



Tax Briefing

Keeping you up to date with events in your sector.

Welcome

Welcome to the Spring edition of our tax briefing.



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As this introduction is being written there is doubt across Europe as to the extent of any growth that is occurring in many economies. The same is true of the UK where GDP did not expand as fast as one had hoped in the final quarter of 2009. The future of UK growth seems to be largely dependant on a fairly significant consumer spending pick-up. Many commentators question the size of the likely increase in consumer spending as there still appears to be a long way to go in households reducing their debt burden which is likely to keep the rate of saving high for a considerable period.

Aligned to this is that Government spending and revenue forecasts will without doubt be revised following the forthcoming General Election, no matter which party or parties form the next Government. One thing that is certain is that there will be a fiscal squeeze and this edition of our tax briefing concentrates on some of the things that can be done before 6 April 2010 in order to alleviate the pain of the already announced increase in tax rates from that date. In addition we have an article on selling your business in the current economic climate.

Pre 6 April 2010 Tax Planning

The introduction of the 50% tax rate from 6 April 2010 has focused minds as to whether income could be realised in the 2009/10 tax year and so suffer tax at 40% rather than the new higher rate.

With the restriction of personal allowances for income in excess of £100,000 this topic is not just relevant for high earners with taxable income over £150,000.

The obvious point to make is that accelerating income also accelerates the payment date for tax (and National Insurance where applicable). Self Assessment liabilities would be advanced 12 months to 31 January 2011, while tax paid under PAYE may only be due a month or so earlier than would otherwise be the case.

There may be flexibility over the timing of bonus payments, which could be accelerated to pre 6 April to take advantage of the lower tax rates. Bonuses can be accrued in the company accounts and, provided they are paid within 9 months of the year end, should be deductible for corporation tax. It is this later date, on which PAYE will be operated, that must fall in the 2009/10 Tax Year to avoid the 50% tax rate.

Equally, however, payment in this respect does not have to mean a cash transfer. For instance it would be possible to transfer the net balance to a loan account, against which the employee or director can draw in future.

Equally, dividend payments could also be advanced pre 6 April to take advantage of the 25% effective tax rate on the net dividend rather than the 36.11% effective rate that will

apply from 6 April 2010. Of course no National Insurance contribution is payable with regard to dividend payments although dividends are not deductible for corporation tax. It is important to remember that a company can only pay dividends from distributable reserves.

Other areas where there may be flexibility over when income is realised and taxed include:

- The exercise of unapproved share options
- Pensions in draw-down, including early vesting to take tax free cash and maximum pension in 2009/10,
- Planned or unavoidable remittances of untaxed foreign income for foreign domiciliaries.

Equally there may be deductions, reliefs or allowances - such as charitable gifts for example - that can be deferred in order to obtain 50% tax relief in 2010/11, rather than 40% in 2009/10.

For self-employed individuals another legitimate way of accelerating income into the 2009/10 Tax Year may be to change their accounting date for tax purposes to 5 April

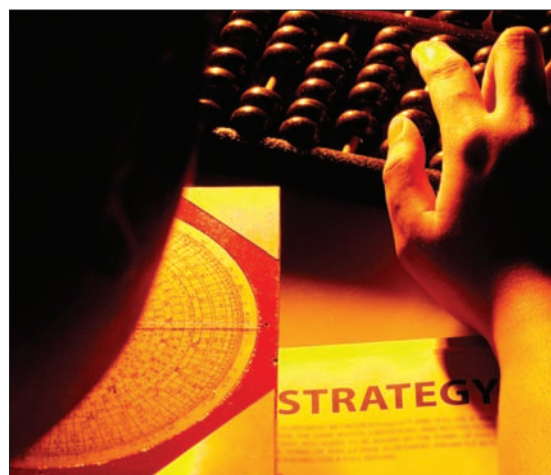


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or 31 March. For traders who currently prepare accounts to 30 April, this will bring a further 11 months profit into 2009/10 rather than 2010/11, less any overlap relief that has been brought forward. The amount of overlap relief available, as well as the expected future profit trends, should be taken into account before making such a decision.

As well as the financing cost involved in accelerating the tax charge, other factors that must be considered include the restriction on future flexibility (as the accounting date can only change for tax purposes once every six years) and, where possible, any expected future changes in tax rates.

The same considerations apply for partners or members of an LLP, although it may be difficult to reach a consensus within the partnership as some partners could be disadvantaged by such a change.



Trusts and the 50% rate

Along with the increase for individuals, trusts where the trustees have discretion over the payment of income to beneficiaries will also be subject to the new highest rates of income tax from 6 April 2010. Payments to beneficiaries from that date must also carry a 50% tax credit, either from the available tax pool or made up in additional tax payments.

It is important that trustees of such trusts, mainly discretionary and accumulation & maintenance trusts, review their position before 6 April 2010 in order to both maximise the use of their current tax pool and look at ways of reducing their tax bill into the future.

Payments made before 6 April only need to carry a 40% tax credit and therefore it may be worth considering bringing forward any planned income payments in order to better utilise any existing tax pool.

Where trustees generally pay out a regular amount to a beneficiary each year, it may now be possible to appoint

a temporary interest in possession to a beneficiary so that they receive a fixed share of the income as of right. This would reduce the amount of tax payable by the trustees to lower rates and also allow the tax credit on dividends, which is effectively lost in a discretionary trust, to be used by the beneficiary. Note this has only become possible since 6 April 2008 due to the changes in the 2006 budget.

Overriding the above though, must be the trustees' primary duty to ensure they are complying with the trust deed and acting in the best interests of the beneficiaries' as a whole.



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It is important that trustees of such trusts, mainly discretionary and accumulation & maintenance trusts, review their position before 6 April 2010.

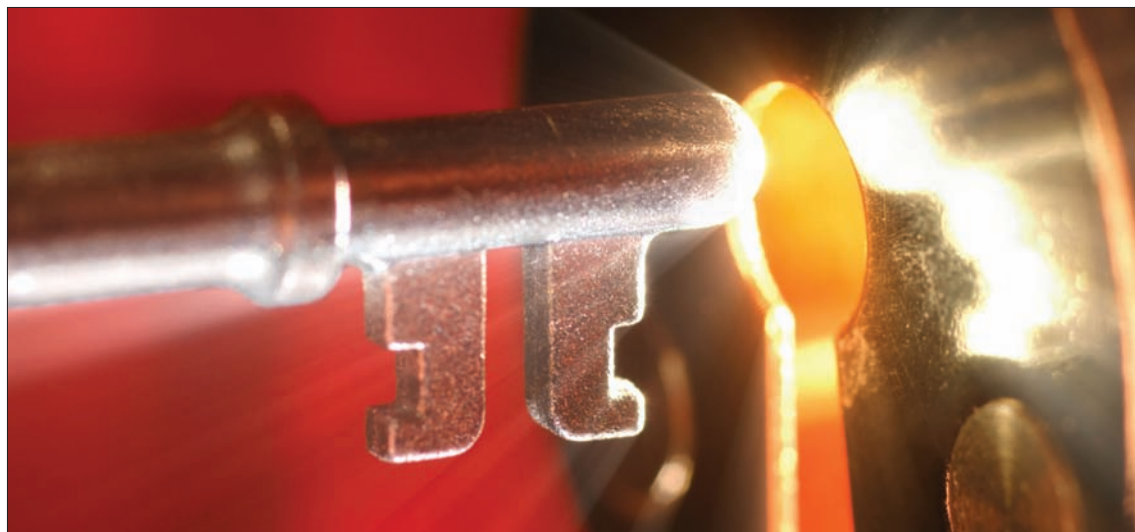


Selling your business: why a VIMBO's may be a way to unlocking value in your business

Traditionally there have been two ways to release the capital value locked up in a successful business; sell it to a trade buyer or float.



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Looking at a vendor initiated management buyout ("VIMBO") may help to unlock value in the business as well as securing often much needed succession.

These however are not always the perfect solutions especially in the current climate. Perhaps you have an excellent management team but still want to have some involvement in the growth of the business or don't really want to expose yourself and your company to the very public gaze of being a quoted company, or are worried about the company losing the culture you have grown by selling to a trade buyer.

In these circumstances looking at a vendor initiated management buyout ("VIMBO") may help to unlock value in the business as well as securing often much needed succession. A VIMBO would typically work for an owner looking for a full exit from the business but can in some circumstances be applied to partial exits.

If a partial exit is to be considered then the exiting owner needs to demonstrate that they are still committed to the business going forward and can hand over the reigns to the second tier management.

Second tier management need to be strong for any MBO to work and a VIMBO is no exception. Securing funding for such transactions will hinge on the ability of the management team to perform against budgets and develop and grow the business. The management team will also need to put some personal equity into a VIMBO to show their commitment to taking the business on. There is no magic formulae for how much equity a management team needs to secure personally but it needs to be an amount which the team would not want to lose thereby focusing their minds on the success of the business.

Historically these types of transactions were structured with as much debt as possible. In the current market this is not advisable and whilst a significant proportion of the transaction can be structured through debt an equity investor may also be required to ensure the business is not too highly geared. Having a business with strong cash flows to facilitate the debt and provide returns to all the shareholders is a must. Despite what we may read in the press there is finance in the markets for these types of transactions but structuring to ensure serviceability is key.

Alternatively the owners could look to take their consideration over a period of time. Caution must be taken however to plan your personal cash flows as you will trigger capital gains tax at the point of sale in most circumstances and therefore incur a tax liability on the full consideration not the element received on day one. There are structures which can be considered to defer this liability though they will be open to changes in tax legislation.

A VIMBO can be an ideal way of shareholders releasing equity in the business they have built up as well as providing a route to empowering the existing management team to continue the growth of the business as a private company. If shareholders have confidence in their management team a VIMBO is an effective solution to succession planning.

CV Capital LLP, the specialist corporate finance boutique of Chantrey Vellacott DFK LLP, work with owners reviewing all options for sale and management teams on structuring and funding MBO's, and VIMBO's. Should you require any further information such transactions please do not hesitate to contact Debbie Clarke.



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Do you have the right structure for your business?

When considering the optimum structure for your business it is important that consideration is given to Limited Liability Partnerships (LLPs) as well as the more conventional choice between a company or sole trade or traditional partnership.

LLPs have become increasingly popular since they were introduced in 2001, and can be seen in many ways as a hybrid structure, combining aspects of both traditional partnerships and companies. LLPs are taxed in much the same way as traditional partnerships and have the same flexibility to vary profit shares or capital and introduce new partners (technically called Members) or retire old ones. There can, however, be National Insurance savings. Unlike traditional partnerships, LLPs share with limited companies the benefit of limited liability, as well as some of the filing and disclosure requirements.

In the right circumstances it is possible to go further and ensure that all the respective benefits of companies and

LLPs are obtained by introducing a company as a member of your LLP, perhaps to take on specific roles in the business in return for a suitable profit share. This can ensure that profits withdrawn are only taxed once in the hands of the partners, but any profits retained in the business face the lower rates of corporation tax. Over time this can be a powerful method of building the working capital of the business, and perhaps reducing any reliance on bank finance.

It is important that a business structure reflects the commercial realities and is properly implemented, so suitable advice from advisers with a strong track record in this specialist area should always be sought.



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Involving Family Members in Your Business

There has been much discussion in recent years with regard to family businesses, which was particularly emphasised by the Arctic Systems case.

Following the House of Lords judgement in favour of the taxpayers, Mr & Mrs Jones, many people believe it is acceptable to pay a salary to a spouse or family member or have them as a shareholder without any reference to the true commercial position.

In fact this case has no bearing on the position of employing family members. However, it is the case that for a tax deduction to be achieved for the cost of employing any individual, including a family member, the cost must be incurred wholly and exclusively for the purpose of the

trade in question. Therefore they must be performing relevant duties to the benefit of the business, and their remuneration must not be higher than would be paid to an unconnected person.

Where a family member is employed in such a role, it is perfectly acceptable to pay them the market rate for the work performed on behalf of the business.

Arctic Systems did defeat (for now at least) the Revenue's attempts to reclassify all dividends paid to spouses as income of the main business owner. Therefore the Revenue have very little ground to challenge the ownership of ordinary shares in a business, so that all adults would be taxed in their own dividends at their appropriate marginal rates. Dividends of any size from a family business paid to minor children are however likely to be taxed as income of the parent. The position is less certain for more restricted classes of shares as the Revenue may be able to sustain an argument that such shares are "wholly or substantially a right to income" and so the exemption that won the day for Mr and Mrs Jones would not apply.

One should also consider the capital gains tax issue associated with involving a spouse or family member. For example Entrepreneurs Relief may be available to reduce the effective rate of CGT to 10% if certain conditions are met. One option may be to appoint an adult child, for example, as company secretary of a family business. Provided they hold the correct number of shares they should be entitled to Entrepreneurs Relief. A commercial fee could also be paid for duties performed.



Where a family member is employed it is perfectly acceptable to pay them the market rate for the work performed on behalf of the business.

Online VAT Filing

Most businesses will be subject to mandatory online filing and electronic payment of VAT liabilities after 1 April 2010. HMRC have powers to charge penalties for not filing online.

The provisions will apply to businesses where:

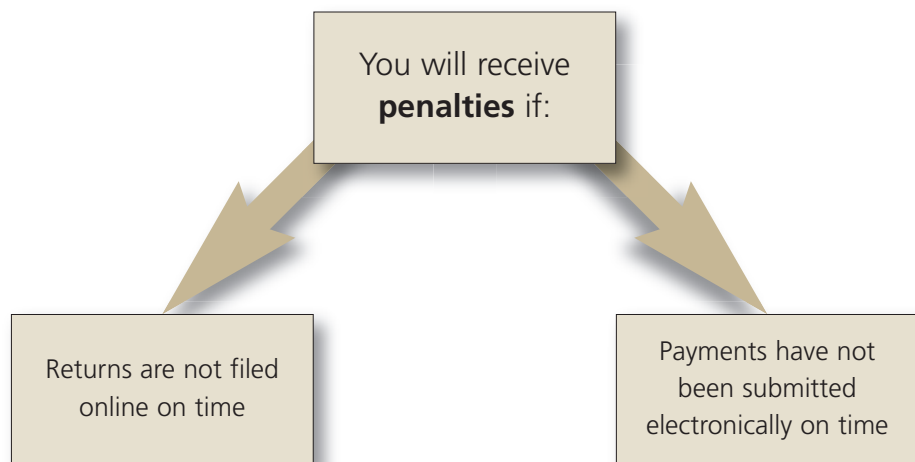
- (a) Turnover exceeds £100,000; or,
- (b) Registered after 1 April 2010

The VAT specialists at Chantrey Vellacott DFK can advise on:

- Procedures
- Software
- Training
- VAT compliance review which can provide assurance against mandatory 30% penalties.



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Realising Gains on Unapproved Share Schemes

Share options give an employee the right to acquire a share or security at a later date where the exercise price is agreed at the start. Although approved share schemes can be very tax efficient they may not be available for overseas companies or where greater flexibility is required.



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Unapproved schemes have three potential trigger points which can produce tax liabilities:

- 1 on the grant of the option in certain circumstances;
- 2 on the vesting of the option in certain circumstances;
- 3 on exercise of the option when the shares are acquired.

Unless the options are granted at a price lower than the market value at that point, tax will normally only arise on the exercise. At this point an employee will pay income tax and national insurance (and the employer national insurance) on the difference between the amount paid and market value of the shares at the time of exercise. Often the exercise cost will be financed by selling some of the shares on the open market (a 'cashless exercise').

When the shares are sold an individual is liable to capital gains tax on the amount of any capital gain. The base cost of the shares is increased by any amounts that are charged to income tax.

The example below shows the capital gain where an individual sells shares for £150,000. The shares were acquired for a zero option price and had a market value of £120,000 at the time of exercise.

Sale proceeds		£	150,000
Base cost:			
Option price			0
Amount charged to Income Tax	120,000	(120,000)	
Capital Gain			30,000

An individual will be able to offset their annual exempt amount (£10,100 for 2009/10) against any gain before the calculation of capital gains tax at 18%. However, they will not qualify for Entrepreneurs' Relief (and so be taxed at 10%) on the gain unless they own more than 5% of the ordinary share capital of the company at the time of the disposal.

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