shipleys LLP
Godalming Business Club

Meeting Summary

21 February 2014

Saving tax

Task 1 - tax saving scenario.

Our delegates were asked to note points for further consideration in the scenario (reproduced below) Issues raised included:

A. Company car

Victor is paying personal tax of almost £12,000 per annum on the £26,250 benefit in kind attributable to the Range Rover company car. Given that it's worth about £6,000 he might want to buy it from the company and run it himself, charging the company for his business travel (45p/25p per mile). Of course he would then be responsible for maintenance and repairs but given the vast ongoing tax cost with the current arrangements it is likely that he would be significantly better off.

B. Mobile telephone

Victor's company could provide him with a mobile phone and meet the cost of business and private call without a benefit in kind arising to him. At present the cost of the phone (c£720 every 18 months) and private calls (c£15 / month) are met by Victor out of his after tax income. Getting him the £660 annual expense costs the company (after corporation tax relief) about £1,600 per annum. If the company incurred and paid these expenses directly, the net of tax cost would be just over £500, saving almost £1,100 per annum.

C. Marginal tax rate and expenses

Victor's £80,000 salary, car benefit of £26,250 (£75,000 list price @35%) and bank interest (@say 1.5%) of £750 mean his income of £107,000 is in the 60% marginal rate band (due to the withdrawal of the personal allowance). The proposed £10k bonus re his expenses would be taxed at 60%, in addition to suffering employers (13.8%) and employees (2%) national insurance contributions (NIC).

The £10,000 bonus plus employers NIC would amounts to £11,380 (or c£9,100 after corporation tax relief) and put £3,800 in Victors pocket. If the company reimbursed these expenses Victor would have no personal tax liability and the cost to the company would simply be £3,800 (no corporation tax relief) - saving the business £5,300. This represents just two or three months expenses, so the annual saving could amount to almost £30,000 (note Victor's marginal tax rate at higher income levels would reduce to 50%). He may also consider what other expenses incurred at his home office should be reclaimed from the company.

D. Other family members

As Mrs Green and the son and daughter all work for the business they could be employed by it. As they have no other income this would take advantage of their personal allowances and basic rate bands, rather than the much higher marginal rate suffered by Victor. They may be some additional NI cost - but likely to be significantly less than the tax saving and this also builds up a NI contribution record for the other family members. If Mrs Green is paid an amount equal to the personal allowance this saves Victor tax of up to est. £5,664 each year.

E. Profit extraction

Victor shoud review the mix of his salary and dividends, as the latter are likely to be more tax efficient. Dividends are not subject to NI.

	Salary £	Dividend £	Salary £7,696 & dividend £
Gross pay excl. employers' NI/ profits	71,232	80,000.00	80,000
Personal tax and National Insurance	25,933	6,674	6,866
Corporation tax	0.00	16,000	14,461
Net income after taxes	45,299	57,326	58,673

Above is a comparison of salary and dividends. A company pension contribution secures full CT relief and is not taxable on Victor.

F. The bar

Consideration should be given to whether the investment in the bar could be structured in accordance with the rules for Seed Enterprise Investment relief (SEIS). This potentially gives Victor a £12,500 (50%) income tax credit, and exempts from CGT of any gain on sale realised after at least three years. Furthermore, if the investment is made before 5 April 2014 it would exempt from CGT gains up to £12,500 (50% of the investment) arising in 2013/14. This is potentially relevant as Victor has a gain relating to the sale of his interest in the bakers.

G. The bakers

Victor stands to make a £50,000 gain on the sale of his half of the bakers. After deducting the annual capital gains tax exemption of £10,900, his chargeable gain of £39,100 will be taxed at 28%, so the tax payable would be almost £11,000.

However, if the bar investment is made in 2013/14, £12,500 of the gain on the bakers will be exempt, saving tax of £3,500 and reducing the bill to about £7,500.

Alternatively, if Victor defers selling his interest in the bakers until July when he will have held it for a year, then the deposal may qualify for Entrepreneurs relief which would mean the gain is taxed at 10%, thus the tax payable would be £3,910.

If Mrs Green had a small stake in the bakers then her gain might have been covered by her own annual CGT exemption.

H. Pension

Victor's pension arrangements should be reviewed.

I. Bank Interest

Victor should consider using his ISA allowance each year so that interest is tax free.

J. Victor's mother

Victor's mother should consider estate planning to mitigate inheritance tax (IHT). The illustration below shows the potential exposure is material - the house may have to be sold to fund it.

	£
House	2,000,000
Cash deposits	200,000
Total estate	2,200,000
Exemption (including that from deceased husband)	(650,000)
Chargeable estate	1,550,000
IHT payable at 40%	620,000

As her income exceeds her outgoings, she might be willing and able to take advantage of the exemption for gifts made out of surplus income. If she lets out the house the after tax income could be given away. If the property is still held on death it will be uplifted tax free to market value at that time for CGT purposes - and this value included in the IHT estate.

She may wish to consider giving away the property now. Such a IHT potentially exempt transfer becomes exempt from IHT if she survives at least 7 years. In the event of death within seven years (say after five years - when the house might be worth £2.5m) taper relief might apply as follows:

	£
Value of property when gift made	2,000,000
IHT exemptions	(650,000)
Chargeable transfer	1,350,000
Tax at 40%	540,000
Tax after taper relief	216,000

The IHT liability taper relief starts to apply three years after the gift and her beneficiaries might want to think about funding a reducing term assurance policy to cover any tax that might arise.

Alternatively she may wish to consider giving away part of her cash savings. Use could also be made of the £3,000 annual gifts exemption and £250 per recipient annual exemption. By giving £3,250 to Victor and £250 each to the wife and children would amount to £4,000 each year. These gifts would be exempt and not treated as potentially exempt. If death occurred after 5 years £20,000 would have been given away saving IHT of £8,000.

Summary

Many of these ideas are quite straightforward and will considerably reduce the tax payable without causing unwanted attention from the tax man! There are potentially huge savings in IHT - although of course his mother will need to decide what she wants to do.

This is not a definitive list or discussion of the issues arising from the scenario and available tax mitigation strategies. Specific advice should be obtained before taking action or refraining from taking action on any of the subjects covered above.

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The scenario

Victor Green is 55 and married with two children at University. He owns and works for Highbrow Events Ltd in Farncombe, It has eight employees and turns over some £600k. Profits are about £100,000 after paying his £80,000 salary. He works partly from home. Now the children are older his wife helps him with the bookkeeping and business admin, but isn't employed by the company. Their daughter who is doing a graphic design degree built the company's website as part of her course and their son also works for the business during the holidays.

Victor's company car is an elderly 2004 Range Rover Vogue supercharged V8, which he still loves and is reluctant to update because it has been so reliable. He likes his gadgets and always has the latest mobile phone, reclaiming the cost of business calls from the company.

He is always entertaining potential new customers but pays for this himself as he knows it's not tax deductable. He is considering paying himself a £10,000 bonus to cover the last few months costs.

Victor has £50,000 savings with his Bank. He's favourably considering investing £25,000 for a 25% stake in a friend's start up late night bar in town - as last July he put £10,000 into a successful speciality bakers, and his business partner Bunny wants to buy out his half for £60,000.

Victor's mother has just moved from the 8 bedroom family home into a nursing home, She has cash savings and a pension from Victor's late father, who was a Detective Inspector with Surrey Police, as well as her own pension from British American Tobacco where she had a successful career as head of PR. Her pensions comfortably cover the nursing home fees and her doctor reports that she should live for at least another 5 years now she has finally agreed to substantially cut back on cigars.

Task 2 -Quiz (The correct answers are those highlighted)

Question 1: What % of a company car's list price is taxed as a benefit if its CO2 emissions are 215 g/km?							
A	10%	**B**	20%	**C**	35% (highlighted)	**D**	75%

Question 2: What is the current ISA subscription limit?							
A	£5,760	**B**	£7,000	**C**	£10,200 (highlighted)	**D**	£11,520

Question 3: What is thestandard inheritance tax "nil rate band"- above which tax is charged at 40%?							
A	£234,000	**B**	£150,000	**C**	£325,000 (highlighted)	**D**	£650,000

Question 4: Entrepreneur's Relief reduces CGT from a maximum 28% to 10% and is available in respect of the sale of shares in your "personal company". A company is your personal company if you own at least:							
A	5% of voting rights (highlighted)	**B**	10% voting rights	**C**	25% voting rights	**D**	>50% voting rights

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