Business Online
Autumn 2007 Newsletter

Investing in a new business: is a loan or shareholding best?

If you are asked to invest in a new business, you may be faced with the choice of providing a loan to the new enterprise, or buying new shares where the business is to be run through a company.

Loans: the safer option?

A loan may seem the more secure option, as the capital should be repaid according to the terms agreed, and interest will be payable whether or not the business makes a profit.

However, you are unlikely to make as significant a profit from a loan, in the event that the business is later sold for a substantial sum or becomes listed on the stock exchange. To realise those exceptional gains you need to hold shares in the company.

On the other hand, many new businesses fail within the first three years. If the company goes bust and your loan is not repaid, you should be able to claim a capital loss.

As long as the funds you provided were used for the trade, and the company was not quoted on the stock exchange when it went down, you will have a capital loss. This loss can be set against capital gains you make in the same tax year, or subsequent years, but as you already have an annual exemption of £9,200 (for 2007/08) to set against capital gains, the loss may not be particularly useful to you.

A share in the rewards?

If you hold shares in the company, and the business fails, the loss you suffer may be available to reduce your income tax liability for the year of the claim. This is far more useful than a loss that can only reduce your capital gains. However, to claim the loss against income you must subscribe for new shares rather than buying them secondhand from another shareholder. The company must also be unquoted, trade mainly in the UK, and not be involved in any of a range of non-qualifying trades that includes leasing and property.

As a general rule, while a loan may represent the less risky option in many cases, if you buy shares you could reap a significantly larger reward and have more scope to capitalise on any losses.

Contact us for further information.

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Keeping you on the right track

We can help your business and your personal finances to stay on the right track.
Call us now and we'll arrange a meeting to discuss:

- Strategies to help your business improve its efficiency and profitability
- Reducing the burden of taxes on your business
- The tax issues that affect you and your family
- Maximising your wealth
- Retirement planning strategies for you and other family members

Is the cost of training tax deductible?

If you pay for training courses for your employees, the cost is tax deductible for your business. Your employees are not taxed on the value of the training, as long as the course relates to their current work or to a task they may have to perform as part of their job. The training can be to enhance or instil very general skills such as driving, letter writing or time management. Provided the employee needs to use the skills as part of their job now, or will need to do so in the future, the cost of the training is tax deductible.

However, the tax deduction does not automatically apply if the employee pays for the training directly. An employee cannot claim a tax deduction for training costs unless the training was actually carried out as part of the employee's job, rather than in order to prepare them to do the job. If your employee needs to pay for a training course or exams, the best policy is to make the training a condition of the employment contract and reimburse the cost to them on submission of an expense claim. If the cost of the course is significant, you could agree a salary substitution arrangement whereby the employee takes a lower salary in return for you paying the training course fees directly.

Training costs for the self-employed

The cost of training for the self-employed is not necessarily tax deductible. If the training tops up the individual's existing knowledge or skills (including the acquisition of "know-how"), and these are used as part of the business, the cost can be deducted from the business profits. However, if the training is to develop a completely new set of skills, HM Revenue & Customs (HMRC) will view this expense as if it was an investment in capital equipment.

The cost of the training for new skills cannot be deducted from profits for income tax purposes, and there is no mechanism for spreading such an expense over several tax years, as there may be for the purchase of physical equipment. However, where the acquisition of know-how is treated as capital, the expenditure may be put into a single pool, qualifying for a writing-down allowance of 25% (reducing balance).

Making the most of flexible pensions

You may think of your pension savings as 'dead' money – locked away until you finally leave the working world at around the age of 65. However, since the reform of pension law on 6 April 2006, this view could not be further from the truth.

You are now entitled to start drawing on your pension fund from the age of 50, if your pension scheme rules permit this and you were born before 6 April 1960. Otherwise you can access the funds from your 55th birthday. In some particular occupations such as the fire service, the age of entitlement is even lower. If you are forced to cease work on medical grounds at an earlier age, you can commence your pension at that point.

There is no obligation to retire or even to reduce your working hours when you start to draw benefits from your pension fund, as your work commitments and pension payments are now completely separate. You can even continue to contribute to a pension fund and draw some benefits at the same time, if your particular pension scheme rules permit this. If they don't, you could still contribute to one pension fund and draw an income from another. For example, you may have one pension plan and the plan may consist of 20 sub-funds. You could start drawing on 10 of the sub-funds and still contribute to the other 10.

These new rules allow you a great deal of flexibility in the latter part of your career. You may work part time, or on short-term projects, taking a rest in between contracts. Your rest periods can be funded from your pension, while your higher earning periods can be used to boost your pension funds.

You may also have other assets that you intend to use to fund your long-term retirement, such as property. In this case it might be possible to maximise the income from your pension fund before the age of 75 by taking an aggressive income drawdown policy, whilst taking less income from your other assets; although this should only be contemplated after taking independent financial advice.

After the age of 75, the amount you can extract from your pension fund in this way is restricted. There are also restrictions on the amount of tax relief you can benefit from once you have drawn down a tax-free lump sum from the pension fund, so do talk to us about your plans first.

The Enterprise Investment Scheme: could my business raise money?

The Enterprise Investment Scheme (EIS) is designed to encourage wealthy individuals to invest in small trading companies, and thus plug a gap in funding which the commercial banks can be unwilling to meet.

Under the scheme, the investor subscribes for new ordinary shares (called EIS shares) in your company and receives income tax relief at 20% of the amount invested. If the investor holds his or her shares for at least three years and the company continues to qualify under the EIS scheme, the investor can then sell the shares free of capital gains tax.

An investor who has previously made a large capital gain can also use an investment in EIS shares to defer the taxation of that gain until the EIS shares are disposed of.

In order for your company to be permitted to issue EIS shares, it must meet the following conditions:

- None of its shares must be quoted on a stock exchange and there must be no arrangements in place for a flotation (although a quotation on the Alternative Investment Market (AIM) does not count)
- It must carry on a trade or trades that do not include to a significant extent (taken to be 20% or more) any activity that is specifically excluded by the legislation. Excluded activities include: leasing; banking; accountancy; dealing in land and land based trades such as farming; property development; or nursing homes
- It must have fewer than 50 full time employees (or part time equivalents) at the time the EIS shares are issued
- The value of the gross assets on the balance sheet must not exceed £7 million before the issue of the EIS shares, or £8 million afterwards; and
- The total amount raised under EIS and similar schemes (Venture Capital Trusts and Corporate Venture Schemes) must be no more than £2 million in the 12 month period ending on the date of the relevant investment.

Subject to these conditions EIS relief is relatively easy to apply for. HMRC has a special department in Cardiff that deals with this scheme, and it is advisable to ask the Inspector in advance if your company is likely to qualify.

You also need to check whether your prospective investors are connected with your company, or have received any value from the company in the two years prior to the issue of the shares. 'Connected' broadly means that the investor was an employee or director, or controlled 30% or more of the voting shares.

Investors can become directors of your company after they buy the EIS shares, as long as they do not take more than a reasonable remuneration for the work that they do for the company.

If you would like to explore the potential of EIS to raise funds for your company, please contact us to discuss your individual circumstances.

Arctic Systems: mixed news for husband and wife businesses?

The long-running high profile Arctic Systems tax case has finally come to an end, with the Law Lords ruling in favour of husband and wife team Geoff and Diana Jones. Following the ruling, many small family businesses might be breathing a sigh of relief. However, although HMRC may have lost this particular battle, the Government has since announced its intention to crack down on what it considers to be a 'tax loophole'.

History of the case

The landmark case involved Geoff and Diana Jones, who owned and ran an IT consultancy called Arctic Systems. Geoff was the major fee earner while Diana helped out with general administrative support. Like thousands of other couples with similar enterprises, the structure of the business was such that both parties held shares in the company, with profits extracted by way of dividends.

However HMRC applied an old piece of legislation, Section 660, to argue that the dividends paid to one partner were really earned by and belonged to the major fee earning partner. According to HMRC the dividends received by Diana should have been treated for income tax purposes as those of Geoff, a higher rate taxpayer. This meant a potential retrospective tax bill for Arctic Systems of £42,000, and many business owners have been concerned that they too could face significant tax demands from HMRC.

What the ruling means

Following the ruling, husband and wife businesses are highly unlikely to be hit with retrospective tax bills similar to the one originally issued to the Joneses.

However, the Government has said that it intends to introduce legislation to end this particular form of 'income splitting'.

So it seems likely that following a period of consultation, new legislation will be introduced to make such arrangements a thing of the past.

We will stay abreast of the legislation, and can advise you on all your tax planning needs, including your business structure. Contact us for more information.

Business round-up:

Next stage of the Companies Act 2006 comes into effect

The Companies Act 2006 received Royal Assent in November 2006, and is being introduced in a series of stages up to October 2008.

Already in force are measures allowing electronic communication with shareholders. Other parts of the Act which are of particular relevance to small companies take effect on 1 October 2007, including:

- The Act sets out for the first time the general duties expected of company directors
- Annual General Meetings will be optional
- Private companies will be able to handle most business without holding a general meeting, should they wish to.

Further provisions will be introduced in April and October 2008, including:

6 April 2008

- A comprehensive code of accounting and reporting requirements to be introduced
- Period for filing accounts shortened from ten months to nine months
- Company secretary to be an optional appointment
- Shareholders may agree limitation of auditors' liability.

1 October 2008

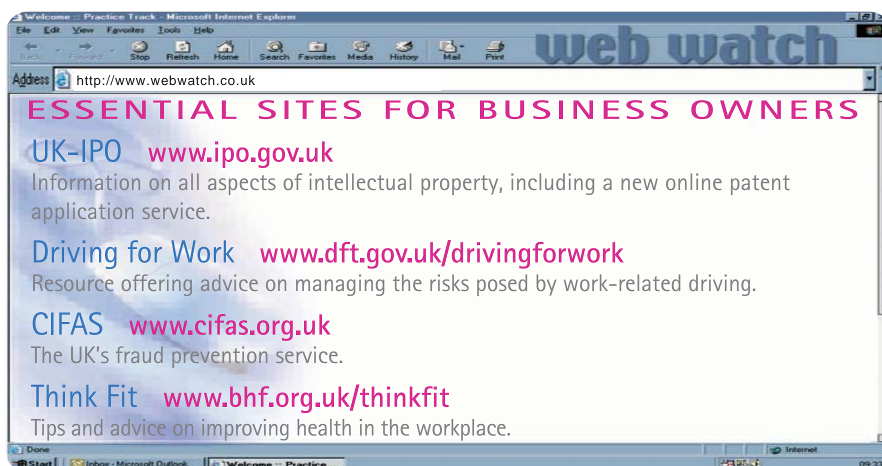
- A simpler method of forming and administering new companies to be introduced
- Concept of authorised share capital to be abolished
- A company to be allowed to give financial assistance for purchase of its shares

- Directors may file a 'service' rather than home address
- Companies must have at least one director who is a 'natural person' (ie a person as opposed to another company)
- Nobody under 16 may be a director
- Introduction of the right to challenge company names.

Existing Companies

Some measures will automatically be incorporated into existing companies' articles of association, but in other cases companies will need to amend them. They will need to review articles of association to ensure they are able to benefit from the changes introduced by the Act. They may wish to adopt the model articles of association wholesale to take advantage of the relaxed regulatory environment. They may at least use them as a source of guidance when considering what, if any, changes need to be made to their current articles of association to update them in line with the Act.

This is a complex piece of legislation. Please contact us for further information relating specifically to your business.



Reminders for your diary

September 2007

30 Deadline for submission of the 2007 Tax Return if you wish HMRC to calculate the tax or, if you are an employee, you wish to have a 2006/07 balancing payment of less than £2,000 collected through your 2008/09 PAYE code.
End of CT61 quarterly period.

October 2007

1 Due date for payment of Corporation Tax for period ended 31 December 2006

5 Individuals/trustees must notify HMRC of new sources of income/chargeability in 2006/07 if a Tax Return has not been received.

14 Due date for income tax for the CT61 period to 30 September 2007.

19/22 Quarter 2 2007/08 PAYE remittance due.

November 2007

1 Please ensure you are retaining your documents for the 2008 Tax Return.

2 Last day for notifying car changes in quarter to 5 July – P46 (Car).

Business and personal planning need not be left until the end of the tax year – talk to us now about tax and financial strategies for you and your business

We are sometimes asked if we are able to help additional clients. We are a growing firm and do appreciate your referrals. We consider it a compliment when you recommend us to your friends and business contacts.

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