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Autumn 2013

UP TO DATE DEVELOPMENTS IN TAX AND BUSINESS PLANNING



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Disincorporation – the right route to relief?

Until recently, the road to incorporation has been something of a one-way street. There are tax reliefs for businesses that incorporate, but the tax charges on ceasing to be a company can make it costly to reverse the decision. However, for a limited period only, certain companies can now take advantage of a new disincorporation relief.

Incorporation has been tax-efficient for many businesses, as profits can be extracted from companies by way of dividends with the associated savings of tax and national insurance contributions (NIC). However, incorporation brings with it the various extra regulatory and administrative burdens associated with being a limited company.

Fortunately, new legislation has now eased some of the barriers to disincorporation for smaller companies for whom incorporation has lost its shine. Disincorporation relief is available to a company that transfers its business to some or all of its shareholders, provided that the transfer of business is a qualifying business transfer and is made within the five-year period from 1 April 2013 to 31 March 2018.

A qualifying business transfer satisfies the following five conditions:

- The total market value of the qualifying assets (goodwill and interest in any land that is not held as trading stock) is not more than £100,000.
- The business is transferred as a going concern.
- The transfer includes all of the assets of the business or all its assets apart from its cash.
- All of the shareholders to whom the

business is transferred are individuals and if they are partners, the partnership is not an LLP.

- Each of those shareholders have held shares in the company for at least 12 months before the business transfer date.

This new disincorporation relief stops two main tax charges arising on the transfer of the company's assets to its shareholders: corporation tax on any chargeable gains arising on the disposal of assets; and corporation tax under the intangible fixed asset rules on the market value of the goodwill of the company's business.

The company and all of the shareholders to whom the business is transferred have to claim the relief within two years of the date of transfer. Once made, the claim is irrevocable.

So, should eligible companies be rushing to take advantage of the relief?

There are pros and cons to disincorporation. Operating as an unincorporated business frees it from the regulatory burden and associated costs of running a limited company and provides the opportunity to take advantage of simplification measures available for sole traders and partnerships, such as the cash basis and fixed rate deductions for certain expenses. However, there are advantages to remaining incorporated, such as flexibility over profit extraction and the ability to take dividends thus saving tax and national insurance contributions.

Ultimately, the decision of whether or not to disincorporate should be made with the best interests of the business in mind. Please get in touch with us to discuss your situation.

When a liability is no longer a liability

You could now be in the position that without actually doing anything, your estate has suddenly increased in value for inheritance tax (IHT). This is because of an unheralded section in this year's Finance Act.

Suppose you have taken out a loan of £250,000 in order to invest in a business valued at £300,000. After a two-year qualifying period, the business could be eligible for 100%

business property relief, and it will then effectively be free of IHT. Previously, when you died, the £250,000 would have been deducted against the value of your taxable estate and this would have reduced the amount of IHT due. You would have had the same tax advantage for assets that qualified for agricultural property relief or woodlands relief.

However, from now on, if you have incurred a liability to acquire, maintain or enhance such property that is eligible for relief, this liability will initially be set against that tax free property, with only any excess amount deducted against the general value of the estate. So in the example above, your estate would see no reduction in IHT because of the £250,000 liability.

The loan of £250,000 will be deducted from the value of the tax free business assets, and the effect will be that the estate will now

have jumped £250,000 in value. It would make no difference, as is often the case, if residential property is used as security for the loan. Trusts will also be affected by this change.



The same principle will apply where a person incurs a liability in order to invest in excluded property, i.e. overseas property that is owned by someone who is non-UK domiciled or owned by a trust set up by a non-UK domiciled settlor. Excluded property, as the name suggests, is outside the

scope of UK IHT. There has also been a tightening up of the deduction of liabilities generally. A liability will now only be deductible against the value of a person's estate if that liability is repaid after death out of the assets of the estate. There is an exception where an estate does not repay a liability for a genuine commercial reason.

The new rules will apply to deaths occurring on or after 17 July 2013. The date when the deceased person actually incurred the liability makes no differences to the situation. There will therefore be a retrospective impact on many estates.

New residence test for the internationally mobile

Before this tax year, you could avoid a large income tax liability, for example on the encashment of a life assurance investment bond, if you could arrange to work full-time overseas and become non-resident for a tax year.

But this option was not generally available because it was often difficult to establish the necessary non-UK residence status. However, it is now much easier to arrange for a temporary period of non-residence thanks to HM Revenue & Customs' (HMRC's) new statutory residence test, which offers greater certainty. Unsurprisingly, the statutory residence test comes with anti-avoidance measures that build upon those previously applied for capital gains tax (CGT) purposes – and in a few other circumstances. The new rules only apply if your year of departure from the UK is 2013/14 or later, and the old rules are still relevant if you left earlier.

The temporary non-residence rules apply if you have been resident in the UK for at least four of the seven tax years before the year of departure, and you are away for a period of up to five calendar years. If you are away from the UK temporarily, the income and gains caught in the tax net potentially include:

- Capital gains.
- Dividends from a close company.
- Chargeable event gains on both UK and offshore life assurance policies.
- Certain pension income, for example under flexible pension drawdown.
- Foreign income for a non-UK domiciled person that is taxable on the remittance basis.

Income and gains that arise during a temporary period of non-residence are



subject to tax as if they arose in the year the individual returned to the UK.

Despite the requirement to be non-UK resident for more than five years to escape CGT, retiring overseas might still be an attractive exit strategy for company owners. Some business owners build up substantial cash reserves in their companies from accumulated profits in order to avoid paying higher rates of income tax. This can sometimes preclude being able to claim CGT entrepreneurs' relief. Instead of paying 10% CGT on dissolving such a company, the business owner might well end up paying 28%.

To help your planning, a trial version of HMRC's residence indicator tool has just been made available, and can be found in the Calculators & Tools section of their website. It is subject to HMRC's usual cautionary note about potential inaccuracies.

A real time update on PAYE

Reporting PAYE in real time is now a reality for most small businesses, with more than 1.4 million employer schemes out of some 1.6 million already onboard. Despite some teething problems, real time information (RTI) is looking more like a success story rather than another central government IT disaster.

Employers that have a fluctuating, weekly paid, workforce are probably the most adversely affected by the change, for example catering and entertainment businesses with casual staff. HM Revenue & Customs (HMRC's) first reporting relaxation was the introduction of a seven-day grace period before employers have to report pay, but only for certain staff such as casual employees. As previously reported, HMRC has also reduced the reporting requirements for businesses with fewer than 50 employees. When first announced, this change was to be just for the first six months of 2013/14, but HMRC is now planning to extend it to the end of the year.

The other saving grace for 2013/14 is the relaxed penalty regime. For this year, no penalties are charged for late filing submissions. A penalty will only apply if the employee information for 2013/14 does not reach HMRC by 19 May 2014. However, inaccurate submissions could attract a penalty. The payment dates for PAYE have not changed, be they monthly or quarterly, and HMRC has recently issued a warning to this effect.

You can check your PAYE position online using HMRC Online Services or by signing up for the PAYE Liabilities & Payments Viewer – but be warned: the figures are only updated twice a month. Employers should also remember that if a PAYE scheme is in operation then they now have to submit payment information for employees earning below the national insurance contributions lower earnings limit. If all their employees earn less than this amount, then no scheme is required – so no submissions – but the level of future payments should be carefully monitored.



Finally, with the added reporting burden that directors of owner/managed companies now face, many of them have decided to opt for an annual PAYE scheme. This avoids having to complete nil payment notifications. Unfortunately, due to high demand, HMRC is currently unable to process requests to move to an annual basis.

Close company loans to shareholders

There are special tax rules about close companies making loans to shareholders and other 'participators'. Without these rules, it would be very easy for these companies to make tax-free loans rather than pay taxable remuneration or dividends. A close company is one that is controlled by five or fewer participators, usually shareholders, or by any number of participators if they are also directors.

A tax charge of 25% is imposed on the company if a loan is made to a participator. The tax is refunded to the company if the loan is subsequently repaid.

However, the charge only applies where the loan is still outstanding nine months after the end of the company's accounting period in which the loan was made. So if the loan is repaid earlier then no charge arises.

You may think that this will not affect you. However, it is quite a common strategy for company owners to take drawings from their company, and then cover these amounts with a dividend declaration at the year end. But then if the company's profits have fallen – perhaps as a result of the current economic climate – this strategy can easily unravel. You cannot take dividends unless they are supported by profits, and this will result in an overdrawn director's loan account.

Unsurprisingly, the nine-month rule has been abused, with participators repaying a loan just before the deadline, and then immediately replacing it with another loan. Since this March, such bed and breakfasting arrangements have been prevented by only giving relief for genuine repayments. Repayments of more than £5,000 are now simply ignored if they are followed by a further loan within 30 days – although repayments that are subject to income tax, such as a declared dividend, are not subject to this restriction.

Even if the 30-day rule does not apply, repayments are ignored if the outstanding loan exceeds £15,000 and at the time of repayment there is the intention to borrow again or there are arrangements in place to do so. In all cases, the relief denied is the lower of the repayment and the further borrowing.

Remember that loans of over £5,000 to directors can also result in a taxable benefit for the director, with a related class 1 national insurance contributions liability for the company.



Cash basis accounting for smaller businesses

New legislation allows smaller businesses to prepare accounts on a cash basis rather than on the accruals basis from 2013/14 for tax purposes. Although introduced as a simplification measure, the new rules have attracted criticism as a result of their complexity.

The cash basis is essentially a money-in, money-out approach. A business using the cash basis only needs to record sales when the money is actually received and payments when the money is actually paid out. The cash basis does not change the rules for the deductibility of expenses, only the time at which the deduction is given. What is more, no account is taken of money owed to the business or that the business owes.

Under the cash basis, a business owner does not need an accounting background as debtors, creditors, stock prepayments and accruals are not accounted for. Cash flow is managed as they just pay tax on money that has been received.

The cash basis is open to sole traders and partnerships whose income is below the VAT registration threshold. This is set at £79,000 for 2013/14. VAT-registered businesses qualify as long as their income is below that threshold. Once a business has opted to use the cash basis, it can continue to do so even if its income rises above the VAT threshold, as long as income does not exceed £158,000.



Above this level, the business must leave the cash basis and return to the accruals basis.

The cash basis rules will not suit every business and there are some restrictions. It may not be the best option if a business has losses to relieve against other income in the same year or if it has high borrowings and deductible interest of more than £500-neither of these are permitted under the cash basis. Certain types of business are also precluded from using the cash basis. A full list is available at www.gov.uk/simpler-income-tax-cash-basis/who-can-use-cash-basis.

Qualifying businesses can switch to the cash basis from 2013/14 by simply starting to use it and ticking the cash basis box on the self-assessment return. Please get in touch with us to discuss your options.

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