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100% SHAREHOLDING IS TAX-INEFFICIENT: By Jonathan Hore

It is always good to start a company from scratch and see it grow. These are what they call start-ups and the experts tell us that the small to medium scale enterprises play a pivotal role in the growth of economies. By default, start-ups are wholly owned by the ones who start them, in most cases to the extent of 100%. People also tend to own 100% shares in companies that they purchase.

It also seems so innocent and reasonable that a couple may each hold 50% shares in a company or group of companies. The problem is that when we make these decisions, we never think about the tax consequences of such moves, especially when those that kick in when we depart from this earth. I want to show you that whilst it looks so good to hold as much shares in a company, it is not so wise, from a tax perspective. In this article, words importing the masculine shall be deemed to include the feminine.

WHAT'S THE BIG ISSUE HERE?

The big issue here is that very few of us think of what happens to our assets when we depart from this earth. Even if we think about it, we are not certain of the tax consequences. Our focus is mainly on the current benefits that we can derive during our lifetime and what happens after our departure rarely crosses our minds. Well, let me introduce you to reality and try to open your mind.
When you depart, your children and or spouse or other heirs take over assets that you currently own. That takeover triggers two taxes, being tax on disposal gains or capital gains tax (CGT) and inheritance tax. Because you will be gone, it is most likely that there may not be so much money in your estate to take care of the taxes. But maybe I should expand more on what these taxes are and who pays them.

ENTER THE TAXMAN!

Immediately upon your departure, an artificial person comes into existence, being the deceased estate. That estate automatically owns what you owned whilst you were alive. But that artificial person lives for a very short time, awaiting the transfer of your assets to your heirs.
So, if you hold shares in a company, the estate will temporarily own those shares and the executor appointed to take care of your affairs will have to transfer them from your name to say, your son's name. The taxman considers that transfer as a disposal of the shares at their market value and that is a killer; trust me. This means that your company's shares have to be valued and the value is used for CGT purposes. The one who bears CGT is the one disposing of the assets, i.e. your estate. Remember that we stated that chances that you would have left little cash in your estate are very high.

Secondly, your son, in our case, will also suffer inheritance tax on the value of the shares that will move from your estate to him. This is a tax that is triggered by inheriting property from another person and it is payable by the receiver of the property, being your son. So, in summary, your estate has to contend with CGT whilst your son contends with inheritance tax.

SO WHAT PLAN B?

The Plan B is for you not to own 100% of shares in any company so as to limit the magnitude of the taxes that your estate and heirs bear when you depart. It should be obvious that if you own 100% of a company, the value of the shares on transfer will be much higher than if you own say 5%. Let me simplify this further by saying if your company

is valued at say P5m and you own 100% of the shares, your CGT will be around P 915 000, assuming you started the company from scratch. Your estate pays that but the big question is whether it will have the resources to fund that tax. Further, your son is likely to pay inheritance tax of around P 236 000. Where will he get such money?

So, when you are starting a company or buying shares in a company, consider having your children holding 95% or so of the shares and you and your spouse hold say 5%. This cuts down the above taxes by about 95% when you depart as the children already own the shares. To make the arrangement much more smatter, you may create a trust which owns your children's shares and they get transferred when you depart. That is also tax-efficient. But don't just transfer the shares that you already own without tax advice; tax may bite you! And if you were worried about whether this arrangement is good for dividends distribution, it is so perfect and you can take my word. Well, let me take this opportunity to congratulate those who stayed awake during the duration of reading this article. You are brave and enduring; you understood all that tax jargon? Clap hands for yourself buddy!

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him. If you want to join our Tax Whatsapp group, send me a text on the cell number below.