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 the process is not quite as straightforward as it might seem and 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 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, who should then update the company's records accordingly.

These company records include:

The company minute book, recording the share transfer resolution

The register of directors' interests (if the new shareholder is a director)

The register of members and shareholdings.

Companies House should also be informed when the next Annual Return is completed and submitted.

The Settlements legislation

When contractors transfer shares in the contracting limited company to their spouse, they need to beware of the **settlements legislation**, Section 624 of the Income Tax (Trading and Other Income) Act (ITTOIA) 2005. This is also commonly referred to by the name of the legislation that preceded it: Section 660.

The original settlements legislation dates back to the 1920s, but was resurrected and applied to contractors by HMRC concerned by what it perceived as excessive tax avoidance by fee-earning contractors making 'bounteous settlements' of shares on their non-fee-earning spouses. The settlements legislation treats the non-fee-earning spouse's income as if it were the fee-earner's income, and taxes it accordingly.

The test case that helped settle the matter involved **Arctic Systems** and went all the way to the Law Lords. The final ruling determined that ordinary shares come with more than just rights to income. They include rights to vote on company matters and the right to a return of capital when the company is closed. This provided contractors with certainty about the settlement legislation's exemption for spouses and civil partners.

But despite the Arctic Systems ruling, contractors should be wary of gifting shares to family members, as it remains 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.

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'.

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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. 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, 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

It is recommended that contractors ideally only transfer shares as a last resort. It is generally better to 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 is a 'belt and braces' strategy for staying out of the settlements legislation.

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. The problem will arise that if the shares are transferred to anyone who is not actively working within the business, the settlements legislation 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 it may only be a matter of time before HMRC catches up with the contractor and applies hefty back taxes, interest and penalties.

When does HMRC get involved?

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 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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