Starting a Business

Advise on whether business should be structured as:

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

	Unincorporated	Incorporated
Legal	Individual(s) own assets (unlimited liability)	Company owns assets Individual(s) own shares in company (limited liability)
Trading Profits	IT (PA/20%/40%/45%) NI: Class 4; Class 2	CT (19%/26.5%/25%) Allowable expense: Salary, Benefits, Em NI (Cash/Benefits)
Reliefs	No R&D, no IFA amortisation/ROR, no CA full expense	R&D, IFA amortisation/ROR, CA full expense
Trading Losses	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
Extraction of Profit†	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
Payment Dates	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
Exiting Business (CGT)	<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) - Dividend - Gain (paid after liquidator appointed) - BADR
Exiting Business (IHT)	BPR 100% if whole business transferred	BPR 100% for unquoted shares
Residential Property	SDLT: additional 3% VAT: No VAT on residential properties IT: Cash basis if rent ≤£150k IT: Finance cost restricted (unless buy-to-sell/FHA[†]) IT: Losses carried forward against property income CGT: Gain on disposal (18/28%) - PRR if lived in property - BADR/GR/ROR if FHA IHT: No BPR as not a trading business - unless buy-to-sell/FHA IHT: RNRB available if lived in property [†]*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 - Dividend - Gain (paid after liquidator appointed) - BADR IHT: No BPR on shares as not a trading business - unless buy-to-sell
Admin	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

CGT / IHT Interaction

	CGT		IHT			
Life Transfer	**Exempt** Asset Cash Cars ISA shares QCB Chattels Transferee Spouse Charity Annual Exemption (AE)	**Reliefs** Tax Deferral 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 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) Tax Rate Reduction BADR - trading assets/shares disposal IVR - Shares disposal Tax Exemption PRR - residential property disposal SEIS - any asset disposal and reinvestment in SEIS shares	**Exempt** Asset N/A Transferee Spouse Charity Political Annual/ Marriage Exemption (AE) Payments made from income	**Reliefs** BPR - business assets/shares	**PET** NRB No LT No DT if survives 7 years DT 40% reduced by TR, FIV relief	**CLT** NRB LT 20/25% No DT if survives 7 years DT 40% reduced by TR, FIV relief, LT paid
Death Transfer	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		**Exempt** Transferee Spouse Charity Political	**Reliefs** BPR - business assets/shares RNRB - Residential property QSR - IHT in last 5 years Reduced rate (36%) - 10% to charity		**Death Estate** NRB/RNRB DT 40%

Reliefs

<u>Tax Deferral Reliefs</u>

- 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 ≤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			
Lifetime			
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	
IHT@20/25%		X	25% if transferor pays - this increases the GCT
GCT		**X**	Transferor has given asset AND paid the IHT
On Death (dies within 7 years of gift)			
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	
IHT @ 40%		**X**	
Taper relief		(X)	Survived 3-7 years since gift
Lifetime tax (LT) paid		(X)	Above
IHT payable		**X**	

Model Answer: December 2020 (ICAEW mock exam: Crocus)

Q1.1

NOX

A company is Resident (R) in the UK for tax purposes if it is incorporated in the UK or managed and controlled (M&C) in the UK.

Nox is incorporated overseas and board of directors meet overseas so appears to be NR.

NR companies are taxed on trading income they earn in the UK from a UK PE.

Nox has a UK PE so PE profits subject to UK tax at 25%.

As profits are also taxed overseas, DTR available at 10% (lower than UK rate).

L appears to be a large group so transfer pricing rules apply. Therefore, UK profits will be adjusted if transactions are not at arm's length.

The revenue earned by the UK is below MV rate so profits in UK are understated.

TP adjustment to increase UK profits:

	Current	MV	Adjustment	25%
Revenue	5000	15000	10000	2500
Per unit	1	3		

There is likely to be an adjustment in respect of previous years.

HMRC should be notified of the errors in the tax returns when group is acquired.

MELANGE

L is UK R for tax purposes because incorporated in UK. Therefore, taxed in UK on UK and overseas profits/gains.

The PE was taxable in UK because it is part of L.

When PE incorporated, trade of PE ceases (BA/BC, final trading profit/loss).

Assets disposed of at MV to new NR company (M is NR because not incorporated in UK and doesn't appear to be managed from UK – need to confirm).