

Episode 1: Form E - Business Assets and Directorships

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SPEAKERS

Chris Salter, David Hickmott, Michael Finnegan

C Chris Salter 00:01

Hello, my name is Chris Salter and welcome to the junior family law podcast: a collaboration between Burges Salmon, Mills & Reeve and Newton Kearns. Over the next eight episodes, we'll be discussing a range of topics likely to be encountered by junior family lawyers. The podcasts are designed to be a practical and helpful discussion through a series of topics you may encounter, as you start out in your family law career. I'm a solicitor at Burges Salmon, having trained in the firm and qualified in September 2020. Today, I'm joined by Michael Finnegan, a two year PQE solicitor at Burges Salmon, and David Hickmott - a four year PQE solicitor at Mills & Reeve. In his inaugural episode, we're going to be discussing section 2.11 of Form E in relation to business assets and directorships. Michael, do you want to tell us how we'll get to this stage? And why would you be looking at completing section 2.11 of Form E.

M Michael Finnegan 00:55

So a Form E is a detailed form setting out the financial details of the party who's completing it. So both parties in divorce proceedings need to complete one of these usually, and it sets out the needs of the person completing a lead children and both parties have detailed to provide full and frank disclosure for family proceedings. So the Form E is the usual way to do this, it can be exchanged voluntarily, before proceedings have been issued, or as part of the court timetable as part of the information gathering process, which is necessary for settlement negotiations can begin and basically it gives a full overview of both parties financial position.

C Chris Salter 01:31

Okay, so we will slowly start to work our way through section 2.11 itself. If you want to follow this through, you should be able to download from a link near this podcast, the page of Form E, which we're looking at. So the first box she'd want to fill in is the name of the business. So David, what can you tell us about this?

D David Hickmott 01:52

It's the most obvious box, but there are still a few things to make sure you get right. Obviously, first thing is to make sure that you've spelled the name correctly, and made sure that you've recorded the actual legal name, it's worth checking that on Companies House because some businesses will trade under a different name to that which they're

checking that on Companies House because some businesses will trade under a different name to that which they're registered under. So make sure that you've got that right. There's other additional basic information that you should include, such as the company number, and in which jurisdiction that company is registered, that's going to be relevant if it's registered outside of England and Wales. And all of that ties in neatly into the nature of the business as well. I'll just talk very briefly about that. Again, you don't need to include a lot of information here. Companies House will give you the basic information, particularly if it's the other side's business, you just need to put a very brief description of what the company does. So if it's a trading company, what it's producing, or marketing or selling. Note, if it's an investment company, or if it's a company holding property. Again, not a lot of detail needed, so just summarise it briefly.

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Chris Salter 03:10

So the next box you will see is a tick box, which asked to identify if you're a sole trader, partner in a partnership or shareholder in a limited company. Just going back to basics very quickly. A sole trader is an unincorporated company. So that could be the person who just owns a tea shop is a very small business. So they have no separate legal personality. A partnership, you generally find farming partnerships. Again, they're not incorporated, so you won't be able to find details on Companies House. The one we're going to focus on mainly in this podcast. For the rest of the form is where you have someone who is a shareholder in a limited company. Limited companies are governed by the Companies Act and means that the company itself has a separate legal personality. That's why you'd be a shareholder you own shares in the business rather than owning it itself. With it being registered. That's why you want to Companies House and find information such as the shareholdings and the annual returns. So we're going to move on. Once you've identified that you have a client who is a shareholder in a limited company, you need to understand that interests in the business. So Michael, how would you go about doing this?

M

Michael Finnegan 04:28

So when you go on to the Companies House paid for the relevant company, it will list the members in the company and will also give an idea of the percentage share they have and whether they have a controlling share in the company. Also, the annual returns on the list of documents filed with company house will give an idea of who the shareholders are and what their share ownership shares are. It's an annual return is essentially a snapshot of a certain company at the anniversary of their incorporation is a separate document. Through the accounts and the details of shareholders, the directors the address all at the date of that document.

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Chris Salter 05:06

So, Michael, when looking at the annual return, will the annual return tell you the percentage shareholding of of that person shareholder? Or will you need to work that out yourself, given the total number of shares, and the shares which the individual client may hold?

M

Michael Finnegan 05:21

So when you look at the annual return, it will have a number representing the overall shares and then the number of shares owned by each of the members of the company. So from that you can you can work out what share in the company that each of the shareholders owns.

D

David Hickmott 05:35

DAVID FINNEMORE 06:00

Okay, great, David, if you have anything you'd like to add at this part? Just a couple of things to look out for. One is whether you have corporate shareholders in the business, depending on the type of business, the presence of a corporate shareholder, might raise a flag of suspicion with the other side. So it's worthwhile just explaining what they do, why they're there. And the other issue is minority shareholdings. If you own less than 50% of a business, then arguably, you don't control it, you don't have the voting rights. And that might have an impact on your client's value of the business. So that's worth flagging up right at the beginning, that's going to be an issue. And the final is just a reminder that when we say business interests, we don't mean directorships or businesses that you work for directorships should be listed separately. Because obviously, you can be a director or an employer of a company or a business, and not have any actual interest in the underlying business.

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Chris Salter 06:44

So the next box is to look at when your next set of accounts will be available. Companies which are incorporated are required to file annual accounts with Companies House. It is worth noting, though the accounts generally run through a period for example, to the 31st of July, however, they do take quite a long time to be prepared. So if a company's end of the year is July, it may not be until, for example, February, the following year, before those accounts will be available. This is information you could obtain from the company accountant or just by speaking to your client to find out when those accounts may next be. Moving on to those company accounts. They are vital and needs to be provided with the Form E, as you can see at the top, Form E helpfully tells you what documentation is required to be attached to the section. And at point A is copies of business accounts for last two financial years. So Michael, do you want to talk about company accounts where you might find them and what you should look out for in those accounts?

M

Michael Finnegan 07:46

So as Chris has mentioned, you need to provide the last two years, company accounts. But that being said, there may be some cases where in fact, you feel that the last two years don't paint an accurate picture of the company. Because for example, there might be special circumstances which might mean the company performed better than usual, but actually isn't going to be the case going forward and you want to demonstrate this. So it may be you want to provide slightly more than that. But that will depend on the facts of the case. When you get the accounts from Companies House, you might notice there are different types of accounts available. So there are abbreviated accounts for example, which are a summarised version of the full accounts, and include the company balance sheet and a reduced number of notes and don't have the profit and loss account. As micro company accounts for smaller companies with a smaller turnover and less employees, less for company accounts, which have the the profit and loss account and the balance sheet and detailed notes to the accountant. So these are those useful when these are available, and have all the essential elements of the full accounts. And they also include an accountant's report and a director's report, which gives further important information about the company. If possible, it's useful for to obtain any of this information from a company accountant because if there is an accountant, they're likely to know more about the accounts and can answer any questions you can have which the client might not be able to answer. So if you can make contact with an accountant, and then that's always a good plan. In terms of when the next accounts are due, you can usually assume this based on if you don't know for sure you can usually assume this based on when the previous ones were prepared for tend to be done to the same period every year. Again, this might be a question for the accountant, it might be something they're working on, they might be able to give you some draft accounts. That's often the case in terms of what the accounts show that there's important aspects on the accounts to look out for which is things like the balance sheet profit and loss account. As I mentioned, the shareholders funds, the shareholders funds is a good one to look at when looking at the interest your client has in that in that company because it shows what their interest in the company actually is. And it's also important to know any dividends that the client might be receiving and if they change year on year, and it's so you might be worth explaining why they've

changed. With partnership accounts, for example, usually look at the drawing that is often with with these types of business with partnerships, people can often meet some of their personal expenditure from those accounts. So it's useful to look at too.

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Chris Salter 10:21

It is also useful in that it can show trends in the business. Company accounts show the year that accounting for and the previous year as well as you can identify year on year whether the business is going in a positive or negative direction. As Michael explained, that may be another time where you'd want to look at previous sets of accounts to see if that trend continues. The Form E also asked in this section, if there's been any material change since the last accounts. This could well be COVID or a similar situation, which generally impacted the business world or for that individual business, something may well have happened, which is causing a negative or positive impact on their accounts. As accounts only prepared annually, the snapshot which you get may not be indicative of the current state of play of the business. So here you'd want to explain in general terms, if the business is doing particularly well or badly and give reasons as to why. It may also be that new competitors have entered the market or new products, which again could have a positive or negative impact on the business. Again, here just a brief explanation of what they may be. The next box here looks at any sums at both the business for directors loan account. Here, you only want to reference money which is owed to your client. For example, a directors loan account could be where your client has sold a previous business for let's say 5 million pounds, and has invested that 5 million pounds into the new business. Therefore your client is owed that money from the business, which is reflected on his directors loan account. So that needs to be stated there as its money which should be effectively taken out of the business because it's owned by your client. There's also what's known as a reverse directors loan account, this is where the balance is nil. So your client may have put no money into the business. So it's not owed anything but continue to draw money out of the business. If there is a reverse directors loan account, you do not want to include that here. Because Form E is only looking at cash and liquidity within the business. You should provide a shedule of your directors loan account with Form E, although there's no requirement for you to do so. It may preempt any questions which come up from the other side sisters after you exchanged Form E. It's also really important to note that there could be tax consequences with directors loan account. Ultimately, DLAs are income so they will be taxed at some point. There are also specific laws around how long money can stay outstanding on directors loan accounts before they are due. The next box on Form E looks at the estimate of the current value of your business interest. David, how would you go about tackling this box?

D

David Hickmott 13:10

What you would put in this box is partly dependent on the type of business that you have. For example, if it's a business that simply holds properties, you might be able to do a straight valuation of the underlying assets. Equally, if it's a consultancy business, for example, it may be that the value of the company is effectively zero because the value is in the work that the consultant is doing rather than the business itself. If you have a shareholding in a trading company, it becomes a lot more complex. It may be that you just want to say that a formal valuation is going to be needed further down the line. Valuing shareholdings can be really complicated. And there are a few things to look out for in terms of just having a clear idea about value and having an idea about the kind of expert that you might be looking for. So think about if there have been any recent sales of other shares, or offers to purchase the business, that might give an indication as to value. So for example, if you own 20% of the shares in a business, and you know somebody else has just sold their 20% share, and you know the value that will give you a good indication about what your share is worth. Similarly, if you own the whole business or you own majority share in the business, and you are aware of an offer in the last month or so, to have the business purchased. Again, that might be a really helpful indication. Valuations can also be based on revenue. So have a look at the kind of profit that's being generated year on year and how that's changing. It may be worth having a friendly accountant or a business valuer, to act as a shadow expert. That is somebody who's not instructed on a joint basis, not an expert approved by the court, but is

available to your client to answer questions and provide advice, which can be particularly useful if you're having to wade through a long, detailed or complex valuation further down the line. So if it is going to be complex, it's likely that you will need a formal business evaluation, you will need an expert appointed by the court. And a single joint expert is going to be necessary.

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Chris Salter 15:38

David that's that's great. And really interesting. Have you got any stories you can give about when you've been trying to complete these sections yourself? Any good case studies you can mention?

D

David Hickmott 15:48

I think one of the challenges is persuading clients that business valuations unnecessary. I think sometimes clients think that a business is simply the underlying assets or simply the cash that it has in the bank. A good example, and something I've dealt with recently is a consultancy business, where the client is insistent that the company has no underlying value. That might be the case. But it's important for clients to understand that there are additional things to think about. So for example, a company may have a client list, which is worth money, a company may have a degree of goodwill, which is associated with a brand name and brand recognition. And that is the kind of thing that is intangible but has a value to it. And it's important to make sure that clients realise this and realise that it's a complex question. And that it may be money well spent, think about instructing experts or agreeing to instruct experts early in the process, rather than becoming entrenched in this idea that a business is just what it has in the bank.

C

Chris Salter 17:06

And I would echo that and say that I've experienced similar issues in the past when trying to think for a value for this business. because later on in this series, there's going to be a podcast on appointing experts, which will include the appointment of experts to value a business, they will be looking at that point at the business as a going concern, but you need to get to a stage first, where you value all the parts of the business to help come up with the overall business value. I've had situations in the past where businesses own property where they own fleets of vehicles, or trademarks. And maybe the case that they also need to be valued separately, before they can feed into an overall valuation of the business is many moving parts, which needs to be pulled together when we're looking at value, which is why as you said, David, it may not necessarily be the best place in Form E to actually assign a value to a business. Michael, do you have anything to add at this stage?

M

Michael Finnegan 18:04

Going back to a few of the different things we've mentioned when talking through section, it reminds me of a case I had some time ago where we had a company where the wife had put in around 20 to 25 million, most of which were nearly all of which was property which was owned by the company, the company as a whole power was owned by her two daughters, and they were the shareholders. But in essence, as we've discussed with directors, loans accounts, this this money was owed to our clients, but there was a company have been set up as an investment company to benefit her daughters, and enable them to inherit as tax efficiently as possible. So in reality, our client was never actually going to receive any of this money back. But on first glance, everything there was a company in which she had put 20 million pounds roughly into and was owed that amount back. So it was sort of it had to be presented in such a way that the other side wouldn't see this and just think that was, you know, 20 million pounds, it's going to come back to her someday, but actually, to provide as much documentation as possible liaise with the

accountants, and be able to present that in such a way that the other side could understand upon reading Form E exactly what the purpose of the company was, why it had been set up and what's going to happen with it and the fact that our company and the fact that our client wasn't actually going to benefit from that company.

C

Chris Salter 19:24

That's really interesting. And just following on from DLA and potential tax consequences, might what would you put in the box about any capital gains tax that may be payable on the disposal of your business interest?

M

Michael Finnegan 19:37

Well, the tax is obviously something which is really important because we are looking to ascertain the net value of the business or the net value of our clients interest in the business. There may be capital gains tax payable in the event of a sale also, if, for example, you have a very small business, then the allowance of 12,300 pounds, tax free may be something that's relevant on top of this. It's useful to think about when there are reliefs available. So for example, business assets disposal relief, which was previously entrepreneurs relief might be available, which would cut CGT to 10%, as opposed to 20% if the company qualifies, and they're also potentially other tax reliefs available to defer or reduce the tax. But this is obviously something that we would need to speak to an accountant about. So again, if there's a company accountant, we can speak to them and ask them for if they can put together a tax calculation in the event that the business was sold in six months or 12 months or now even what the tax consequences would likely be. Similarly, if an experts provided a report, it might be that in the instructions to the expert, we've already asked them to provide an estimate of the tax that will be payable in the event of the sale of a business and if anything can be done to mitigate tax in the event of a sale. So it's certainly something you would want to, to preempt when you were instructing an expert. But yet others say otherwise, an accountant is usually able to help with that kind of stuff. And it's, it's something which is sometimes overlooked, or TBC'd. But it's something that's really important if you can get a tax figure in there.

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Chris Salter 21:10

Okay, great. That's really interesting. And then that now leads us to the last box, which is the net value of your interest in any business after capital gains tax liability. So as you may have guessed, as you've listened to this podcast, our indication is that you may want to leave this box blank. Or as Michael said, TBC, there are many issues which needs to be identified before you want to assign a value to a business. And it may well be that experts need to be appointed before you can do so. If you do leave it blank or TBC. I don't see a call criticising a solicitor for doing that, as there are many moving parts and it'd be so difficult to tie down a value for business, especially in a large limited company, which could have multiple millions worth of turnover. Well, that brings us to the end of section two point 11 or Form E, and the end of this first podcast in this series. Thank you very much for listening. As I said at the start, this will be a series of eight podcasts and the other seven will follow over the next coming weeks and we'll continue to look at various sections of Form E, there will also be a podcast which we'll look at children issues, nuptial agreements, and as we've alluded to throughout this podcast, the instruction of experts. Thank you.