

Tax News



BOOTH AINSWORTH LLP

SUMMER
2008

Capital Gains And Entrepreneurs Relief

From 6 April 2008 the standard rate of capital gains tax is 18%, by comparison to 5 April the rate was variable, up to a maximum of 40%, depending upon the nature of assets sold and the length of ownership.

The 18% rate is one of the lowest in Europe and is good news for the short to medium term non-business investor. For the business investor, the initial proposal was a disaster and represented an 80% increase in the tax liability he could otherwise have expected. It was for this reason that the much discussed entrepreneur's relief was introduced, which in many respects puts the entrepreneur back in the pre 6 April position. The qualifying conditions for entrepreneur's relief are detailed and beyond the scope of this Newsletter (although we do look at one specific point further in this Newsletter).

Unlike business asset taper relief, which it replaced, entrepreneur's relief is subject to a lifetime limit of £1m of qualifying gains. HMRC's research suggests that this will be sufficient to cover 90% of business disposals, but what about the remaining 10%?

Let us look at the position of shares held in a family trading company. The key requirements are that the individual making the disposal:

- Must have owned the relevant shares or securities for a minimum period of one year.

- Must own 5% of the ordinary share capital, which gives at least 5% of the voting rights.

- Must be an officer or employee of the company.

To put this into context, if you anticipate selling shares in your company for a gain which will exceed £1m it would make sense to transfer a proportion of the shares to your spouse; giving her at least 5% of the ordinary share capital and to make her a director of the company. There is no working time requirement but it would be sensible to ensure that she attends board meetings (and that this is recorded in the relevant board minutes) and receives an appropriate salary.

Surprisingly HMRC have confirmed that providing an individual qualifies for entrepreneur's relief in respect of an initial shareholding it is possible to top up that shareholding shortly before sale and for the whole of the new shareholding to qualify for entrepreneur's relief. This means that it is possible to look at the relevant shareholdings shortly before sale to ensure that both spouses will obtain the maximum entrepreneur's relief.

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To the “Entrepreneur’s Relief” EMI share options retain attraction

The withdrawal of Business Asset Taper Relief (BATR) by the Finance Bill has caused many to question the value of EMI share options. Certainly a number of special tax advantages of holding EMI options have been lost, and are not replaced in Entrepreneur’s Relief (ER), but overall the benefits of EMI’s for companies and employees still endure.

The changes

Under BATR the qualification period of 2 years ran from the grant of the option, under ER the shares have to be owned ie. the option needs to be exercised 12 months before any sale. To qualify employees will have to fund the share acquisition; of course most but not all EMI schemes are designed for exercise immediately before a sale and so the 12 month holding period was not necessarily envisaged and cannot apply.

There is a 5% share holding requirement in voting shares. For employees and officers EMI options are often granted on lower holdings and in many instances may not fulfil voting requirements. A further problem exists for employees leaving an employer, with exercised options, in that they may not fulfil the rule of being employed for a whole year prior to sale.

The benefits that remain

- Incentivising and motivating employees and retaining the loyalty of key managers this is the main commercial reason and benefit and it will endure over tax issues.
- The grant of a share option under an EMI scheme is tax free and normally free of PAYE and NI on exercise.
- The EMI shares are subject to the capital gains regime now at a maximum of only 18%.
- Many employees receive only a small number of shares which can fall wholly within their CGT annual exemption (£9,600), or sales can be split over two tax years and perhaps split between spouses prior to disposal.
- A corporation tax deduction for the company on the difference between market value on exercise and the sum paid by the employee based on the value at grant.

Rent up Frustration

In this article we look at one of the many issues associated with entrepreneur’s relief.

Take the example of a typical family company where the company owns the trade and the family (personally) own the premises from which the company trades. This is a typical structure and one which made a lot of sense prior to the introduction of entrepreneur’s relief. The structure provided a degree of asset protection, it was likely that the ultimate sale of the property would qualify for business asset

taper relief (and an effective tax rate of 10%) and the payment of a market rent was a tax efficient way of withdrawing funds from the company.

Unfortunately this strategy does not work under entrepreneur’s relief. This is because where the asset has been provided for the payment of rent or other consideration, the relief available is restricted. Where the rent paid is at a full market value, the relief is reduced to nil. Where the rent paid is less

than market rent the relief is restricted on a just and reasonable basis.

If this was not bad enough, the sale of the premises must be linked to a disposal of the shares in the company; to use the phraseology of the legislation it must be “an associated disposal”. The relevant rules are complicated but in simple terms the disposal of the business premises must take place within three years of the sale of the shares.

P11D Dispersations

The P11D season is now behind us for another year, but before moving on to the next pressing matter it might be useful to consider how the work load can be reduced for next year.

HMRC may grant dispensations for certain expenses and benefits that are for genuine business purposes. The most common expenses items that may be included are travel & subsistence, entertainment, home telephone and professional subscriptions. This would mean that items included in the dispensation no longer need to be reported on forms

P11D. This will save you time and reduce the risk of penalties for incorrect returns and employees would no longer need to submit expenses claims to HMRC. Even HMRC benefit as they have fewer forms to review.

Dispersations are clearly beneficial for all concerned and as they have to be applied for in advance now is the time to act.

For further information, please speak to Dawn Foden-Smith, direct dial: 0161 475 1532 or email dawnf@boothainsworth.co.uk.

Limited Liability Partnerships

Limited liability partnerships (LLPs) are the UK's newest form of corporate vehicle providing many of the advantages (and a few of the disadvantages) of a limited company with the tax treatment offered to a partnership. This gives some interesting tax planning opportunities.

Before looking at these we will take a quick look at the background to LLPs. The impetus for the creation of LLP status was driven mainly by large professional firms who required the protection of limited liability for their partners. It was against threats from these firms to move offshore that the LLP legislation was rushed through with the tax rules being added later as an after thought.

It is also possible for a company to be a member of an LLP along with individuals. This means that it is possible to consider the following structure.

This structure can resolve many common problems such as:

- A company making profits of over £300k and therefore affected by a loss of small companies rate of tax.

- Company making profits approaching/just in excess of £1.5m and facing quarterly payments of corporation tax.

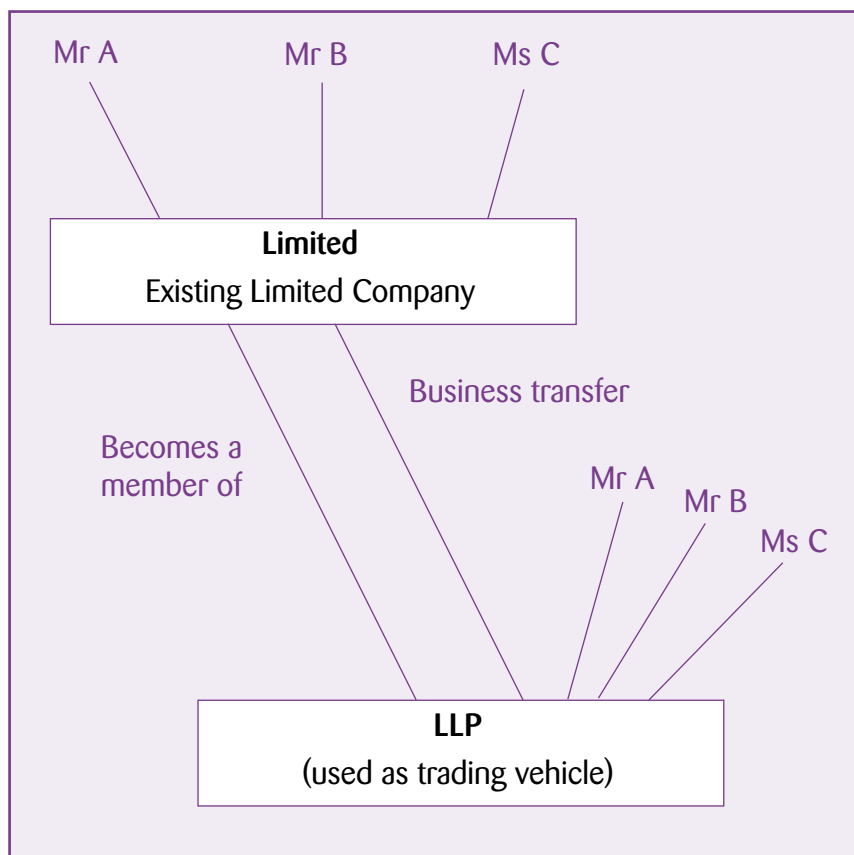
- Those with expensive cars both in and out of the business.

- Holiday homes or other property in the company used by directors/shareholders.

- Companies wanting to bring in a new management team.

- Companies wanting to make investments but worried about loss of entrepreneur's relief.

In addition, useful NIC savings can be made by making payments to the individuals through the LLP rather than the company giving an overall reduction in tax liabilities of about 7%.



Time to Take Care

The practical impact of the merger between the Inland Revenue and Customs and Excise is being seen in many ways, one of which is the introduction of a new penalty regime, for all taxes, which resembles in many ways the old penalty regime for VAT errors.

The new regime for errors and omissions on returns and documents came into force on 1 April 2008 (some may say an appropriate date). In summary, there will be fixed (i.e. non-negotiable) penalties of 30%/70% and 100% of the tax unpaid. The lower penalty will apply where there has been a lack of reasonable care with the higher penalty applying where there has been deliberate concealment and falsification of documents. The appropriate penalty will be reduced by 50% where the matter is brought to the attention of HMRC before they question the position.

Reasonable care or the lack of it is a new concept and one which is going to entail a cultural change within the former Inland Revenue. HMRC recognises that reasonable care will be different for every tax payer and depend on their abilities and circumstances. What is reasonable care for an unrepresented tax payer will differ from that for a large international company. All they have to do is to take care within their limits of competence. Even for one tax payer, what is reasonable care in relation to a simple transaction will differ when the tax payer is

involved in the complex transaction which he has never encountered before. HMRC expects those in unfamiliar territory to ensure that they apply the right tax treatment.

One of the most striking aspects of the new regime is the suspension of penalties, although suspension only applies to failure to take reasonable care. The principle is the same as suspended sentences in criminal cases! The penalty that would otherwise apply is set, but not levied. Conditions are set and if these are met during the period of suspension (which can be up to two years) the penalty is cancelled. HMRC's rationale behind this is to encourage and support compliance and the UK is the first tax authority in the world to explore suspended penalties in this way.

It will be interesting to see how former Inland Revenue inspectors apply the new regime.



All Change for Capital Allowances

The new capital allowance regime post March 2008, leaves a complex interplay between the 100% Annual Investment Allowance (AIA), on the first £50,000 of expenditure, and allowances available on the various pools. The AIA will benefit most smaller businesses significantly.

A new category of expenditure integral features, which includes cold water systems and electrical wiring, has widened the scope of plant in all buildings but has reduced the rate of writing down allowances (WDA) applicable to many items to 10% pa. Consideration of integral features and other plant in buildings will become an important planning aspect.

The WDA on the general pool has been reduced to 20% pa from its previous 25% pa.

Enhanced capital allowances for investment in environmentally beneficial plant and machinery is becoming an increasingly important feature of investment decisions, with 100% first year allowances on them, and a new payable tax credit for loss making companies.

With all these different rates, allocation of the AIA to particular expenditure could make a critical difference to tax saved.

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