

Transferring shares within a contractor limited company

Contractors often choose to split the ownership of the shares in their [contracting limited company](#) between themselves and their spouses. Typically, this is done to reduce tax bills, by making full use of available tax allowances.

However, according to Phil Richards of contractor accountants [Blevins Franks](#), the process is not quite as straightforward as it might seem and, he warns, it could end up costing the contractor more in the long run.

"Although the paperwork element of the process of transferring shares is reasonably straightforward," explains Richards, "potentially costly complications can arise depending on the timing of the transfer and the recipient of the shares."

The stock transfer process

If a contractor owns 100% of the shares in their contractor limited company and wants to transfer 50% of the shares to another person, they need to complete and sign a stock transfer form.

"The stock transfer form should be sent to the Company Secretary, who may be the contractor's accountant but is very often the contractor's spouse," continues Richards, "who should then update the company's records accordingly."

These company records include:

- o The company minute book, recording the share transfer resolution
- o The register of directors' interests (if the new shareholder is a director)
- o The register of members and shareholdings.

[Companies House](#) should also be informed when the next Annual Return is completed and submitted.

Section 660 and income shifting

When contractors transfer shares in the contracting limited company to their spouse, they need to beware of [Section 660](#) and [Income Shifting legislation](#), which has also been called the 'family business tax.'

Some of the legislation and tax laws relating to income shifting date back to the 1920s and the infamous [Arctic Systems](#) case, which capped [HMRC's](#) apparent ambitions to sting virtually every small and medium enterprise in the UK with massive tax increases.

But despite the Arctic Systems ruling, Richards warns contractors that gifting shares to family members is still a minefield: "Gifts between spouses are, in theory, exempt. But complications arise if the gift is simply a right to income, which is to say purely the income from [dividends](#), rather than the rights and responsibilities and liabilities that come with share ownership in a business."

If not managed correctly, the contractor could find themselves paying tax on the entire dividends in their business as if they solely owned the shares, and it's likely they would be doing so at the higher rate of tax.

"Income shifting, or the family business tax legislation, was due to be brought onto the statute book in the April 2009 budget," continues Richards. "However, in the November 2008 pre-budget review, it was [announced](#) that the proposals had been shelved, and there are no existing changes in the legislation."

Stamp Duty

Following the 2008 budget, share transfers (often referred to as stock transfers) of from zero pounds to less than £1,000 are exempt from stamp duty. The term 'consideration' is often used to refer to the value of the shares being transferred, and this is where further complications often arise.

If the value of the shares is calculated to be in excess of £1,000, then the stock transfer form must be sent to the Birmingham Stamp Office with a cheque for the duty, which is calculated at 0.5% of the consideration value.

So, for example, if the contractor's 50% shareholding was valued at £5,000 then the 'responsible person' within the business, which may be the Company Secretary or the contractor him or her self, should send the signed and dated stock transfer form with a cheque for £25 for 'stamping'.

How is the 'consideration' valued?

“Valuation of shares in a micro-business, such as a contractor limited company, is extremely difficult and, if absolutely necessary should only be undertaken by a contractor’s accountant,” warns Richards. “The consideration must be a fair market value of the shares, which can be interpreted in a huge number of ways.”

“This recommendation is not a ploy to up accountancy fees,” he adds, “but because HMRC will have a keen interest in how the fair market value was calculated. For example, the taxman may ask very awkward questions if the contractor cannot substantiate the valuation to their satisfaction.” And if found wanting, the contractor could end up paying more in duty, tax and penalties.

Plus, the range of valuation techniques that can be used are numerous and require considerable expertise to apply in any meaningful way, particularly if the contractor’s objective is tax mitigation.

Alternatives to transferring shares

In an ideal world, Richards recommends that contractors only transfer shares as a last resort, and consider alternatives that could still achieve the contractor’s objectives but use alternative routes.

For a new limited company, the spouse who is not the main fee earner, but who nevertheless plays a vital role in the running of the business and is the director, should register all the shares in incorporation in their name, and then transfer an agreed proportion to the fee-earning spouse. This significantly reduces the chances of the transfer of ownership being viewed as a ‘settlement’, which in the eyes of HMRC is a tax avoidance ploy and will instantly attract their attention.

Where the contractor wishes to allocate ownership to another family member or a business partner, then issuing new shares is probably the best solution.

Can I transfer shares to anyone apart from my spouse?

“There is nothing in the law that says a contractor cannot transfer shares to any person they wish to, including their children, other family, friends and so on,” says Richards. “The problem will arise that if the shares are transferred to anyone who is not actively working within the business, then Section 660 rules will almost certainly apply.

Contractors can transfer shares to their children, mother-in-law, and even their mate down the pub, and many have in the past. But Richards warns it is only a matter of time before HMRC catch up with the contractor and applies hefty back taxes, interest and penalties.

When does HMRC get involved?

According to Richards, HMRC generally has higher priorities than acting on changes in share capital within a business. They are much more likely to spot an increase in one spouse’s income and a decrease in the other’s as a result of a transfer of shares and investigate accordingly.

This is where expert professional help from the outset is essential, as Richards explains: “As part of their tax planning, contractors can have multiple shareholders within their contractor limited companies and they can also legitimately mitigate some tax liabilities this way.

“However, this is a complex area of the tax legislation and case law, which is under constant review and scrutiny by HMRC, so contractors should beware of taking significant decisions without expert support.”

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Phil Richards, Blevins Franks

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