



BUSINESS & PERSONAL TAX SUPPORT


# Companies - Use of alphabet share structures 2023-24



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**To comply with company law requirements, dividends must be paid to shareholders with the same class of shares in proportion to their shareholdings. Using an alphabet share structure overcomes this restriction providing flexibility when declaring dividends.**

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## What are alphabet shares?

Where a company adopts an alphabet shareholder it will typically have a different class of share for each shareholder, i.e., A ordinary shares for one shareholder, B ordinary shares for another shareholder, C ordinary shares for another shareholder, and so on.

This provides a number of advantages over a share structure whereby the company has a single class of share, and all shareholders hold that class of share.

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## Advantages of an alphabet share structure

The main advantage of an alphabet share structure is to provide flexibility. Having different classes of share means that different rights can be ascribed to different shareholders. For example, some shares may carry voting rights and rights to assets in a winding up, whereas others may only carry a right to a dividend.

Using an alphabet share structure is also advantageous from a tax planning perspective as it allows profits to be extracted in a tax efficient manner, tailoring the dividends paid to the shareholder's circumstances.

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## Creating a new class of share

Ideally, the company should be set up with an alphabet share structure from the outset. However, where this is not the case, it is usually straightforward to create new classes of shares where this is permitted by the articles of association. Where the company is formed with model articles, new classes of shares can be created by ordinary resolution. These can be allotted and paid for. Form SH01 should be registered at Companies House.

It is prudent to consider in advance what you want to achieve from the alphabet shareholder and ascribe the rights accordingly. Consideration

should be given not only immediate requirements, such as the need to tailor dividends, but also to future requirements. For example, business asset disposal relief is only available on the disposal of shares in an individual's personal company if the individual has both a minimum of 5% of the shares and 5% of the voting rights.

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## Beware the settlements legislation

When creating a new class of share to facilitate the tax efficient extraction of profits, it is necessary to be mindful of the settlement's legislation. This is anti-avoidance legislation that HMRC may try to invoke if they suspect the shares are being created to divert income from one shareholder to another so that it is taxed at a lower rate. Ensuring the new class of share has voting rights will counter any challenge.

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## Utilising unused dividend allowances

In a family company scenario, an alphabet share structure can be used to make use of the dividend allowances of family members who work outside the company, but who do not have any other dividend income.

The dividend allowance is an allowance that is available to all individuals regardless of the rate at which they pay tax. The allowance is really a nil rate band rather than an allowance. Dividends, which are treated as the top slice of income, are taxed at a zero rate to the extent that they are sheltered by the 'allowance'.

The dividend allowance was set at £2,000 for 2022/23. However, it is reduced to £1,000 for 2023/24. It is to be further reduced to £500 from 2024/25.

The reduction in the dividend allowance reduces the attractiveness of alphabet shares as a mechanism for using up the dividend allowances of family members. However, tax savings remain available.

### Example

A Ltd is a family company.

Mr A owns 100 A ordinary shares. His wife owns 100 B ordinary shares. His three daughters own, respectively, 100 C ordinary shares, 100 D ordinary shares and 100 E ordinary shares.

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Mr and Mrs A both pay tax at the higher rate.

None of their daughters have other dividend income.

To make use of their dividend allowances to extract profits from the company, a dividend of £10 per share is declared for C, D and E ordinary shareholders, so each receives a dividend of £1,000, using up their 2023/24 dividend allowance. No tax is payable as the dividends are sheltered by the allowances, allowing the company to extract £3,000 of profits tax-free.

Had a dividend of £3,000 been paid to A or B ordinary shareholders, the dividend would have been taxed at the higher dividend rate of 33.75%, generating a tax bill of £1,012.50 (£3,000 @ 33.75%).

If one of the daughters, say the daughter with the C ordinary shares, had already used £500 of her dividend allowance (leaving £500 available), the dividends declared could be tailored to pay a dividend of £5 per share to C ordinary shareholders to use up the remaining dividend allowance of £500, while paying a dividend of £10 per share to D and E ordinary shareholders to use their full £1,000 dividend allowance.

The use of alphabet shares allows the dividends to be tailored to the shareholder's circumstances to extract profits tax-free.

## Using lower tax bands

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An alphabet share structure also allows dividends to be tailored to make use of lower tax bands, reducing the tax payable on the extracted profits. For example, if one spouse has some of their basic rate band remaining, it makes sense to use this up before paying dividends that would be taxed at the upper dividend rate.

### Example

B Ltd is a family company. Mr B has 100 A ordinary shares and Mrs B has 100 B ordinary shares. Before paying dividends, Mr B has income of £30,270 for 2023/24 and Mrs B has income of £40,270.

Mr B has £20,000 of his basic rate band remaining and Mrs B has £10,000 of her basic rate band remaining.

The company extracts profits of £30,000 to utilise the remaining basic rate bands, paying a dividend of £200 per share to A ordinary shareholders (a dividend of £20,000) and a dividend of £100 per share to B ordinary shareholders (a dividend of £10,000).

The first £1,000 of each dividend is sheltered by the dividend allowance, and the remainder is taxed at the dividend ordinary rate of 8.75%.

In the absence of an alphabet share structure, had each held 50% of the shares, each spouse would have received a dividend of £15,000 if £30,000 been paid out by way of dividends. In this scenario, £5,000 of Mrs B's dividends would be taxed at the dividend upper rate of 33.75% while £5,000 of Mr B's basic rate band remained available.

Using an alphabet share structure allows dividends to be tailored to extract profits in a way that minimises the tax payable.

## We can help

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We can help you formulate a tax-efficient dividend policy and explain the associated tax implications.

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