Winter 2013

Talking Tax

Guiding you to lifelong prosperity

Introduction

Welcome to the Winter edition of Talking Tax. We are in festive mood here at Hazlewoods, with a shiny selection of tax nuggets for your enjoyment and benefit. In this edition we demystify employee share schemes, showing you what is available and why they are increasingly popular. We shine a (fairy) light on the changing world of partnerships and give you the low down on the Chancellor's Autumn Statement, hot off the press. Our tax experts share their Christmas wish list and we pull our belts in tight to suggest some New Year's Resolutions that are so easy you'll keep them up until at least the end of the tax year! Finally, we hope you have a restful Christmas break and we wish you and yours a very Happy Christmas and a prosperous and peaceful New Year.

Santa believed strongly in maximising his gift relief

Contents:

Britain on the road to recovery

The Chancellor was able to be upbeat in his Autumn Statement with forecasts about the health of the economy much improved since the Budget in March this year.

The growth forecast issued by the Office for Budget Responsibility was 0.6% in March, for the current year. This has now been increased to 1.4%. Meanwhile, the percentage of debt to Gross Domestic Product has dropped from 7.5% in March, to 6.8%. This is down from 11% when the current Government came into power.

But what about tax announcements? There were a few and, perhaps unsurprisingly, not all positive but many of them do not come into force for a number of years yet.

So let's start with the positive news. For small businesses, the business rates relief, which was due to end in April 2014, has been extended by one year. Also any rate increases from April 2015 will be capped at 2% per annum. Further help for all business comes in the form of an exemption from April 2015 for employer national insurance contributions on all employees under the age of 21 who are earning less than £813 a week.

For individuals, the personal allowance was confirmed as rising to £10,000 in April 2014. In addition a new, transferrable, married couples allowance of £1,000, will be introduced for basic rate taxpayers in April 2015.

Fuel duty is to be frozen next year, meaning that the price of a litre of fuel will be 20p cheaper than if the previous Government's fuel escalator had continued to apply.

As has become a regular announcement, more

Continued on page 2

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DRIVING LIFELONG PROSPERITY

anti avoidance legislation is to be introduced. This will target individuals using companies to avoid an employer/employee relationship being created. The detail will need to be reviewed as to how this is going to impact on individuals and businesses alike.

The biggest hits on the taxpayer came in respect of capital gains tax. Firstly, non residents will be required to pay capital gains tax on any property held by them in the UK from April 2015. There was more of a shock in respect of private residence exemption, which has remained untouched for many years. Under current legislation, if the property has been your private residence at some point, the last three years of ownership is automatically exempt, regardless of whether it was your private residence at the time of sale. This is to be halved to 18 months from April 2014 and is expected to raise an additional £360m for the Government's coffers by April 2019.

With just 18 months before the next election, the Chancellor must be quite happy with the message he's been able to deliver although, as he pointed out, we've still got quite a way to go. Hopefully the recovery will continue and George Osborne will be able to dust off his Santa suit next spring to give everyone some Budget gifts.

Shared success - rewarding employees

As the year ends, you may well be faced with making bonus payments to your key employees. Have you thought about how you are rewarding them? Is a straight bonus the best way? Could you give them more while costing you less? Following recent developments in the world of share schemes, you might be pleasantly surprised at the options (no pun intended) available these days.

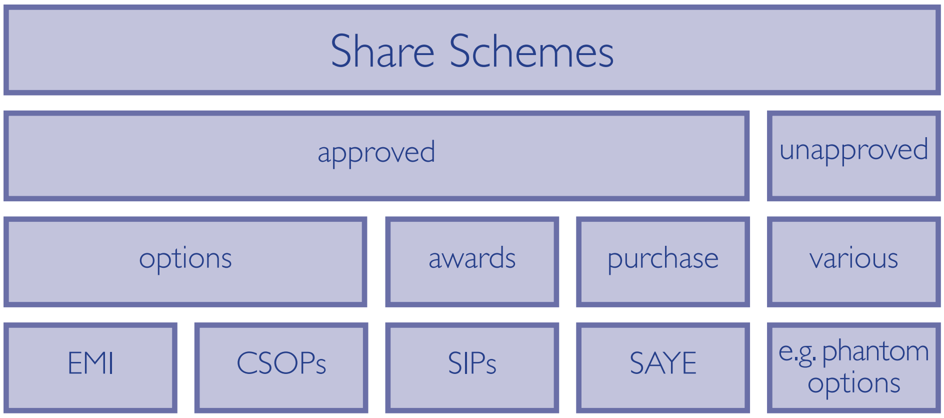
Employee share schemes and option schemes provide a way to give employees a current or future stake in your business with an aim to help improve both their and its performance.

Let's look at some of the possible share schemes and option schemes you may like to consider. We have deliberately not gone into too much detail to give you a manageable overview - the fine details are important but not essential when gauging which structure could suit you. Implementation is where we manage the technical finer issues.

In March 2012 the Office of Tax Simplification (OTS) completed a review of tax advantaged employee share schemes. Unsurprisingly, the review suggested various legislative and administrative simplifications. These are being considered by HM Treasury, and include the possible phasing out of the Company Share Ownership Plan (CSOP). The OTS is now examining the complexities involved in unapproved share schemes. No changes have yet been announced based on the OTS's work so, while we will keep a watchful eye open, we continue to work with the rules as they stand.

What are the differences between HMRC approved and unapproved schemes?

HMRC approved share schemes and option schemes have tax and NIC advantages. Unapproved schemes do not have tax breaks, but as a result they can be more flexible. The right scheme for you will depend on what you want to achieve, who you are rewarding, what your finances are like and what your employees expect.



Option schemes

The diagram above summarises the types of scheme available. Of these, the Enterprise Management Incentive (EMI) scheme is the most popular. Under this approved scheme, tax advantaged share options with a market value of up to £250,000 may be granted to a qualifying employee of a qualifying company, subject to a total share value of £3 million under EMI options to all employees.

The grant of the option is tax-free and there will normally be no tax or National Insurance contributions for the employee to pay when the option is exercised. There will normally be no National Insurance contributions charge for the employer. This is one of the most popular aspects because it means that no cash needs to be paid up front.

The relief is aimed at companies with gross assets below £30m and less than 250 employees with employees sharing in the real commercial risk of the business activities. Certain activities are excluded from EMI such as banking, farming, property development, provision of legal services and ship building.

If you can't meet the EMI rules, the other approved option scheme available is a Company Share Option Plan ('CSOP'). This is open to a wider range of companies and there are no restrictions on the size of the company or its business activities. Options may be granted over shares worth up to £30,000. The shares under option must be fully paid up ordinary shares. The exercise price is usually the market value of the shares at the date the option is granted.

If the CSOP options are exercised between three and ten years after they are granted, there are tax advantages for the employee/director receiving options. Provided certain conditions are met there is no income tax or NIC charge on either the grant or exercise of the option.

The only tax charge arising is for both EMI and CSOP should be a Capital Gains Tax (CGT) liability on ultimate disposal of the shares acquired.

The charge is a reduced one, however, gains on the shares from grant to sale will give rise to a charge of 18% for basic rate taxpayers and 28% for higher and additional rate taxpayers (or 10% if certain conditions are met) rather than income tax charges of 20%, 40% or 45% respectively. Employers and employee NIC are not due either.

With such benefits possible, both of these option schemes are tightly drafted, with a number of requirements that must be met. We can walk you through the technical detail if you want to see if they could work for you.

A variation on the option theme is the **Phantom Share Option Plan.** Rather than an officially approved scheme, this is a deferred cash bonus plan under which the amount of the bonus is determined by reference to the increase in market value of a fixed number of shares over the option period. No shares are actually issued or transferred to the option-holder on the "exercise" of the phantom share option.

The employee is granted an option over a number of 'phantom shares at an exercise price' which is usually equal to the market value of a share at the date of grant of the option. When the employee exercises the option he simply gets a cash bonus which is equivalent to the increase in the market value of the underlying shares. The bonus is subject to income tax and NIC in the normal way.

Purchase and/or Award schemes

Share Incentive Plans (SIPs) lock in your employees into owning shares for at least 5 years to get the benefit of no Income Tax or National Insurance on their value. If the shares are kept in the plan until sale then any gain will be tax free too. If they are taken out early , tax becomes due. The limits have just been raised in the Autumn Statement and an estimated date of 6 April 2014. Shares can be acquired by:

- gifting up to 3,600 shares per employee per year - 'free shares';
- the employee buying up to the lower of £1,800 or 10% of income for the tax year out of gross (pre tax) salary - 'partnership shares';
- matching each partnership share with up to 2 more shares; and
- the employee buying shares using dividend income from the above types of share.

The final approved scheme is the simple but not very flexible Save As You Earn (SAYE) plan where employees can save up to £500 per month for a set period of time (3 or 5 years) which then goes to buy shares at the end of that period. The interest and any bonus at the end of the scheme is tax free and there is no NIC or income tax if the shares are sold to the employee at a discount. If the shares are then put into an ISA or a pension when acquired any gain on eventual sale will be tax free too.

But what if an HMRC-approved scheme or a bonus arrangement cannot be used? Then it may be worth considering other share incentive arrangements. Such arrangements include:

Growth Shares

The employees acquire shares of a new class which participate only in the growth in value of the company after that date or after it has achieved a certain, agreed value, often referred to as a 'hurdle'.

When they are issued the value of these shares is usually very low so they can be bought at minimal cost and without triggering any significant tax liability. Any future growth in value is charged to CGT, which is currently 18% for basic rate taxpayers and 28% for higher and additional rate taxpayers (or possibly 10% if certain conditions are met) when the shares are sold. This compares favourably to bonus arrangements based on future performance, which would usually be subject to income tax rates of 40% or 45%.

Partly Paid Shares

Under these arrangements, the employee acquires shares for their full value but only pays part of the price on acquisition. The balance of the share price is left outstanding and may only be payable when the company or the shares are sold. At this point the employee should have the funds to pay up the balance outstanding.

As the unpaid balance on the shares effectively represents an interest-free loan from the company:

- if the company is broadly controlled by up to five individuals, the company may have to pay tax of 25% of the unpaid balance, though this can be mitigated if the arrangement is structured correctly and certain conditions are met; and
- in some circumstances there may be an ongoing income tax charge on the employee in respect of the interest benefit received.

These arrangements do need to be considered carefully, as the employee may be committed to pay the balance on the shares and is therefore at risk of financial loss if the shares fall in value or, worst case scenario, the company fails.

Share schemes are not for everyone but they are increasingly popular, and so cannot be ignored when you are looking to attract and retain good employees. Other employers may be offering packages that include shares. We recommend you at least consider the various alternatives. Then you will be able to make a fully informed decision as to what works for you, your business and your workforce.

A field guide to share schemes...

Share-option schemes offer the lowest level of commitment from the employee, providing flexibility and freedom of choice. These schemes 'grant' employees share options, which are the right to buy a certain number of shares in the company at a fixed price in the future. When an employee "exercises" their options they buy or are given the shares.

The granting and exercising of options can be made dependent on reaching certain targets. When the conditions are met the options have 'vested' although they may not be exercised until later. The exercise is at the price fixed at the date of grant and it is not affected by the market value of the company's shares at the time of exercise.

Share-award schemes give employees actual shares, either free or for less than their market value. The eventual price will depend on how much of a reward you want to give.

Share-purchase schemes allow employees to buy shares; save money to buy shares; or buy shares for a small deposit, paying the rest at a later date.

All we want for Christmas...

We catch a glimpse of the Hazlewood's' tax team's wish list before it gets posted off to Santa...

Your tax information - if you haven't sent in your personal tax return information for 12/13 please send it in ASAP, and definitely before Christmas. January 31st comes round very quickly!

A consistent approach from HMRC - a complex tax code means that technical interpretations can differ from Inspector to Inspector. Greater transparency from Technical division with their conclusions available publically would be a great advancement.

Time to catch our collective breath - at the last count there were 34 live consultations at various stages in their passage from ideas to legislation. Add to that the various OTS projects in train and you have a complex and changing environment. A flexible approach goes without saying but time for changes to bed in would be much appreciated.

Some new followers - we now have a Twitter account. You could make our day by following us @Hazlewoods_Tax

A new iPad Air - we've definitely all been good this year!

Musical chairs - how partnerships' tax affairs are being reshuffled

We look at the current climate for business partnerships and what is on the tax horizon.

Partnerships are not a new concept and, historically, changes in governing legislation have moved at a snail's pace. The Partnership Act itself dates back to 1890. But the realm of the professional partnership seems to hold a darker intent than just making profit, if you look at the range of recent announcements from HMRC on the subject.

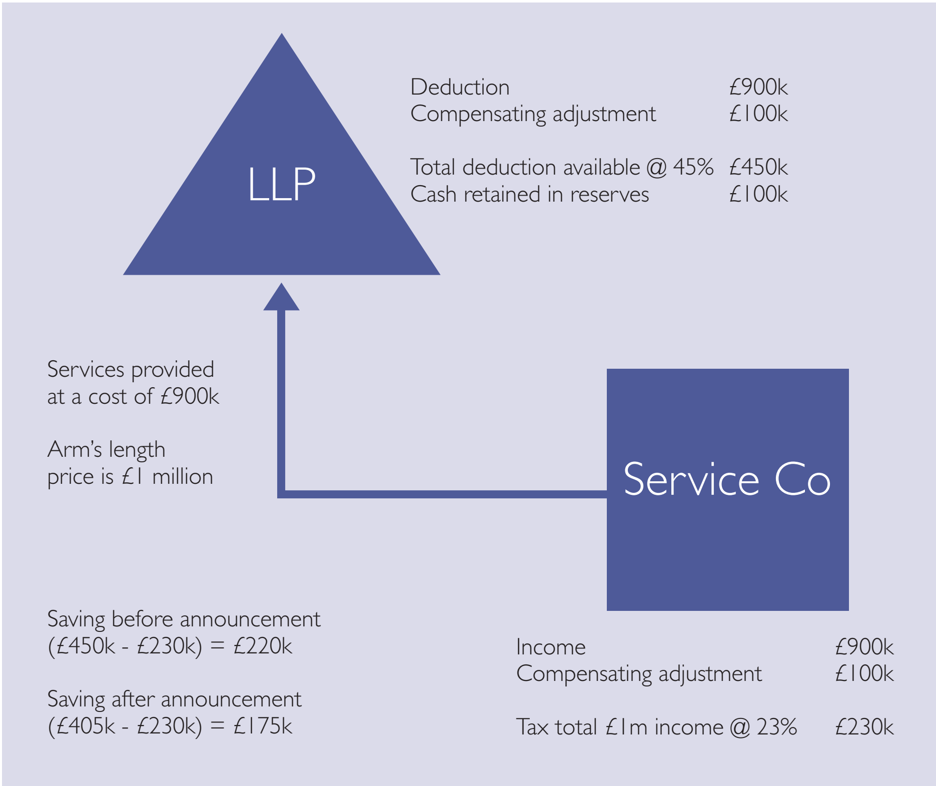
In the wake of the increasing use of a Limited Liability Partnership (LLP) as a legitimate way of ring fencing commercial risk, HMRC have sought to re-examine the substance behind some partnership arrangements. They began with the HMRC policy note 'Evasion, Avoidance and Debt recovery' which points a finger firmly in the direction of partnerships .Anti avoidance legislation was then included in Finance Act 2013 with effect from April 2014 aimed at removing the 'presumption of self-employment for partners of Limited Liability Partnerships (LLPs).

In addition, the whole question of profit allocation (or 'manipulation' according to HMRC) between all types partners was put out for consultation and the Government announced on 17 September 2013 that it would take action against arrangements involving the 'compensating adjustment' rules.

These rules are part of the transfer pricing code. Tax advantages can be secured by individuals extracting profit from connected companies while paying tax only at corporation tax rates. A brief period of technical consultation was announced which concluded after a month. With effect from 25 October 2013, Service companies operated by professional firms have, effectively, been made, if not redundant then definitely on notice. Here's why:

Transfer pricing legislation concerns the prices charged in transactions between connected parties. It has enjoyed a certain celebrity thanks to high profile media attention on the tax affairs of groups like Starbucks. We could be forgiven for thinking this is just an issue for multinational groups but there is a UK transfer pricing regime too.

In a nutshell, transfer pricing asks whether the actual price paid for the provision of goods or services between connected parties is different to an 'arm's length price' i.e. the price an unconnected provider of the same goods or services could command. If it is different, then the arm's length price is substituted to cancel any tax advantage. If these rules are used in the UK to adjust prices to increase one party's profit, a claim can be made to reflect the same price for the other party. This adjustment is known as a 'compensating adjustment'.



Bearing this in mind then, service companies owned by professional services firms have become widespread. A typical structure uses the service company to engage employees to sell their services to the professional services firm LLP at a profit. This lets the profit earned flow away from the LLP and into the company, which is taxed at corporation tax rates rather than income tax rates. The picture above shows how this would work with a £100k compensating adjustment. There is also a cashflow benefit with £100k available for distribution after only suffering 23% tax.

HMRC have now acted to stop this where the transfer price used was not an arm's length price, with immediate effect (In the example above, there is still a saving to be made). So, while the difference in tax rates can still be used to some benefit, the sometimes massive cash flow advantages that were to be had by keeping the transfer price low have now gone.

The main change will prevent persons (other than companies) within the charge to income tax from claiming a compensating adjustment where the counterparty is a company. Therefore, this will apply to partnerships or LLP's where there is a compensating adjustment between them and their connected service company.

The changes will take effect in relation to amounts or service fees that relate to the period on or after 25 October 2013. This means that any amounts accruing before that time are outside the scope of the new legislation. For accounting periods which straddle the 25 October 2013 HMRC have indicated that a compensating adjustment will potentially be available for the period up to 25 October 2013. No compensating adjustment will be available after that date.

The story does not end there, however. The OTS is currently reviewing the whole area of partnership taxation, saying it is ripe for an overhaul because it does not meet modern needs or business models. Anti-avoidance is included in the project and the focus on LLPs looks set to continue. With all this interest, it is fair to say that the once staid world of partnerships is looking almost racy. Snail's pace may be about to move up a gear.

Letting go

How you hold rental property can have major tax implications

What came first, the tax or the business advantage? In truth, this is often hard to call but when determining how to own your rental properties the first question should not be 'how do I cut my tax?' but 'what do I want from this business?'

There are a wide range of tax related factors that need to be considered to come to a fully informed decision. The right combination for you will depend on what you are planning for the commercial venture just as much as how much tax could be saved. The factors include:

Attitude to risk - are you more comfortable with recognised arrangements and simple structures or are more complex arrangements more attractive. Although they normally deliver a greater potential return, they are inherently risky.

Business strategy - are you looking for a quick return by buying and selling your properties as well as renting or do you expect to hold them for a while and grow a portfolio, for example? What is your strategy? By understanding your goals you can tailor the tax planning to suit.

Financing position - is there debt in your business? What are the terms of the lending? Banks can require minimum interest cover levels that can affect the ease with which you can extract cash, for example. Interest payments need to be deductible and ideally relieving income taxed at higher rates rather than basic.

Flexibility - do you have an exit route planned or do you want to be able to flex your arrangements depending on what the future holds? Perhaps you will want to involve family members now or later?

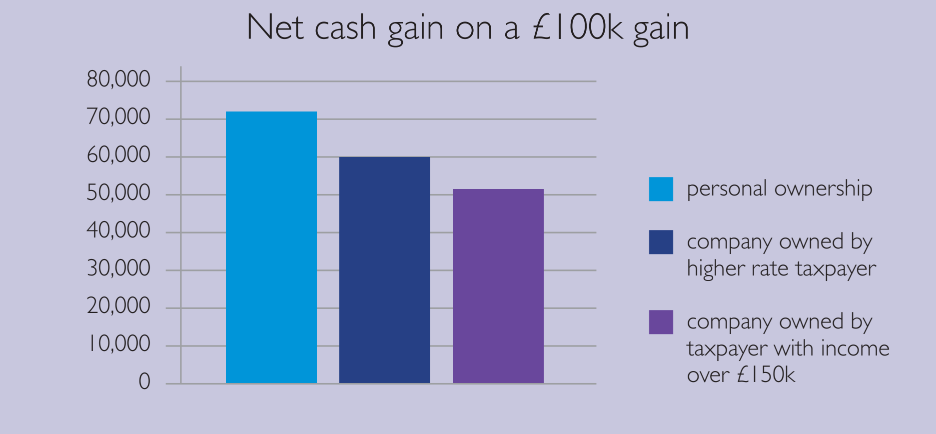
Ownership options to consider

Personal

Often the easiest and quickest route, owning the properties directly means that the rental income is taxed at your marginal rate, as is any gain on eventual disposal. The chart shows that, in a simple case of a capital gain on disposal, this delivers the most net cash after tax too. However, once complicating factors such as debt, multiple properties and managing commercial risk are brought into the equation, other options may become more attractive.

Joint ownership

Often an option for family businesses is to jointly own the property portfolio. Ownership, rental income rights and costs can be spilt, often using a Partnership Agreement, to use up basic rate tax bands and personal allowances. The down-side to this option is that you incur legal fees and decision making can be laborious if everyone has to be involved.



Company ownership

Ring fencing your liabilities by using a company to own the property(ies) is a popular option, especially for higher rate taxpayers who are not looking to take money from the business, but to reinvest it in more properties or keep the cash as a 'pension pot' for later in life. If the £100k in the chart is not extracted from the company, corporation tax is at 20% (assuming it is a small company) leaving cash for reinvestment of £80,000.

Running your own management company can be a good idea, where a saving can be made on tax rates. A fee would cut your personal income and be taxed at the lower, corporate rate. This idea can fail on the substance test, however. Management companies need to demonstrate they are actually managing. One idea is to manage properties owned by others and not just your own.

Other options

Pension funds are a possibility(so long as your property isn't residential) - income and gains will accumulate in a tax free environment, obviously an attractive option. However, extracting that value can be onerous and you will need to deal with the trustees of the fund, possibly increasing costs and reducing flexibility. There are also financing thresholds to be aware of. Finally, putting any previously owned properties into a pension fund will trigger a charge on any unrealised gain at that point - pensions work better for new acquisitions.

There are many variations on these basic themes out there and each needs to be considered against the commercial and tax factors outlined here.

The impact of Stamp Duty Land Tax also needs to be included as it can be a substantial part of the final bill.

Hazlewoods have a specialist property team ready to guide you through the available options.

Factor	Personal ownership	Corporate ownership	Owned by a pension fund	LLP ownership
Set up	Easy	Medium	Medium	Can be complex
Running costs	-	Annual returns audits professional fees	Fund manager fees, professional fees	Professional fees
Flexibility	Good	Good/Medium	Low	Medium/Low
Risk profile	Medium	Low/Medium	Low/Medium	Medium
Ease of access to cash	Good/Low	Medium	Low	Medium
Capacity for growth plans	Medium	Good	Medium	Medium./Good
Similar structures	Joint personal ownership - partnership	Management companies leasing a property to a company		

Out with the old - bring in 2014 with some Tax Resolutions

Out with the old - bring in 2014 with some Tax Resolutions

We are not about to expect you to become specialists in obscure tax reliefs (that's our job) but there are some quick wins that could save you time, money and stress. Here's our top five suggestions:

1. **Keep a record** - whatever goes into your tax return, being able to prove it is vital. Having the right documentation will increase the scope for claiming reliefs such as capital allowances. We can help you decide what to keep and what to bin.

2. **Get tax aware** - no business or financial decision is complete without taking the tax pros and cons into consideration. Tax is integral. Too often we see opportunities lost because tax has been forgotten until it is too late.

3. **Don't stand still** - tax legislation is constantly evolving. It makes sense to review your tax arrangements on a regular basis. A tax health check makes sense every couple of years or so, just like an MOT. We can check under the bonnet for you.

4. **Clean the cobwebs** - do you have dark and dusty corners you haven't peered into for years? Sunlight is, as they say, the best disinfectant. Make 2014 the year you settle any outstanding issues with HMRC. Voluntary disclosure minimises penalties. We can guide you through the process.

5. **Keep in touch!** We are always keen to understand the twists and turns of your business and financial affairs. Tax can be a bumpy road and keeping in regular contact helps us help you avoid those inevitable pot holes. We'll keep in touch via our website, Talking Tax and our Twitter account. Don't be a stranger!

Hazlewoods Tax Team

Services

We provide specialist advice in all areas of tax including the following:

- Business structuring
- Employer services
- Inheritance Tax and estate planning
- Partnership Tax services
- Tax Investigations
- VAT
- Corporation Tax
- International Tax services
- Owner Managed Businesses
- Personal Tax
- Trust Tax
- Stamp Duty and SDLT
- Transactions, planning and support
- Capital Gains Tax planning
- Tax Litigation Support

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