights some of the main tax issues that may arise where employees – including employees leaving a company – sell shares to their employer under arrangements facilitated by these regulations. Its main focus is tax implications for individuals, rather than businesses.

Distribution or capital?

Companies need to determine whether or not a POS is a distribution of the company's funds. Where a company buys back its shares the purchase price is normally a distribution to the extent that it exceeds the amount subscribed for those shares, and is therefore taxable as income of the recipient.

However, there are exceptions. Where a company's POS is made for the purpose of benefitting the company's trade, and other conditions are satisfied¹, the POS is not a distribution. Any money paid out for the shares is treated instead as capital in the hands of the recipient, and potentially subject to capital gains tax (CGT).

All employees in identical circumstances will attract the same tax treatment when they sell shares to their employer. But where individual circumstances differ, this may give rise to differences in tax treatment. For instance, the period of time for which an employee has held the shares may affect whether any sales proceeds are taxed as distributions or capital.

HMRC's guidance on distributions of company funds and on POS can be found at:

<http://www.hmrc.gov.uk/manuals/ctmanual/CTM15000.htm>

¹ For example, the vendor must: be resident in the UK, not be connected to the company after the sale, and have a minimum period of ownership of the shares). An employee is connected for this purpose if he possesses more than 30% of the ordinary share capital, loan capital or voting power of the company.

HMRC operates a statutory clearance procedure to help clarify the position for companies purchasing their own shares.

Instalment arrangements

Where shares are sold to the company in return for a series of instalment payments, any unpaid future instalments are liabilities of the company, akin to loans to it from the employee who has sold the shares. Such liabilities may need to be taken into account when considering whether the employee is connected to the company for the purposes of the distribution rules.

However, where capital treatment is appropriate, the relevant disposal value for CGT purposes where shares are sold via a single unconditional contract is the full amount receivable for all the planned instalment payments. This can be amended at a later date if the full amount is not actually received.

HMRC's guidance on capital gains tax can be found at:

<http://www.hmrc.gov.uk/manuals/cgmanual/CG10200c.htm>

Readily Convertible Assets (RCAs)

Where a charge to tax as employment income arises in relation to employee shares the employer needs to consider whether those shares are RCAs at that time. The new POS regulations do not themselves make shares into RCAs: the status of shares as RCAs is determined with reference to the full facts. If the shares are RCAs then income tax and NICs should be reported and paid through the PAYE system.

HMRC's guidance on RCAs can be found at:

<http://www.hmrc.gov.uk/manuals/eimanual/EIM11855.htm>

Employment income tax charges on shares

The new POS regulations will not themselves give rise to an employment income tax charge for employees holding shares. However, certain events facilitated by the regulations may trigger such a charge, as set out below.

Lifting of a restriction on shares

Restricted shares are those that have conditions, limitations or requirements attached that reduce their value. An example is a limitation on the ability to sell the shares for a period. Where an employee holds restricted shares by reason of their

employment, the introduction of a POS arrangement could constitute the lifting of a restriction, and income tax may become due.

For example: If there is a restriction on employees' shares preventing their sale, and as part of implementing a POS scheme to buyback shares from employees the company lifts that restriction on all or certain shares, a tax charge may arise where the restriction is lifted, to the extent that the lifting of the restriction increases the value of the shares.

There may be a further income tax charge on disposal if there is a distribution of company funds.

HMRC's guidance on restricted shares and income tax charges can be found at:

<http://www.hmrc.gov.uk/manuals/ersmmanual/ERSM30000.htm>

Shares sold not at market value

Income tax charges may arise where employees sell shares acquired as part of their employment at a value in excess of market value. This includes sales under POS arrangements. HMRC's guidance can be found at:

<http://www.hmrc.gov.uk/manuals/ersmmanual/ERSM80000.htm>

Share options

Under the general rules for taxing employee shares provided by as part of employment, the exercise of an option or right to receive shares by an employee gives rise to an income tax charge. HMRC's guidance can be found at:

<http://www.hmrc.gov.uk/manuals/ersmmanual/ERSM110000.htm>

Such an exercise of share options by an employee prior to a purchase of their shares by the company may result in two income tax charges: one on exercise of share options and another if there is a distribution of company funds.

Close companies

The ability of a company to hold shares in treasury may affect its status as a close company² for tax purposes. This could affect the company's tax position in a range of different ways, including by:

- Extending the meaning of distribution to include certain benefits that may be disguised distributions of profits to shareholders of their families;
- Generating tax charges in respect of certain loans made to shareholders, which could represent the extraction of profits without payment of tax;
- Imposing restrictions on close companies that are close investment holding companies (broadly companies that are not trading companies or investment companies) which mean they are charged at the main CT rate and not the small profits rate.

HMRC's guidance on close companies can be found at:

<http://www.hmrc.gov.uk/manuals/ctmanual/CTM60000.htm>

Stamp duty

Stamp duty is generally payable on sales of shares. Further guidance can be found at: <http://www.hmrc.gov.uk/sd/index.htm>

² A close company is broadly one which is under the control of five or fewer participators, or of participators who are directors. For more detailed guidance see HMRC's Company Taxation Manual at paragraph CTM60060: <http://www.hmrc.gov.uk/manuals/ctmanual/CTM60060.htm>