

## Starting a Business

Advise on whether business should be structured as:

- unincorporated business (sole trader/partnership); or
- incorporated business (company)

	Unincorporated	Incorporated
<b>Legal</b>	Individual(s) own assets (unlimited liability)	Company owns assets Individual(s) own shares in company (limited liability)
<b>Trading Profits</b>	IT (PA/20%/40%/45%) NI: Class 4; Class 2	CT (19%/26.5%/25%) Allowable expense: Salary, Benefits, Em NI (Cash/Benefits)
<b>Reliefs</b>	No R&D, no IFA amortisation/ROR, no CA full expense	R&D, IFA amortisation/ROR, CA full expense
<b>Trading Losses</b>	CY or PY against individual's other income/gains Losses in first 4 yrs c/b 3 yrs against other income	Can only be used against company income/gains
<b>Extraction of Profit†</b>	NA - cash already belongs to individual	Salary: IT (PA-45%) and NI Benefits: IT (PA-45%) or exempt Dividends: IT (0%/8.75%/33.75%/39.35%) Loans: 33.75% CT charge if close company
<b>Payment Dates</b>	POA: 31 Jan and 31 Jul - 50% of PY IT and NI 31 Jan - balance	CT: 9m and 1 day after AP end if profits ≤£1.5m IT: PAYE on salary
<b>Exiting Business (CGT)</b>	<u>Disposal of assets</u> Gain for individual(s) - BADR, GR, ROR	<u>Disposal of shares</u> Gain for individual(s) - BADR, IVR, GR  <u>Disposal of assets</u> Gain for company Cash paid out to shareholder(s) <ul style="list-style-type: none"> <li>- Dividend</li> <li>- Gain (paid after liquidator appointed) - BADR</li> </ul>
<b>Exiting Business (IHT)</b>	BPR 100% if whole business transferred	BPR 100% for unquoted shares
<b>Residential Property</b>	SDLT: additional 3% VAT: No VAT on residential properties IT: Cash basis if rent ≤£150k IT: Finance cost restricted (unless buy-to-sell/FHA <sup>†</sup> ) IT: Losses carried forward against property income CGT: Gain on disposal (18/28%) <ul style="list-style-type: none"> <li>- PRR if lived in property</li> <li>- BADR/GR/ROR if FHA</li> </ul> IHT: No BPR as not a trading business <ul style="list-style-type: none"> <li>- unless buy-to-sell/FHA</li> </ul> IHT: RNRB available if lived in property <sup>†</sup> FHA days: let ≥105, available ≥210, ≤31 per person	SDLT: additional 3%; 15% SDLT if property >£500k VAT: No VAT on residential properties ATED: if property >£500k (unless buy-to-let/sell) CT: Finance costs deductible as NTLR CT: Losses offset against TTP (CY and carried forward) CT: Gain for company on disposal and cash paid out <ul style="list-style-type: none"> <li>- Dividend</li> <li>- Gain (paid after liquidator appointed) - BADR</li> </ul> IHT: No BPR on shares as not a trading business <ul style="list-style-type: none"> <li>- unless buy-to-sell</li> </ul>
<b>Admin</b>	No statutory filings Individual tax return	File accounts at Companies House Company and individual tax return

### Family Investment Company (FIC)

- Close company with shares held by family members
- Company invests in assets which produce non-trading (passive) income e.g. property, shares
- Parent controls company with voting shares and by being appointed as director
- Child entitled to dividends and capital growth with non-voting shares
- Like a trust, this enables child to benefit from income generated whilst ensuring capital wealth is preserved and not wasted

#### Setting up FIC

- Parent subscribes to new shares
  - Stamp duty: newly issued shares exempt
- Parent gifts cash to child so child can subscribe to new shares
  - CGT: cash exempt
  - IHT: PET
  - Stamp duty: newly issued shares exempt
- Parent gifts existing shares to child
  - CGT: gain with proceeds at MV because connected (no reliefs as non-trading company)
  - IHT: PET (no BPR as non-trading company)
  - Stamp duty: gifts exempt
- Parent transfers assets (property, shares) to company
  - CGT: gain with proceeds at MV because connected; consider CGT reliefs (above)
  - IHT: no IHT on transfer to company
  - Stamp duty: 0.5% on shares; up to 15% on property
  - VAT: commercial property if new (<3yrs) or OTT

#### Operation of FIC

- Company owns assets (property, shares, bonds/loans) and earns rent, dividends, interest
- Company may also sell assets to generate cash
- Company pays CT on income and gains
  - Rent: Property income
  - Dividends: exempt
  - Interest receivable: NTLR
  - Gains on disposal of assets: Chargeable gain (consider SSE on share disposals)
- Interest payable on loans taken by company to acquire assets deductible as NTLR
- CT rate 25% on all profits as close investment company
- Profits extracted to provide income to shareholders/directors
  - Dividends: IT, no NI
  - Salary: IT and NI
  - Benefits: IT or exempt
  - Loans: 33.75% CT charge as close company
- Income paid to child under 18 is taxed on parent

#### Exit from FIC

- Parent transfers shares to child in life
  - CGT: gain with proceeds at MV because connected (no reliefs as non-trading company)
  - IHT: PET (no BPR as non-trading company)
  - Stamp duty: gifts exempt
- Parent transfers shares to child on death

- CGT: death not a disposal; base cost uplift
- IHT: NRB; 40%; no BPR as non-trading company
- Stamp duty: inheritance exempt

Comparison to owning assets personally or in a trust

- Advantages: CT rate lower than IT rates; dividends exempt; interest payable deductible; less IHT compared with a trust
- Disadvantages: CT rate higher than CGT rate; double layer of taxation if income paid to shareholders/directors is taxable; company admin; potential for anti-avoidance legislation

SAMPLE - NOT FOR USE

**CGT / IHT Interaction**

	CGT		IHT			
<b>Life Transfer</b>	<b>Exempt Asset</b> Cash Cars ISA shares QCB Chattels	<b>Reliefs</b> <u>Tax Deferral</u> ROR - trading asset disposal and reinvestment in trading asset GR - trading asset/shares disposal GR - any asset disposal if LT IHT EIS - any asset disposal and reinvestment in EIS shares	<b>Exempt Asset</b> N/A	<b>Reliefs</b> BPR - business assets/shares	<b>PET</b> NRB  No LT  No DT if survives 7 years	<b>CLT</b> NRB  LT 20/25%  No DT if survives 7 years
	<b>Transferee</b> Spouse Charity	Disposal of asset could cause past gains previously deferred under the following to now become chargeable: ROR, GR, IR, EIS, gains on shares deferred following takeover (SFS)	<b>Transferee</b> Spouse Charity Political		DT 40% reduced by TR, FIV relief	DT 40% reduced by TR, FIV relief, LT paid
	Annual Exemption (AE)	<u>Tax Rate Reduction</u> BADR - trading assets/shares disposal IVR - Shares disposal	Annual/Marriage Exemption (AE)			
		<u>Tax Exemption</u> PRR - residential property disposal SEIS - any asset disposal and reinvestment in SEIS shares	Payments made from income			
<b>Death Transfer</b>	Death is not a disposal for CGT so no tax to pay Recipient's base cost is uplifted to value at death Death has optimal outcome for CGT		<b>Exempt Transferee</b> Spouse Charity Political	<b>Reliefs</b> BPR - business assets/shares RNRB - Residential property QSR - IHT in last 5 years Reduced rate (36%) - 10% to charity		<b>Death Estate</b> NRB/RNRB  DT 40%

## Reliefs

### Tax Deferral Reliefs

- Tax deferral reliefs have a cash flow benefit but do not reduce tax payable as the gain is just deferred until a future disposal

### **Rollover Relief (ROR)**

- Disposal of trading asset and replacement with new trading asset
  - Applies to disposal of:
    - L&B and P&M used in unincorporated trading business
    - Goodwill
- Replacement trading asset can be purchased one year before disposal/3 years after
- Any proceeds not reinvested are taxable now
- Gain on the old asset reduces base cost of the new asset
- When new asset is sold, gain will be higher as the base cost is lower
- Holdover Relief (HOR) if new asset has UEL  $\leq 60$  years; gain held over for maximum of 10 years

### **Gift Relief for Business Assets (GR)**

- Gift of business assets or shares
  - Applies to disposal of:
    - Trading assets used in unincorporated trading business (L&B, P&M, Goodwill)
    - Shares in donor's trading company (5% of shares and voting rights)
    - Shares (unquoted) in a trading company
- Treat company as non-trading if  $>20\%$  of turnover/assets/staff relate to non-trading
- Gift amount reduces the gain chargeable now and the base cost of the assets/shares
- When donee sells asset/shares, gain will be higher as the base cost is lower
- Restriction when shares are transferred to exclude non-trading/investment assets
  - GR: Chargeable trading assets / Total chargeable assets

### **Gift Relief when IHT due**

- Special type of GR when there is a lifetime IHT charge on asset (CLT)
  - Applies to disposal of:
    - All assets where there is a lifetime IHT charge
- Gift amount reduces the gain chargeable now and the base cost of the assets/shares
- Still applies when IHT payable is nil due to AE, NRB or BPR

### **Incorporation Relief (IR)**

- Unincorporated business transferring assets to company
  - Applies to disposal of:
    - Sole trader/Partners transferring assets to company in exchange for shares
      - Going concern
      - All assets transferred (except cash)
- Gains on old assets reduce base cost of the shares
- When shares are sold, gain will be higher as the base cost is lower

### Chargeable Lifetime Transfer (CLT)

- Discretionary trust
- Interest in possession (IIP) trust

CLT			
<b>Lifetime</b>			
Value of transfer		X	Fall in value of transferor estate
Reliefs		(X)	BPR
AE		(X)	AE b/f if not used in PY
Chargeable transfer		X	
NRB	£325k		
Gross Chargeable Transfers (GCT) made in 7 years before gift	(x)		GCT: transfer value AND IHT paid by transferor (LT IHT on CLT) Chargeable transfers only - PETs not chargeable until death
NRB available		(X)	
		X	
<b>IHT@20/25%</b>		X	25% if transferor pays - this increases the GCT
GCT		X	Transferor has given asset AND paid the IHT
<b>On Death (dies within 7 years of gift)</b>			
GCT		X	Above
BPR withdrawn		X	BPR withdrawn if transferee not using asset (or replacement) for business use
Reliefs		(X)	Fall in value of asset since transfer
Chargeable transfer		X	
NRB	£325k		Higher if spouse died without using their NRB
GCT made in 7 years before gift	(x)		GCT: transfer value AND IHT paid by transferor PETs now chargeable as transferor died
NRB available		(X)	
		X	
<b>IHT @ 40%</b>		X	
Taper relief		(X)	Survived 3-7 years since gift
Lifetime tax (LT) paid		(X)	Above
<b>IHT payable</b>		X	