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# **ALPHABET SHARES: THE ESSENTIAL GUIDE FOR TAX ADVISERS 2026/27**

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## Contents

<b>About Nick Wright</b>	<b>.....</b>	<b>5</b>
<b>About this guide</b>	<b>.....</b>	<b>5</b>
<b>1 Introduction to alphabet shares</b>	<b>.....</b>	<b>6</b>
1.1	What are alphabet shares? .....	6
1.2	Historical context and development .....	7
1.3	Types of alphabet share structure: An overview.....	7
<b>2 Legislative framework</b>	<b>.....</b>	<b>8</b>
2.1	Overview of the overlapping regimes .....	8
2.2	ITEPA 2003, Part 7: Employment-related securities .....	9
2.3	ITTOIA 2005, Part 5, Chapter 5: The settlements legislation.....	10
2.4	TCGA 1992: Capital gains aspects .....	10
2.5	Companies Act 2006: The corporate law foundation .....	11
<b>3 HMRC reporting requirements and enforcement</b>	<b>.....</b>	<b>11</b>
3.1	The new close company dividend reporting regime.....	11
3.2	ERS annual reporting obligations .....	13
3.3	HMRC's enforcement approach .....	14
<b>4 Creating alphabet share structures: Legal considerations</b>	<b>.....</b>	<b>15</b>
4.1	Constitutional requirements .....	15
4.2	Are alphabet shares genuinely separate classes?.....	15
4.3	Procedural requirements .....	16
<b>5 CGT considerations in establishing alphabet share structures</b>	<b>.....</b>	<b>17</b>
5.1	The reorganisation provisions .....	17
5.2	The value shifting provisions .....	18
5.3	Stamp duty and SDLT considerations .....	19
<b>6 Employment-related securities: Detailed analysis</b>	<b>.....</b>	<b>20</b>
6.1	The fundamental charging provision.....	20
6.2	The Vermilion decision: The 'bright line' rule .....	20
6.3	The personal relationship exemption.....	21
6.4	Valuation of alphabet shares on acquisition .....	23
6.5	Growth shares as a planning tool .....	24
6.6	Readily convertible assets and PAYE or NIC.....	25
<b>7 Dividend planning with alphabet shares</b>	<b>.....</b>	<b>25</b>
7.1	Alphabet shares as an alternative to dividend waivers .....	25
7.2	Legal requirements for valid dividend waivers.....	26
7.3	Leading cases on dividend waivers .....	27

7.4	Inheritance tax implications of dividend waivers .....	28
7.5	Practical advantages of alphabet share structures .....	28
<b>8</b>	<b>The settlements legislation: Detailed analysis .....</b>	<b>29</b>
8.1	Definition and scope .....	29
8.2	Bounty concept .....	29
8.3	<i>Arctic Systems</i> decision .....	30
8.4	<i>Patmore v HMRC</i> : A substance-over-form approach .....	31
8.5	The spousal exemption and its limitations .....	32
8.6	The retained interest problem .....	33
8.7	Minor children .....	33
8.8	Risk assessment framework for settlements legislation .....	36
<b>9</b>	<b>Earnings or dividends? .....</b>	<b>37</b>
9.1	The fundamental distinction .....	37
9.2	<b>PA Holdings</b> : The leading authority .....	38
9.3	HMRC's Chapter 3B approach .....	38
9.4	The 'dividend priority' rule .....	39
<b>10</b>	<b>Practical planning guidance .....</b>	<b>40</b>
10.1	Establishing commercial substance .....	40
10.2	Documentation best practices .....	40
10.3	Common pitfalls to avoid .....	41
10.4	Transitioning from dividend waivers to alphabet shares .....	42
10.5	Working with other advisers .....	43
<b>11</b>	<b>Practical planning guidance .....</b>	<b>43</b>
11.1	Scenario 1: Spouses, family company .....	43
11.2	Scenario 2: Employee incentive arrangement .....	44
11.3	Scenario 3: Family investment company .....	47
<b>12</b>	<b>Inheritance tax considerations .....</b>	<b>47</b>
12.1	Alphabet shares and business property relief .....	47
12.2	Value transferred by alphabet share arrangements .....	49
<b>13</b>	<b>Considerations for advisers .....</b>	<b>50</b>
13.1	Tax adviser responsibilities .....	50
13.2	The reserved activity issue .....	50
13.3	DOTAS considerations .....	50
<b>14</b>	<b>Conclusion .....</b>	<b>51</b>
	<b>Appendix A: Statutory provisions .....</b>	<b>52</b>
	<b>Appendix B: Key cases summary .....</b>	<b>53</b>
	<b>Appendix C: Glossary of key terms .....</b>	<b>54</b>

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## About Nick Wright

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Nick specialises in complex corporate tax matters, including:

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Nick is host of “The Tax Hour”, a podcast dedicated to sharing expert tax advice from the industry’s leading specialists.

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## About this guide

Alphabet shares – different classes of shares, typically designated by letters such as A, B, C ordinary shares – represent one of the most widely used yet frequently underestimated tools available to owner-managed businesses in the United Kingdom. Their appeal lies in the flexibility they offer, the ability to direct dividend income to specific shareholders based on their individual tax positions, contribution to the business or personal circumstances. Yet that same flexibility, if not carefully managed, can attract unwelcome attention from HM Revenue and Customs (HMRC) and potentially trigger adverse tax consequences.

This report provides a comprehensive analysis of the tax implications of alphabet share structures as well as a brief analysis of the legal issues that should also be considered. It examines the commercial rationale for their use, the statutory regimes that govern them, the key judicial decisions that have shaped the law and the practical guidance that tax advisers must follow when creating and maintaining such arrangements for their clients.

The taxation of alphabet shares cuts across multiple statutory regimes – each with its own scope, conditions and consequences – examined in full in Section 2 of this report.

The stakes are high. Where dividend payments through alphabet share structures are recharacterised as employment income, the tax cost can be significant. Combined income tax and National Insurance contributions can reach 47% for additional-rate taxpayers, compared to just 39.75% for higher-rate dividend taxpayers, plus employer’s National Insurance. The settlements legislation, meanwhile, can attribute income entirely to the higher-taxed settlor regardless of to whom it was actually paid, potentially reversing years of careful tax planning.

Recent developments have heightened the risk profile of these arrangements further. From the 2025/26 tax year, directors of close companies are required to disclose their dividend income and shareholding percentages on their self-assessment tax returns, a change that significantly increases HMRC’s ability to identify and challenge arrangements it considers to lack commercial substance. The Supreme Court decision in *Vermilion Holdings Ltd* [2023] established a broad ‘bright line rule’ for employment-related securities, whilst the Upper Tribunal in *Gould* [2024] provided useful clarification on dividend timing. The High Court in *Gu v Whibberley* [2025] has introduced new commercial law uncertainty regarding the validity of alphabet share structures themselves.

This report concludes that alphabet shares remain a legitimate and valuable planning tool when properly structured, commercially justified and transparently documented. However, the days of casual implementation are over. The professional adviser who creates or maintains alphabet share structures for clients must have a thorough understanding of the overlapping statutory regimes, the evolving case law and the heightened reporting obligations that now apply and must ensure that the commercial substance of any arrangement can withstand rigorous scrutiny.

# 1

## Introduction to alphabet shares

### 1.1 What are alphabet shares?

There is no single statutory definition of ‘alphabet shares’. The term is a colloquialism of long standing in UK tax and company law practice, used to describe different classes of shares within a single company that are distinguished by the letter designations given to them – typically A ordinary, B ordinary, C ordinary, and so on. Their use spans a wide spectrum of commercial and tax planning objectives, and it would be a mistake to associate them solely with dividend planning, though that remains their most common application.

In their most familiar form, alphabet shares are ordinary shares that carry substantially similar rights to capital participation and voting but are structured so that the board of directors has discretion to declare different dividend rates for each class. This discretion allows profit distributions to be targeted to specific shareholders in amounts that suit their particular tax positions, enabling, for example, a higher-rate taxpayer to receive a smaller dividend in a given year, whilst a basic-rate taxpaying spouse receives a larger one. This flexibility distinguishes alphabet shares from a conventional single-class structure in which all shareholders must receive proportionate dividends.

However, the concept extends well beyond simple dividend flexibility. Alphabet shares may also be used in the following ways:

- **Growth shares:** a class of shares issued to employees or in family investment company contexts that carries entitlement only to capital value above a pre-set ‘hurdle rate’. By reference to current market value, these shares may have a low initial value, making them tax-efficient to grant, whilst still providing meaningful long-term economic participation.
- **Preference shares:** a class carrying a fixed or preferential dividend or capital rights. These are commonly used in investor arrangements or in succession planning.
- **Restricted shares:** shares with limited voting rights, transfer restrictions or capped dividend entitlements, which may be used to incentivise employees whilst maintaining control within the founding shareholders.
- **Investor shares:** separate classes reflecting different levels of financial commitment, risk appetite or governance rights between founding shareholders and outside investors.
- **Succession planning:** different classes used to transfer economic interests to the next generation whilst retaining control within the existing owners.

The fundamental commercial rationale for alphabet share structures rests on the recognition that shareholders in the same company are not necessarily in identical positions. A working shareholder-director has a different relationship with the company from a non-executive investor. A spouse who provides part-time administrative support has different income needs and tax circumstances from the founder. A senior employee who has been brought

into ownership has different risk exposure from a family member who has inherited their stake. Alphabet shares provide the structural flexibility to reflect these differences in a commercially coherent way, provided always that the structure has genuine substance and is not merely a mechanism for tax avoidance.

## 1.2 Historical context and development

The use of multiple share classes in private companies has deep roots in UK corporate law. The flexibility to create shares with different rights has always existed under the general principles of company law, and private companies have historically exploited this flexibility for a wide variety of commercial purposes.

The specific practice of using alphabet share structures primarily for dividend planning purposes became particularly prevalent from the late 1990s and early 2000s, coinciding with a period in which differential tax rates between employment income and dividend income were particularly marked. The introduction of lower dividend tax rates for basic-rate taxpayers, combined with the National Insurance advantages of dividend extraction over salary, created strong incentives for owner-managers to structure their remuneration packages accordingly.

Alongside the development of alphabet shares, there was a parallel growth in dividend waiver arrangements, formal waivers by one shareholder of their entitlement to declared dividends, enabling other shareholders to receive enhanced payments. Both practices attracted increasing scrutiny from HMRC during the 2000s, and the case law that emerged from that period, including the House of Lords decision in *Arctic Systems*, the settlements legislation decisions in *Buck*, *Patmore* and *Donovan*, and the Court of Appeal's ruling in *PA Holdings*, significantly shaped the legal landscape. Those decisions are examined in full in Sections 8 and 9 of this report.

The landscape changed again following various regulatory bodies announcing that producing dividend waivers constitutes a 'reserved activity', meaning that most accountants and tax advisers lack the legal authorisation to prepare them on behalf of clients. This created renewed interest in alphabet share structures as an alternative mechanism for achieving similar objectives without the need for formal deeds of waiver and, in some respects, with greater legal certainty about the differential treatment of different shareholders.

The reporting and enforcement environment has tightened considerably in recent years, as examined in Section 3, and the expectation that arrangements lacking genuine commercial substance will escape scrutiny is no longer tenable.

## 1.3 Types of alphabet share structure: An overview

Before examining the specific tax and legal issues in detail, it is helpful to map out the principal types of alphabet share arrangement that practitioners commonly encounter. Each gives rise to distinct considerations under the legislative regimes discussed in this report.

Structure type	Primary characteristics and key risks
<b>Family dividend splitting</b>	Shares in different classes held by spouses or civil partners, enabling dividend income to be directed to the lower-taxed partner. Subject to the settlements legislation and requires the spousal exemption to apply.
<b>Employee participation</b>	Shares issued to employees or directors as part of an incentive arrangement. Primarily governed by the ERS regime under ITEPA 2003, Part 7.
<b>Growth shares</b>	Shares carrying capital entitlement only above a hurdle rate, typically issued to employees. Low initial value minimises ERS income charge on acquisition; capital growth taxed as CGT.
<b>Family investment companies</b>	Shares in multiple classes used within a family investment company structure, often for wealth management and succession planning across generations.
<b>Investor arrangements</b>	Different share classes reflecting different levels of investment, governance rights or return preferences between founders and external investors.
<b>Management buyout structures</b>	Multiple classes used to distinguish management equity from institutional equity, often with ratchets and performance conditions.
<b>Succession planning</b>	Shares transferred or issued to the next generation, sometimes combined with lifetime giving or trusts, as part of IHT planning.

## 2

## Legislative framework

### 2.1 Overview of the overlapping regimes

The taxation of alphabet share arrangements does not fall neatly within a single legislative code. Instead, it sits at the intersection of at least three distinct statutory regimes, each of which has its own scope, conditions and consequences. Understanding how these regimes interact, and which takes priority in any given situation, is essential to advising clients competently on alphabet share structures.

The three principal regimes are:

1. the earnings regime in ITEPA 2003, Part 3, which treats receipts of 'money's worth' as earnings and taxes receipts of cash, which in substance are earnings, to PAYE and NIC;
2. the employment-related securities (ERS) provisions in ITEPA 2003, Part 7, which seek to ensure that employees and directors are appropriately taxed on share-based benefits received by reason of their employment; *and*
3. the settlements legislation in ITTOIA 2005, Part 5, Chapter 5, which