

LE LAC

by Milton Grundy

Monsieur C gazed contentedly out of the window. The bank's building was nineteenth century and picturesque, but his office was – as befits the Managing Director – at the top of the building, and had a large plate-glass window looking out to a terrace, with rooftops beyond, and now that the leaves had fallen he could see the lake in the distance. *Ô lac!* – the line came back to him from his last year at Princeton – *l'année à peine a fini sa carrière*. His secretary had phoned through to say that Mr. Smith was on his way up in the lift. Monsieur C was looking forward to the meeting. Mr. Smith was not bringing his lawyer with him, and Monsieur C had not asked the bank's lawyers to attend the meeting. They were here to do a business deal.

Mr. Smith entered. He was a man in his early 50s, with an easy manner and good tailoring. He uttered a few pleasantries, admired the view of the lake and settled down to tell his story. He had been working in London for a well-known financial institution, which had come apart at the seams during the recent financial crisis. Happily, he had some money put by. He had his friends and contacts. And of course he had his expertise. His plan was to open a “boutique” business in Mayfair, run it for the next – say – seven years, and then sell it to one of the large companies. He was perfectly happy to pay UK tax on his personal earnings and on the profits of the company, but it irked him that he would also have to pay capital gains tax on the gains he made when he sold. It was only 18% at the present rate, but it would be 18% of

quite a lot, and moreover rates have a habit of creeping up when a government is short of money – which most governments looked like being for some time.

“I understand,” said Monsieur C. “But what can I do for you?”

“First of all,” said Mr. Smith, “I need a lot of statistical information, which I believe you have. And I think I can present it in such a way that it will be useful to other people in the investment business. Can we form a partnership to exploit this idea?”

“It’s not something the Bank would do, but we have a special purpose vehicle which does that kind of thing.”

“We might make some money that way,” said Mr. Smith, “but the real money will be made in Mayfair. What I need is a UK company with an issued capital of a couple of million. I’d like your SPV to form a UK holding company and hold the shares. The holding company will form a UK Trading Company of which I shall be the MD. I shall make a £2 million deposit with the Bank to guarantee you against loss. I should like a contract with the SPV to buy the Holding Company at the end of the seven years at a price of £2 million plus a little percentage for you, the contract to be conditional on my not having withdrawn my deposit. There will be the usual bits in the small print, one of which will forbid the declaration of dividends by the Holding Company and require the dividends it receives from the Trading Company to be kept on deposit with the Bank.”

“I see that,” said Monsieur C. “But why do you need to involve the Bank? You could form your UK Trading Company yourself and get on with the business without any help from us.”

“Well,” said Mr. Smith, “there is of course the advantage that if we have a good and profitable relationship for several years, you would be the natural person to talk to if I wanted to move on to greater things and needed to raise money to do so. But the concrete advantage is the tax advantage. There is always the risk that the law may change in the meanwhile, but as things are, my capital gain when I dispose of the shares in the Holding Company is to be computed on the footing that my acquisition cost is not the £2 million plus percentage that I pay, but the market value at the time the contract becomes unconditional – which can reduce my capital gain very substantially, and even to nothing at all.”

“That’s very interesting,” said Monsieur C, “though you of course understand that the Bank does not have any view about the tax consequence of your transaction, still less do we give any advice about that. Commercially, it could be an attractive deal. Shall we take out a piece of paper and see what the figures look like, and then go to lunch? There’s a nice little place by the lake.”

This article is taken from the author’s Six Fiscal Fables, to be published next April. If you would like a complimentary copy of this publication, please e-mail Stephanie Talbot on st@taxbar.com