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Infocus

Experts Update

May 2015

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UK200Group expert panels and forum comprise of skilled technical advisers who work independently or as part of a multi-disciplinary business team to achieve the best possible solution for members and their clients. Each adviser brings experience from the different disciplines of tax, corporate finance, forensic accounting & dispute resolution, business strategy, business recovery & insolvency and international business.

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Entrepreneur's relief clamp down

As part of the 2015 Budget, the Chancellor announced further changes to close loopholes in the Entrepreneur's Relief regime. Following the recent changes announced in the Autumn Statement, the tax relief available under the associated disposal rules have been almost re-written.

Associated disposals (following a material disposal of shares)

One change imposed by the Chancellor, with immediate effect, is the relief available when disposing of personally held assets used in a business carried on by a company (or a partnership).

Before now, providing the usual criterion for Entrepreneur's Relief was met, the gain on the associated personal asset will be subject to the 10p tax charge, providing:

'... An individual makes a material disposal of business assets which consists of...(b) the disposal of (or of interest in) shares in or securities of a company.'

Individuals were able to dispose of a nominal number of shares to demonstrate a disposal of interest in shares. The legislation was silent regarding the number of shares and similarly gave no mention to the voting rights attached to the shares.

The draft Finance Bill 2015, published on 24 March 2015, now looks at partnership assets, shares and securities, separately in three sub-sections of condition A. Condition A2, relevant to the disposal of shares, reads;

'Condition A2 is that P makes a material disposal of business assets which consists of the disposal of shares in a company, all or some of which are ordinary shares, and at the date of the disposal .....the ordinary shares disposed of constitute at least 5% of the company's ordinary share capital and carry at least 5% of the voting rights in the company.....'

As expected, material disposal is now quantified at 5%. The legislation continues from this to ensure the 5% disposal represents 5% of the company's overall ordinary share capital, which in turn carries 5% of the overall company's voting rights.

Further legislation ensures that condition A2 is not met by way of a share reduction, unless made in the course of dissolving or winding up the Company and finally, there are no arrangements for connected persons to purchase the shares.

Hayley Bradfield, h.bradfield@watts-gregory.co.uk
Watts Gregory LLP

Private Residence Relief

UK property owned by non-residents

The provisions to tax gains on residential property in the UK owned by non-UK residents became effective on 6 April. New CGT legislation is included in Sections 37 to 39 and Schedules 7 to 9, Finance Act 2015.

A useful guide was issued on Budget day in the form of an FAQ. It confirms the way in which the charge will operate including clarification of a number of likely practical scenarios.

Firstly, and most obviously, capital gains on disposals of residential property in the UK owned by non-residents will now be subject to CGT. The charge will only apply to gains arising after 5 April 2015, and for properties owned since before that date there will generally be a choice between time apportioning the total gain or using a valuation as at 5 April 2015.

There will be restrictions to prevent private residence relief being claimed unless an occupancy test - broadly, living there for at least 90 days each year - is met. The same test will apply to UK residents wishing to nominate properties situated outside the UK. Vendors will be required to notify HMRC within 30 days after the date of conveyance.

Where we have not already done so, we should contact our non-resident clients, and our UK resident clients with properties abroad, to ensure they are aware of the new rules.

Recent cases

Cases concerning various aspects of private residence relief continue to occur, indicating that HMRC are prepared to identify and litigate cases where they believe relief is being claimed incorrectly. These serve as a useful reminder of areas of risk for our clients.

Matters considered in the courts in recent months include:

- Whether an individual who repeatedly bought houses, renovated them, and sold them was in reality carrying on a trade. A partial victory for HMRC but actually a pretty lenient judgement in my view which we shouldn't rely upon too heavily (Hartland v HMRC TC04187)
- Whether taxpayers are entitled to allocate a proportion of development value to the residential element of a house and land sold for development (they are – Oates v HMRC UT 31.10.14)
- Whether a brief occupation of a property already on the market constitutes residence for PPR purposes (it doesn't – Iles & Kaltsas v HMRC TC03565).

Richard Bunker, richardbunker@wpp.uk.com
Whyatt Pakeman Partners

Members of the Tax Panel

BANBURY
Alan Boby
Ellacotts LLP
01295 250401
aboby@ellacotts.co.uk
www.ellacotts.co.uk
1, 2, 3, 4, 8, 11, 12

BIGGLESWADE
Philip Blackburn
George Hay Partnership LLP
01767 315010
phil.blackburn@georgehay.co.uk
www.georgehay.co.uk
1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14

BRISTOL
Richard Bunker
Whyatt Pakeman Partners
0117 973 0294
richardbunker@wpp.uk.com
www.wpp.co.com
1, 2, 3, 4, 7, 10, 11, 12, 13

CARDIFF
Watts Gregory LLP
www.watts-gregory.co.uk

Anne Smith
029 2054 6600
a.smith@watts-gregory.co.uk
1, 2, 3, 4, 5, 8, 9, 11, 12, 13

Hayley Bradfield
029 2054 6600
h.bradfield@watts-gregory.co.uk
1, 2, 3, 4, 5, 7, 8, 11, 12, 13

CHELMSFORD
Francis Whitbread
Edmund Carr LLP
01245 261818
fwhitbread@edmundcarr.com
www.edmundcarr.com
1, 2, 3, 4, 7, 11, 12, 14

HUNTINGDON
Barry Jefferd
George Hay Partnership LLP
01480 426500
barry.jefferd@georgehay.co.uk
www.georgehay.co.uk
1, 2, 3, 4, 7, 8, 10, 11, 12

LONDON N3
BKL Tax
www.bkltax.co.uk

Stephen Deutsch
020 8922 9119
stephen.deutsch@bkltax.co.uk
1, 2, 3, 7, 8, 9, 11

Terry Jordan
020 8922 9360
terry.jordan@bkltax.co.uk
4, 12

Anthony Newgrosh
020 8922 9144
anthony.newgrosh@bkltax.co.uk
1, 2, 3, 4, 7, 8

Doug Sinclair
020 8922 9328
doug.sinclair@bkltax.co.uk
10

David Whiscombe
020 8922 9306
david.whiscombe@bkltax.co.uk
1, 2, 3, 5, 6, 7, 8, 9, 10, 11, 13

LONDON NE
Haslers
www.haslers.com

Debra Dougal
020 8418 3426
debra.dougal@haslers.com
14

Paul Reynolds
020 8418 3421
paul.reynolds@haslers.com
3, 11, 14

LONDON WC1
Robert Postlethwaite
Postlethwaite Solicitors Limited
020 3818 9420
rmp@postlethwaiteco.com
www.postlethwaiteco.com
3

NEWCASTLE UPON TYNE
Graham Purvis
Robson Laidler LLP
0191 281 8191
gpurvis@robson-laidler.co.uk
www.robson-laidler.co.uk
1, 3, 4, 7, 11, 12

NORTHWICH
Mike Donnan
Howard Worth
01606 369000
mikedonnan@howardworth.co.uk
www.howardworth.co.uk
1, 2, 7, 8, 11

SELBY
Alastair Byrne
JWPCreers LLP
01757 294959
ajb@jwpcreers.co.uk
www.jwpcreers.co.uk
1, 2, 11

SHREWSBURY
Duncan Montgomery
Whittingham Riddell LLP
01743 273273
dmontgomery@whittinghamriddell.co.uk
www.whittinghamriddell.co.uk
1, 2, 4, 7, 9, 11, 12

SOUTHAMPTON
Andrew Jackson – ***Chairman***
Fiander Tovell LLP
023 8033 2733
andrewjackson@fiandertovell.co.uk
www.fiandertovell.co.uk
1, 2, 5

STOCKTON-ON-TEES
Catherine Scott
Baines Jewitt LLP
01642 632032
cs@bainesjewitt.co.uk
www.bainesjewitt.co.uk
2, 10, 11

TEWKESBURY
Christopher Hobbs
CB Chartered Accountants
01684 290123
cjh@cbcharteredaccountants.com
www.cbcharteredaccountants.com
1 ,2, 4, 7, 8, 10, 11, 12

KEY

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2 Corporate Tax Issues, Sales
3 Employee Share Incentives
4 Inheritance Tax
5 International Tax
6 Offshore Tax Planning
7 Partnership Tax Planning
8 PAYE and NI
9 Stamp Duty Land Tax
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Corporate Finance

Simple Planning opportunities to smooth the way in a company share disposal

We have recently seen a couple of opportunities where, with some simple planning in advance, it could make the sale of a company more attractive from a tax perspective and potentially therefore easier to conclude, which is in everyone's benefit.

Entrepenuers Relief (ER) – are you maximising the relief?

In an SME business it is relatively simple to obtain an additional £10m of entitlement, with some simple planning in advance. I would urge all members to review their client shareholdings in detail at an early stage. If a husband (or wife) is the sole shareholder then by transferring 5% of the ordinary share capital to their spouse and appointing them as company secretary the ER clock starts ticking.

If your client is then in the lucky position that an approach is made and the 12 month period has been met it is possible for the majority shareholder to transfer a larger shareholding to the minority shareholder (nil gain/nil loss) and then maximise the ER entitlement.

I would also urge all members to ensure that non-voting shares, or other types of shares do not disqualify certain shareholders from ER relief, even though they hold over 5% of the voting rights.

Differing divisions in a company

Again, with advance planning, a company that operates two trades can be made more attractive from a buyers perspective and also from a tax perspective for the vendors. We have recently helped a new client hive their two divisions into two separate subsidiaries with a holding company. This means they will now report the financial performance of the two divisions separately and it should make it easier to sell one division at a time. We always doubted that the two divisions would sit well with one trade buyer. After 12 months we can sell one of the subsidiaries using the Substantial Shareholding Exemption, if the opportunity comes up, but in the meantime, if one division is unsuccessful, it won't bring down the other.

Please review your clients positions and think about how an exit may be best achieved!

Michael Watts, michael.watts@haslers.com
Haslers

Strong UK economy gives appetite to invest

With a more positive economic environment, low interest rates and plenty of cash that has been saved over the past six years, it does seem like there is a real entrepreneurial appetite again to invest. Many businesses are recruiting; whilst others are looking at acquisitions – both of businesses and assets.

We are seeing banks that are far more willing to lend, albeit with appropriate caution compared to pre-2008, and new banks coming to the market seeking to shake up the lending environment without the legacies of the major names that restrict their activities.

We see a few businesses using peer to peer debt funders, but more using crowd [equity] funding, with organisations like Syndicate Room (www.syndicateroom.com) innovating constantly.

Perhaps the most obvious impact on the market that we have seen in recent months is the number of strategic buyers approaching our owner managed clients. Often these are buyers based outside of the UK, looking at investing in to the strong UK economy, perhaps using the UK as the launchpad into Europe for American buyers in particular.

Dealing with overseas buyers creates lots of interesting challenges though, such as:

- Language: speaking to the targets, interpreting or even obtaining the buyer's financials;
- Time zone - the UK is a great time zone to be in, until you have both American and Asian parties in the same transaction!
- Currency issues – getting those formula the right way round when converting is important!;
- Cultural issues (are Heads of Agreement legally binding), is a celebratory glass of champagne acceptable with an Arabic buyer or remembering that Friday afternoon is not a good time to try and complete something with our Jewish friends; and
- Risk mitigation (what level of liability cap does a US buyer expect), However, overseas buyers do often have deeper pockets – particularly if it is their first foray into the UK, and this has been borne out in a number of deals in 2015 with others in the pipeline.

International deals do of course give us the opportunity to work with our IAPA and International Associate colleagues around the world and present the stronger advisory offering to our UK clients.

Simon Blake, simon.blake@pricebailey.co.uk
Price Bailey LLP

Members of the Corporate Finance Panel

ALTRINCHAM
Akeel Latif
Myerson Solicitors LLP
0161 941 4000
akeel.latif@myerson.co.uk
www.myerson.co.uk

BEVERLEY
Mike Beckett
Forrester Boyd Robson
01482 889400
m.beckett@forrester-boyd.co.uk
www.fbrobson.co.uk

CARDIFF
Lindsay Hogg
Watts Gregory LLP
029 2054 6600
l.hogg@watts-gregory.co.uk
www.watts-gregory.co.uk

CHELTENHAM
Will Abbott
Randall & Payne LLP
01242 548600
wja@randall-payne.co.uk
www.randall-payne.co.uk

DERBY
Simon Bursell
Dains LLP
0845 555 8844
sbursell@dains.com
www.dains.com

HULL
Jeremy Allison
Smailes Goldie
01482 326916
jeremyallison@smailesgoldie.co.uk
www.smailesgoldie.co.uk

LEWES
David Martin
Knill James
01273 480480
david@knilljames.co.uk
www.knilljames.co.uk

LONDON EC2
Simon Blake – ***Chairman***
Price Bailey LLP
020 7065 2660
simon.blake@pricebailey.co.uk
www.pricebailey.co.uk

LONDON N3
Daniel Shear
BKL Corporate Finance
020 8922 9321
daniel.shear@bkl.co.uk
www.bkl.co.uk

LONDON NE
Michael Watts
Haslers
020 8418 3333
michael.watts@haslers.com
www.haslers.com

NEWTON ABBOT
Linda Lugger
Peplows Limited
01626 208802
lindal@peplows.co.uk
www.peplows.co.uk

OXFORD
Justin Ray
Critchleys LLP
01865 261100
jray@critchleys.co.uk
www.critchleys.co.uk

YORK
Tony Farmer
JWPCreers LLP
01904 717260
jaf@jwpcreers.co.uk
www.jwpcreers.co.uk

Preparing for your day in court

My Partner and I mused over how we should plan our attendance at court as an expert witness or as a single joint expert witness.

Some of the points may be de rigueur to hard bitten FADR[1] colleagues but they may help the less experienced player entering into the adversarial arena.

1. Be sure you know exactly where you are going. Check the court address and directions on the internet. That may seem obvious but I had to appear as a expert witness in Coventry once and arrived at the wrong court.

2. Make sure you have the contact details for the court so you can call if you have a problem and are delayed.

3. Get there early so you can establish the layout of the court (and the court room if at all possible). Rooms do vary and it helps to have some prior knowledge. I have been in a modern well equipped court room and one that was like a Dickensian office.

4. Always be clear whether you are an expert witness or a single joint expert witness. If the former, you will be with a legal team and you can buddy up with them on arrival. There may well be a room for you to use. As a single joint expert witness, you tend to be on your own. Care must be taken to remain independent and impartial. You cannot talk to one party alone, even some unguarded comments. Immediately you compromise your independence.

5. As an expert witness you will be able to deliver input into the legal team's approach, not so as a single joint expert witness.

6. The court process can be a lottery. In particular, you may feel, as a single joint expert witness, that you are not being asked the right questions. That may well be so but we are there to respond to the questions put to us by both sides and no more. It may be that the judge will intervene with specific questions and give one the opportunity to make points, but that again will be up to the judge.

7. One just has to adopt a professional demeanour and that involves accepting the decision of the court even if one does not agree with it. John has an anecdote about a case he attended where the decision was founded on the basis that none of the warring parties would be able to reach agreement. The following day, outside of the confines of court, they duly came to an agreement.

8. The court room is adversarial and possible gladiatorial. One must not forget this and keep alert when under close examination from a lawyer looking to trip one up. We will need to remind ourselves it is not personal. He is just a professional going about his job. I was a single joint expert witness in a divorce case with two young barristers going hammer and tongs at each other and at me. Afterwards I was pleased when they both congratulated me on my evidence and then proceeded to decide where to go out for a drink that evening.

Paul Short, paul@lambert-chapman.co.uk
Lambert Chapman LLP

Members of the Forensic Accounting & Dispute Resolution (FADR)

BRAINTREE
Paul Short
Lambert Chapman LLP
01376 326266
paul@lambert-chapman.co.uk
www.lambert-chapman.co.uk

CAMBRIDGE
Denise Cullum
Price Bailey LLP
01223 565035
denisec@pricebailey.co.uk
www.pricebailey.co.uk

CARDIFF
Christopher Hatcher
Watts Gregory LLP
029 2054 6600
c.hatcher@watts-gregory.co.uk
www.watts-gregory.co.uk

LONDON N3
Marjorie Hurwitz-Bremner ***Chairman***
BKL
020 8922 9388
marjorie.bremner@bkl.co.uk
www.bkl.co.uk

MIDDLESBROUGH
Nicholas Upton
Anderson Barrowcliff LLP
01642 660300
nicku@anderson-barrowcliff.co.uk
www.anderson-barrowcliff.co.uk

PRESTON
Neil Calvert
Rushtons
01772 693111
mail@rushtonsaccountants.com
www.rushtonsaccountants.com

STOCKTON-ON-TEES
Lee Bramley
Endeavour Partnership LLP
Solicitors
01642 610300
l.bramley@endeavourpartnership.com
www.endeavourpartnership.com

WATFORD
Grant Franklin
Hillier Hopkins LLP
01923 232938
grant.franklin@hhllp.co.uk
www.hillierhopkins.co.uk

WITNEY
Jonathan Russell
ReesRussell LLP
01993 702418
jrussell@reesrussell.co.uk
www.reesrussell.co.uk

What can we and our clients learn from personal goal setting?

What is your main objective for the end of the week? What do you want to be doing in three years time? How important is achieving each goal? If it isn't important, then why bother…?

Two things about goals:

- They can be daunting if we are ambitious (and why wouldn't we be; most of us relish a challenge) but not unattainable
- Key people affected need to understand our goals too, as their own plans may help or hinder us.

Have you had a personal goal to complete a new and significant challenge: either physical i.e. to walk the three peaks, run the marathon; academic i.e. passing an Open University degree; or in home life i.e. planning a new garden.

Where do we start?

- A deadline gives focus. Then tell someone, because that makes us accountable. Choose someone vocal yet supportive.
- What do we need to do along the way? Do we have the skills? What help do we need? Can we measure progress? What is critical?
- Is it clear that the goal is achievable or does it need a different approach.
- Review progress.

Try imagining yourself at the finish line. Work backwards through the timeline and set mini goals, but all the time you know the next step in the process and how key each stage is to the outcome.

Who else will be affected?

- Individual goals can be selfish, so compromise might be needed. Equally goals can be complementary; just tweak the timing so you all gain.
- Discussion, regular communication and realism are vital

Put this into a business context

- Personal motivations affect business goals. Not everyone wants to double their income; others may want to get their handicap down while keeping challenging client work.
- The goals of key players should not be overlooked; keep them under review. Goals change with time.
- Finding a way to achieve personal goals within the overall business context makes attaining your business goals more likely.
- Action plans, deadlines, skill-sets, progress reviews are all needed.

Many businesses effectively run single-handedly and need us for an external view: what a privilege that can be.

Oh, and don't forget your own goals either…….

Monica Finlayson, monica@fbraccounting.co.uk
FBR Accounting Limited

Why a prescription may not fix your business

We have seen strong demand for business strategy work since the start of 2015. I am still working out whether that is New Year's resolutions, stronger confidence or some other reason.

What I am aware of is the increasing number of providers offering similar services and therefore the increasing difficulty for business owners to make the right choice.

Many Problems – One Solution

With this approach the adviser often has only one tool or business model that they are familiar with. The issue for the business is that the adviser will invariably sell their solution as being the one to solve your problem, whatever that happens to be. Tools, such as the Business Model Canvas or the Balanced Scorecard, are powerful when used appropriately to deal with the right problem at the right time. They are not a panacea for all ills. You might think of these as "False Hope" solutions. You now have a great business model and feel full of energy. But how do you make the real changes to the business to reflect the new model?

Some Problems – Some Solutions

These advisers are more sophisticated and have developed a list of common business problems and lists of common solutions. As a business owner you can choose a problem to fix and choose a solution, or be guided by your adviser.

Although there is a wider choice there is limited research or probing into the issue lest an unknown problem should arise, for which a list of solutions is not available. The adviser will steer you towards a common problem and use the list of possible solutions to build credibility.

If the chosen solution does not produce the result you desire, you can try again. A true "Trial and Error" approach.

Many Problems – Many solutions

The medical analogy is a powerful one. Think of the last time you visited your GP. How long was spent analysing your symptoms and diagnosing the underlying causes, compared with the time

spent deciding on the solution and writing the prescription? It would not be far away to say a 90-10 split.

What we have learnt is that the best approach invests much more time in diagnosing.

We call this facilitation and it is based on having multiple *ways* to diagnose problems and their causes and multiple *ways* to develop a solution. It is not an out of the bag solution, and can deliver significant return on investment with costs which are comparable to the alternatives.

It is both challenging and inspiring for the facilitator, the client and the team members. It truly is the best medicine.

Will Abbott, wja@randall-payne.co.uk
Randall & Payne LLP

Members of the Business Strategy Panel

CARDIFF
David Challenger
Watts Gregory LLP
029 2054 6600
d.challenger@watts-gregory.co.uk
www.watts-gregory.co.uk

CHELTENHAM
Will Abbott
Randall & Payne LLP
01242 548600
wja@randall-payne.co.uk
www.randall-payne.co.uk

LEWES
Christopher Ketley
Knill James
01273 480480
chris@knilljames.co.uk
www.knilljames.co.uk

LONDON EC2
Nick Mayhew – ***Chairman***
Price Bailey LLP
020 7065 2660
nickm@pricebailey.co.uk
www.pricebailey.co.uk

NANTWICH
Andrew Hague
Howard Worth
01270 626162
andrewhague@howardworth.co.uk
www.howardworth.co.uk

TOTTON (SOLENT)
Monica Finlayson
FBR Accounting Limited
023 8086 0260
monica@fbraccounting.co.uk
www.fbraccounting.co.uk

WORCESTER
John Painter
CB Chartered Accountants
01905 454854
jhp@cbcharteredaccountants.com
www.cbcharteredaccountants.com

Business Recovery and Insolvency

Insolvency outlook for 2015

With continuing low interest rates it is not surprising that the number of formal insolvency cases in the UK continue to decline. Furthermore, banks' attitudes are far more supportive than in previous times where it is incredibly rare to see a loan called in or other enforcement action being taken.

This is good news for many in business. However, many business owners say that times are tough and consumers just aren't spending as they used to...

Cash flow pressures are a recurring theme. We regularly advise clients where there is no issue with the quality of their work but funds are received late as a result of factors beyond their control. In a recent case, the knock on effect was almost catastrophic. A substantial sum had been outstanding for a significant amount of time. Our client had barely sufficient reserves to meet the day to day overheads of the business so any payments to historic trade creditors were impossible. In this situation we worked with the client to arrange a 'Time to Pay' arrangement with HM Revenue & Customs and with the trade creditors until such time that the funds arrived. Significant work was necessary to manage the expectations of creditors, particularly with those that were experiencing cash flow pressures of their own. In appropriate circumstances, it is possible to apply to the court for protection for a grace period whilst a plan is formulated. The protection prevents creditors from bringing or continuing enforcement action.

The old adage, 'Cash is King' remains. Furthermore, in the current climate there is a danger if the cash runs out that businesses continue in an almost 'artificial' environment as they are merely 'existing', not actually making a profit nor contributing to the economy.

Some commentators suggest that in fact more insolvencies would help to stimulate the economy as 'zombie' businesses would be put out of their misery; assets would be put up for sale and entrepreneurs would set up new, stronger businesses with better foundations including adequate funding and investment.

The current year will inevitably bring uncertainties, and hence more risk of insolvency, caused by many factors including: the general election; continuing economic weakness in Europe; tensions in the Middle East; risks in Russia and unforeseen events such as the impact of rapid structural change in some industries. Furthermore, the oil and gas production and distribution sectors start the year with low commodity prices. Additionally, we may also see a return to local authorities pushing for winding up orders and bankruptcies as pressures mount on councils to recover debts when funding is being reduced.

Regardless of the outcome of the predictions in 2015, the insolvency professional will remain busy working on turnaround and business recovery assignments in instances where there is a viable underlying business and directors seek assistance at an early enough stage. Additionally, the insolvency practitioners' work includes the restructuring or winding up of solvent entities and these liquidations often come with significant tax benefits for the shareholders when the company has reached the end of its purposeful life and are an attractive mechanism to conclude the affairs of the business with no fear of claims arising at some point in the future...

Should your clients be experiencing financial difficulty we recommend they speak with an Insolvency practitioner as soon as possible, if they wish to rescue something, otherwise it may be too late.

Paul Pittman, paul.pittman@pricebailey.co.uk
Price Bailey LLP

The Directors' Dilemma

A director has a general duty to stakeholders to promote the success of a company as set out in the Companies Act 2006. When a director knows or suspects that a company is facing financial distress or some form of insolvency then that focus ought to shift, as a duty of care will primarily be owed to the company's creditors.

However, all too often, the company will be the director's main, or only, source of income. Temptation may exist to put their own financial wellbeing ahead of that of the company, commonly to the detriment of the company's own creditors, and in particular HMRC.

Such action may leave a director open to personal claims, criminal prosecution or directors' disqualification in the event of formal insolvency. Typically these offences arise because a director breaches the fiduciary duty they owe to the company, piercing the corporate veil thus losing the benefit of limited liability. These breaches, whilst not exhaustive, include the granting of preferences, the gifting of assets, wrongful trading, re-use of trading names, misappropriation of company monies and other misfeasant or fraudulent activity.

If formal insolvency does occur then the liquidator or administrator (office holder) has a duty to investigate the company's affairs to establish what recoveries can be made, including potential claims against directors, both past and present. The office holder also has an obligation to report any material adverse conduct to the Secretary of State and also to report any criminal activity.

The office holder will obtain evidence from the company's own records and personnel, and from the outcome of any criminal prosecution or disqualification proceedings, although the latter may not always be influential as courts will take a pragmatic view.

Ultimately, the office holder will consider bringing civil

proceedings against the director personally if a good claim exists and it is commercially viable. Many insolvent companies have insufficient cash to fund litigation, so an office holder may turn to CFA agreements and insurance policies. This all adds to the amounts claimed by the office holder who will need to consider whether the director will be able to satisfy any judgement made.

In conclusion, to mitigate the potential exposure to personal liability, directors' of companies having cash flow issues or in distressed situations ought to seek early impartial advice from a UK200Group member.

Simon Blakey, sblakey@robson-laidler.co.uk
Robson Laidler LLP

Members of the Business Recovery & Insolvency

BIRMINGHAM
Martin Smith – ***Chairman***
Dains LLP
0845 555 8844
msmith@dains.com
www.dains.com

BISHOP STORTFORD
Paul Higley
Price Bailey LLP
01279 755888
paul.higley@pricebailey.co.uk
www.pricebailey.co.uk

CAMBRIDGE
Paul Pittman
Price Bailey LLP
01223 565035
paul.pittman@pricebailey.co.uk
www.pricebailey.co.uk

CARDIFF BAY
John Cullen
Bethan Evans
Harris Lipman LLP
029 2049 5444
john.cullen@harris-lipman.co.uk
bethan.evans@harris-lipman.co.uk
www.harris-lipman.co.uk

DERBY
Nicki Hawksley
Dains LLP
0845 555 8844
nhawksley@dains.com
www.dains.com

LONDON EC2
Guy Harrison
Price Bailey LLP
020 7065 2660
guy.harrison@pricebailey.co.uk
www.pricebailey.co.uk

LONDON N20
Martin Atkins
Freddy Khalastchi
Barry Lewis
Jonathan Bass
Harris Lipman LLP
020 8446 9000
martin@harris-lipman.co.uk
freddy@harris-lipman.co.uk
barry@harris-lipman.co.uk
jonathan.bass@harris-lipman.co.uk
www.harris-lipman.co.uk

LONDON NE
Roger Cain
Richard Hooper
Nick Nicholson
Stratford Hamilton
Haslers
020 8418 3333
roger.cain@haslers.com
richard.hooper@haslers.com
nick.nicholson@haslers.com
stratford.hamilton@haslers.com
www.haslers.com

NEWCASTLE UPON TYNE
Martin Daley
Simon Blakey
Robson Laidler LLP
0191 281 8191
mdaley@robson-laidler.co.uk
sblakey@robson-laidler.co.uk
www.robson-laidler.co.uk

OXFORD
Sue Roscoe
Anthony Harris
Lawrence King
Critchleys LLP
01865 261100
sroscoe@critchleys.co.uk
aharris@critchleys.co.uk
lking@critchleys.co.uk
www.critchleys.co.uk

SHEFFIELD
Christopher Brown
Emma Legdon
Hart Shaw LLP
0114 251 8850
chris.brown@hartshaw.co.uk
emma.legdon@hartshaw.co.uk
www.hartshaw.co.uk

STOCKTON ON TEES
Lee Bramley
Endeavour Partnership LLP – Solicitors
01642 610300
l.bramley@endeavourpartnership.com
www.endeavourpartnership.com

Company tax residence

A company that is tax resident in the UK will generally be taxed in the UK on its worldwide income. A company that is not tax resident in the UK will only be chargeable to UK corporation tax to the extent that it carries on a trade through a permanent establishment (PE) in the UK. Corporate residence rules are therefore important in establishing which country has taxing rights over a particular company and to what extent.

A company that acquires UK tax residence may come within the charge to UK corporation tax on its worldwide income from the date UK residence is acquired. Overseas tax rules may need to be reviewed for any consequences of losing residence including confirmation of whether tax on chargeable gains arise. Notification will need to be made to HM Revenue & Customs (HMRC) of coming within the charge to corporation tax.

1. When will a company be tax resident in the UK?

A company is tax resident in the UK if either:

- it is incorporated in the UK, or
- the central management and control of the company is found to be exercised in the UK.

Therefore, a company incorporated in the UK will be tax resident in the UK as will a company incorporated overseas if its central management and control is exercised in the UK.

2. Central management and control

The test of central management and control developed as a result of UK case law in the absence of a definition of 'residence'. These cases have shown that the central management and control test is based on the facts in each particular case in determining where central management and control is actually exercised.

3. Practical guidelines

As a broad rule, the following need to be considered for the test of central management and control:

- Whether the majority of the directors are UK resident
- Where the meetings of the board of directors are held
- Whether board meetings are preceded by adequate notice and circulation of an agenda and relevant information and documents
- Whether the board takes all decisions affecting matters of policy or management of the company's business at meetings of the full board
- Whether the directors use proxies
- Whether the directors undertake their duties in the UK
- Whether company records, minute books and documents required by statute are kept in the UK.

The above is not an exhaustive list and evidence of board meetings and decisions relating to central management and control should be kept with the company's books and records in the UK.

Alan Boby, aboby@ellacotts.co.uk
Ellacotts LLP

Members of the International Panel

BANBURY
David Stevens – ***Chairman***
Alan Boby
Ellacotts LLP
01295 250401
aboby@ellacotts.co.uk
dstevens@ellacotts.co.uk
www.ellacotts.co.uk

BIGGLESWADE
Philip Blackburn
George Hay Partnership LLP
01767 315010
phil.blackburn@georgehay.co.uk
www.georgehay.co.uk

CAMBRIDGE
Martin Clapson
Price Bailey LLP
01223 565035
martinc@pricebailey.co.uk
www.pricebailey.co.uk

CARDIFF
Anne Smith
Watts Gregory LLP
029 2054 6600
a.smith@watts-gregory.co.uk
www.watts-gregory.co.uk

LEWES
Christopher Ketley
David Martin
Knill James
01273 480480
chris@knilljames.co.uk
david@knilljames.co.uk
www.knilljames.co.uk

LONDON EC2
Simon Blake
Price Bailey LLP
020 7065 2660
simon.blake@pricebailey.co.uk
www.pricebailey.co.uk

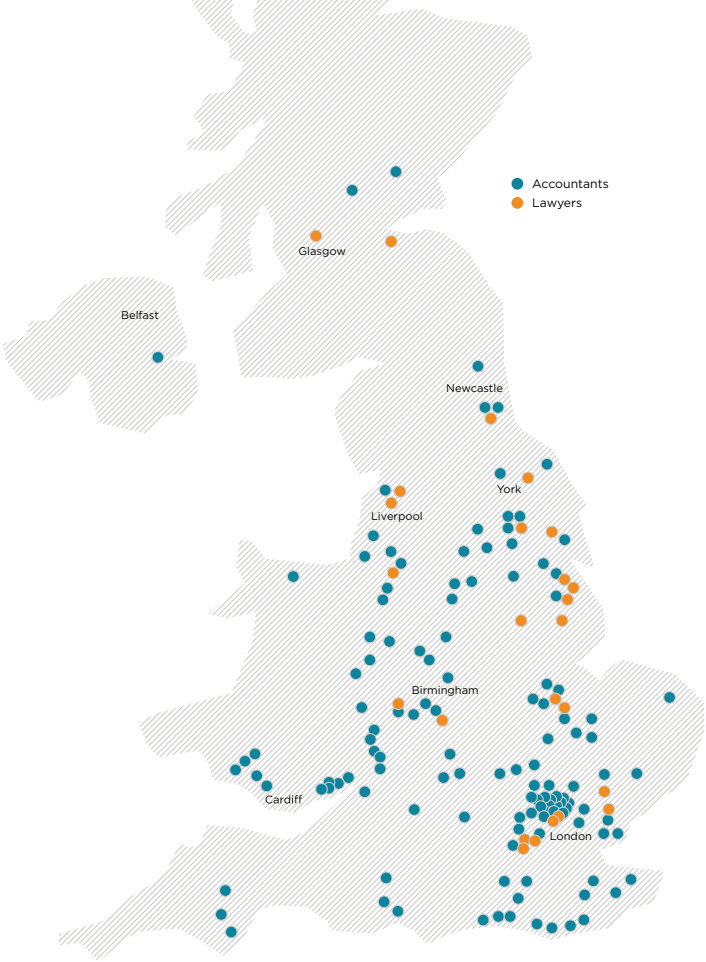
LONDON N3
Adrian Thomas
David Whiscombe
BKL
020 8922 9222
adrian.thomas@bkltax.co.uk
david.whiscombe@bkltax.co.uk
www.bkl.co.uk

LONDON N20
Martina Fitzgerald
Harris Lipman LLP
020 8446 9000
martina.fitzgerald@harris-lipman.co.uk
www.harris-lipman.co.uk

LONDON W5
Steve Darlington
Albert Harwood
Martin Howe
Howe & Co Solicitors
020 8840 4688
s.darlington@howe.co.uk
a.harwood@howe.co.uk
m.howe@howe.co.uk
www.howe.co.uk

WITNEY
Jonathan Russell
ReesRussell LLP
01993 702418
jrussell@reesrussell.co.uk
www.reesrussell.co.uk

WORTHING
David Macdonald
The Martlet Partnership LLP
01903 600555
david@martletpartnership.com
www.martletpartnership.com



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UK200Group
3 Wesley Hall, Queens Road,
Aldershot, Hampshire GU11 3NP
Tel +44 (0)1252 401050
Tel +44 (0)1252 350733
admin@uk200group.co.uk

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