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How do you handle share plan difficulties in the run up to a transaction, e.g. BADR and the uneven allocation of sales proceeds between selling shareholders (with or without alphabet shares)?

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Four questions in one



How do you generally handle share plan difficulties in the run up to a transaction?



Are there problems with BADR (formerly known as entrepreneur's relief)



What about uneven allocation of sales proceeds between selling shareholders



Do alphabet shares solve this?

How do you generally handle share plan difficulties in the run up to a transaction?



Get ahead of the transaction



Check the plan rules / contract etc



Own the problems and fix the ones you can (allow a month)



Insurance (very competitive market place)

How do you generally handle share plan difficulties in the run up to a transaction?

- EMI Multiple possible mistakes to be made
- <https://www.taxation.co.uk/articles/common-traps-mistakes-in-emi-share-option-plans>
- Is it too late? Are there “arrangements in place”?
- Generally, heads of terms is the line in the sand but check out ETASSUM52031:
 - “genuine requirement for external approval, which is outside of the control of the parties, before a transaction can proceed will prevent the existence of arrangements”

How do you generally handle share plan difficulties in the run up to a transaction?

- Employee Benefit Trusts (see David's previous talk)
- <https://www.taxation.co.uk/articles/dealing-with-an-employee-benefit-trust-on-an-m-a-transaction>
- All the President's Men
 - “Follow the money”
 - How was the EBT funded?
 - Who gets the cash?
- Don't ignore part 7A ITEPA

Are there problems with BADR (formerly known as entrepreneur's relief)

- Post Budget??? Is it worth the effort?
- Need 5% of the share capital (what is ordinary share capital)
 - Ordinary share capital exclude capital “to which the holders have a right to a dividend at a fixed rate but have no other right to share in the profits of the company. “
- HMRC Manual at CTM00514
- One year 360 days Wait until two years have elapsed
- 14% becomes 18% soon

Are there problems with BADR (formerly known as entrepreneur's relief)

- Rectification 4.999%?? Some you win, some you lose
- Options with fresh shares have dilutive effect
 - Exercise post transaction (unpopular and disproportionate)
- Dilution election HMRC Manual CG64053
 - Market Value deemed sale (no minority discounts) but value?

What about uneven allocation of sales proceeds between selling shareholders

- Your choice:
 - £1 million; or
 - £800k plus earn-out?
- Second choice:
 - £1 million subject to risk; or
 - £800k with no risk?
- Is this a share right or a personal right?
- Valuation issues

What about uneven allocation of sales proceeds between selling shareholders

- Change the articles? Does that give rise to an income tax charge?
- Consider 446K ITEPA on non-commercial increases?
- What about the earn-out risk?
- Key indicators of earn-out being sale consideration ERSM110940
 - “the vendor continues to be employed, the earn-out is not conditional on future employment, beyond a reasonable requirement to stay to protect the value of the business being sold”.

Do alphabet shares solve this?

- Ordinary A shares and Ordinary B shares with different capital rights are very common and *almost always* in a private equity transaction.
- Therefore, not all shares are equal:
 - But don't be too clever and watch out for eg (HMRC Spotlight 62) Dividend diversion scheme used to fund education fees and settlement legislation.
- Family Investment companies:
 - Fine in principle but don't be too clever; check out what Dan Neidle has said on this.

Do alphabet shares solve this?

- Going from one class of shares to multiple classes is fraught with danger
- If you are close to an M&A transaction it is highly unlikely you will want to do this.
- Growth shares work and are effective but you need valuation advice and clear water
- Additional share classes create traps for participation in EBTs and EOTs. (Eg for EOTs you are an Excluded Participant if own 5% or more of any share class) TCGA 236J(6)

Ask something off the wall!

Questions for John?

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Tax is tricky. This presentation, responses to Q&A and accompanying talk is an introduction only. Detailed advice should be taken before acting or choosing not to act.

I have assumed the transaction is not a sale to an EOT but if it is, have a look at my article in Practical Law Magazine

<https://www.marriotharrison.com/the-employee-ownership-trust-is-it-the-optimal-exit>

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