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AUTUMN 2013

MakeYour Business 'Entrepreneurs' Relief-Ready'!

Does the business qualify?

'Business' means a trade, so property development should qualify, but not property letting. Furnished holiday letting is specifically deemed to be a trade for capital gains tax (CGT) purposes, including entrepreneurs' relief.

Do assets that I own personally qualify?

If you're a sole trader, the assets must belong to you but you can only claim entrepreneurs' relief if you dispose of the business or of the assets *after* you have ceased to carry on the business. So if you're planning to cease and have arranged a sale of a major asset it may not be worthwhile carrying on the business after the date of contract, which fixes the date of disposal for CGT purposes.

If you intend to continue trading after the sale this could be the time to transfer the business to a company but retain the asset to sell personally after the business has been transferred.

Groom your business

You may not be planning to sell now but it would be a shame to lose out on relief because the business isn't prepared when it might have been. Some actions must be taken at least a year before disposal.

What do you need to do at least a year before sale?

The first thing to remember is that you must have owned the business or held your shares for at least a complete year. You don't have to sell the business immediately after a cessation: you have three years from ceasing to trade in which to arrange a sale.

There is no minimum partnership share requirement but if you are a shareholder you must have owned shares entitling you to 5% of the voting rights and ordinary share capital for a minimum of 12 months ending on cessation of business or sale of the company (note that the 5% minimum requirement doesn't apply to shares acquired under the enterprise management incentive (EMI) scheme).

If you have claimed entrepreneurs' relief when disposing of a previous business, check how much of the lifetime allowance of £10million you still have available.

If you want your family to participate in the sale proceeds you can bring them into partnership or give them shares but remember that:

- they then have to hold their shares for the 12 month minimum period;
- company shareholders must satisfy the 5% minimum requirement; and
- company shareholders must also be an employee or office-holder throughout the 12 month qualifying period.

Check that more than 20% of the company's assets are not held for non-business purposes.

What can you do less than 12 months before sale?

If you've transferred company or partnership shares to someone else but the sale is going to happen before they can meet the 12 month qualifying period, consider taking their share back from them to use your own entrepreneurs' relief allowance if you already qualify.

If you rent assets to your partnership or company you cannot claim full entrepreneurs' relief and may not be able to claim the relief at all, but you can transfer the asset into the company or partnership before the business or company is sold. Make sure you take the time to complete last-minute grooming before you sign the contract for sale. HMRC can be expected to check your paperwork and verify dates.

Practical Tip:

Incorporate your business by sale - If you sell your business to your own company chargeable assets, including goodwill, can get entrepreneurs' relief. You can leave the sale proceeds on loan to the company, having paid only 10% instead of income tax at 20% to 45% if you draw profits out and pay income tax.

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Dufton Kellner Limited
Barnston House,
Beacon Lane,
Heswall,
Wirral
CH60 0EE

Email:post@duftonkellner.co.uk • Tel: 0151 342 6405 • www.duftonkellner.co.uk

Loans to Shareholders – Three "Loopholes" Closed

If a close company lends money to a "participator" (broadly, a shareholder or his close relatives), there is a tax charge (under CTA 2010, s 455). The charge is 25% of the amount loaned, and is repayable if the loan is repaid or written off. If the loan is repaid within nine months of the company's year end, no s455 tax needs be paid, but if not, the tax is not repaid until nine months after the accounting period in which the loan is repaid.

This year's Finance Act contains legislation to block three "loopholes" in the rules for loans to shareholders, which apply to transactions after 20 March 2013.

Loophole #1

Mr Jones owns all the share capital of Jones Ltd, and he trades in partnership with the company, so the partners in The Jones Partnership are Mr Jones and Jones Ltd. There are several reasons for this structure, and one of the main ones is that the company only pays corporation tax on its share of the partnership profits at 20%.

If the company lends money to the partnership, it used to be thought that s 455 did not apply to such a loan because the partnership is not a shareholder in the company, but now the law has been amended to charge the company 25% tax as if it had made the loan directly to Mr Jones.

This includes capital introduced into the partnership by the company.

Loophole #2

This goes even further than the first loophole closure. It applies if a company does not draw its entire profit share from the company. Typically, a company only draws enough of its profit share to meet its own corporation tax and other expenses, leaving the rest in the partnership bank account as working capital. It appears in the partnership accounts as the company's current account with the partnership.

If Mr Jones overdraws his own partnership current or capital account, then the company will now be charged s 455 tax on the lower of:

- The amount overdrawn by Mr Jones, and
- The amount of profits not drawn by the company

Loophole #3

We began by learning that if the loan is repaid within nine months of the year end, no s 455 tax is payable, so it is not surprising that it has been quite common for such loans to be repaid just before the nine month deadline.

Sometimes this is done by voting a dividend to clear the loan, but in some cases all that has happened is an exercise often called "bed and breakfasting", where the loan is repaid just before the nine month deadline, and then the money is again lent to the shareholder just after the nine month time limit.

HMRC have always tried to counter this by saying the repayment was a sham, but it has been difficult for them to win this argument. Now, they can ignore the repayment in two situations:

- Where more than £5,000 is repaid before the nine month time limit, and more than £5,000 is loaned again within 30 days;
- Where more than £15,000 is repaid before the deadline, and there are "arrangements" or "an intention" for a further loan from the company in the near future.

It will be interesting to see how "arrangements" and "intentions" will be established – though in reality, the onus is likely to be on the company to show there was no such intention, in a case where a further loan has in fact been made.

Practical Tip:

All business structures involving a company in a partnership need to be reviewed urgently to ensure they do not fall foul of the new rules, and bed and breakfasting will have to stop!

Playing The Mortgage Game To Lower Property Taxes

It can be possible to pay off the mortgage on your home by releasing equity from your buy to let properties, and thus converting your domestic mortgage (on which the interest is not an allowable deduction) to a mortgage secured on your buy to let properties, with the interest deductible from your rental income.

The general wisdom in these matters is that mortgages on your home are to be avoided if possible, and replaced by mortgages on rental properties, precisely because of the interest being deductible on the buy to let mortgages.

However there are situations where the opposite is true –a mortgage secured on the family home proved more flexible and tax efficient than a mortgage on the buy to let property.

Example 1 – Buy to let mortgage

Mr and Mrs Dali jointly own a buy to let property bought with a BTL mortgage secured on the let property. The property produces a taxable rental profit of £400 a month, which is (as the law requires), assessed equally on each of them. Mrs Dali has a well-paid job and is a 40% taxpayer, so she pays income tax of £960 on her half share of the profit. Mr Dali is an as yet unsuccessful artist and his share of the rent is covered by his personal allowance and he pays no tax.

They would be better off if they transferred most of Mrs Dali's share in the property to Mr Dali, and signed a "Form 17" to require HMRC to tax them on their actual shares in the property. This will involve converting their joint ownership to a "tenancy in common", getting agreement from their mortgage provider – and no doubt paying some form of "arrangement fee" – and depending on the size of the mortgage, there may also be some SDLT to pay. This more than swallows up the first year's saving, but they go ahead anyway.

A couple of years later, Mr Dali becomes successful – hugely successful – as an artist, and his strange and (to some tastes) macabre paintings sell for hundreds of thousands of pounds. Mrs Dali is able to give up her job and take things easy – a fitting reward for years of toil to finance her husband's endeavours. It would, of course, make sense to transfer the majority of the buy to let property back to Mrs Dali, with the attendant hassle and professional fees.

But what if the let property had been purchased with a mortgage secured on the family home?

Example 2 –Remortgaging of family home

The Matisses are in exactly the same situation as the Dalis were – she works hard to support his as yet unsuccessful artistic career – but they bought their BTL property by remortgaging the family home. Because there is a clear audit trail showing that the loan was used to acquire the BTL property, the interest can be deducted against the rental income.

Transferring the ownership of the let property, however, is much simpler, and only involves a declaration of trust. The mortgage provider does not have to give permission as the loan is not secured on the let property being transferred, and for the same reason there can be no question of SDLT to pay.

When Mr Matisse also hits the big time and Mrs Matisse puts her feet up, the transfer back is equally cheap and painless – simply another declaration of trust and another Form 17.

Practical Tip:

Generally speaking you are better off having mortgages on your buy to let properties rather than your home, but the tale of the Dalis and the Matisses shows that like all general principles, there are exceptions in some circumstances.

Personal Tax

Utilising Spouse's Or Civil Partner's Annual CGT Exemption

Each spouse or civil partner has their own capital gains tax annual exempt amount. Further, assets can be transferred between spouses and civil partners at a value that gives neither a gain nor a loss. By transferring assets into joint names prior to sale or to your spouse or civil partner, you can utilise your spouse's or civil partner's annual capital gains tax exempt amount as well as your own if he or she has not used it.

For 2013/14 the annual exemption is £10,900 which means that a couple can make gains of up to £21,800 before paying any capital gains tax.

Transfers between spouses and civil partners are treated as a no gain/no loss transaction and hence the spouse/civil partner steps into the shoes of the other holder, taking over their base cost and length of ownership.

This can be especially useful when selling investment properties, although stamp duty land tax considerations need to be taken into account.

Case Study:

Mr Smith (a higher rate taxpayer) wants to sell shares in 2013/14 which will realise a taxable gain of £21,000.

If he goes ahead and sells the shares and utilises his annual exemption, he will pay capital gains tax on £10,100 @ 28% = £2,828.

However, if Mr Smith transfers half of the shares to his wife prior to the sale then Mr and Mrs Smith would each have a taxable gain of £10,500, which would be covered by their annual exemption of £10,900.

By using their annual exemptions (£10,900 each) the shares can be sold without triggering a capital gains tax liability leaving them £2,828 better off.

Property Tax

Equity Release And Tax Savings

Interest paid on a mortgage taken out to release capital in a rented property can still be deducted from the rental profit received from that property should the capital raised then be used to purchase another property or even to reduce the capital outstanding on the main residence. The actual reason for the mortgage is not important.

.The key criterion is that the total amount of capital released must not exceed the market value of the property when originally brought into the letting business. If the property had originally been bought for letting then this amount would be the purchase price; otherwise use the market value at the date of transfer.

Case Study:

Anne wishes to raise £150,000 via a mortgage on two BTL properties that were purchased with cash some years ago. The purchase price of the properties was £125,000 and they were let out immediately on acquisition. The mortgage monies will be used as capital to purchase a holiday cottage for personal use.

The maximum amount of interest allowable will be the proportion relating to the amount paid for the properties originally, i.e. £125,000.

There is no need to include the cottage in the portfolio for tax relief to be allowed; it can be kept for private use but interest on £25,000 will be disallowed.

Business Tax

Carry Back Early Year Losses

A business often makes losses in the early years of the trade. There is a special loss relief available to individuals (whether sole traders or partners in a partnership), which allows a loss made in the tax year in which the individual first carried on the trade or in any of the three succeeding years to be relieved against total income of the preceding three tax years. The loss is relieved against an earlier year before a later year.

Carrying back the loss relieves the loss at the earliest opportunity and generates a tax repayment.

It should be noted that a cap on income tax reliefs applies from April 2013. The cap is the greater of 25% of income and £50,000 and applies to various types of loss relief and relief for qualifying interest. In some cases the operation of the cap may limit the amount of early years' loss relief that can be obtained.

Case Study:

Jessica starts her business in 2013/14 making a loss in the first year of £15,000.

In 2010/11 she had total income of £70,000. In 2011/12 and 2012/13 she had income of £80,000 and £65,000 respectively.

Carrying the loss of £15,000 back three years and setting it against her total income for 2010/11 of £70,000 will reduce her income for 2010/11 to £55,000 and generate a tax repayment of £6,000 (£15,000 @ 40%) plus interest.

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