UK200Group technical advisers

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infocus

UK200Group
technical advisers

UK200Group specialist 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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UK200Group tax

Changes to partnership taxation

HMRC have recently released a consultation document on partnership tax. It's aimed at countering what HMRC perceives as avoidance, but is likely to have much wider impacts.

The proposals are looking at two main areas:

1) LLP members who have a fixed income and no capital stake in the LLP, so are effectively employees in HMRC's eyes.

This is aimed both at the high-end such as professionals seeking to spread the advantages of being a "partner" to senior employees, and the low-end where employees of a cleaning company may be transferred to be members of an LLP.

These people will be taxed as employees: so Class 1 NI will be due, and benefits in kind may be affected. Essentially, this is IR35 for partnerships.

2) Partnerships (not just LLPs), where income is attributed to partners on a basis that HMRC regards as unreasonable.

Three situations have been set out:

- Mixed partnerships of individuals and their connected companies, so some income is subject to corporation tax. HMRC propose that income of corporate partners should be attributed to the connected individuals, using a reasonable allocation based on the underlying economic position and any other factors they think relevant.
- Mixed partnerships where individuals are allocated the initial losses, and later profits are allocated to corporate partners. There need not be any connection between the partners. This is aimed at marketed schemes. The losses allocated to the individuals will simply be disallowed.
- Partnerships where members have different tax attributes – say where income is transferred to someone who has tax losses, in return for capital contributions to the partnership. The counteraction is simply to say "this is tax avoidance" and levy what HMRC considers the right tax - a capital payment by one partner might be taxed as income of another.

Overall, the proposals are written very broadly and allow significant discretion for HMRC to bring as much income as possible into the highest possible tax band. Although only a consultation, this is a clear statement of intent by HMRC. Partnerships with any unusual attributes at all should review their positions carefully.

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Research & Development Tax Relief

R&D relief has been around for more than a decade, however, there are still many eligible companies who fail to claim the relief to which they are entitled.

Typically, the companies will be manufacturing companies who undertake process improvements that qualify for R&D relief, however, any company in other sectors may undertake R&D activities, including work on software, which is contributing to the resolution of scientific and technological uncertainty. It should be remembered that expenditure can qualify for R&D relief whether or not the activities are successful in resolving the uncertainties.

There have been recent changes to the operation of the relief that make it even more attractive:-

1. The SME's repayment is no longer capped at the underlying PAYE paid in the period.
2. The de minimis limits for making a claim have been abolished.
3. Contract staff, including those providing IT services, can be included in a claim if eligible, regardless of whether they are supplied by an agency or via their own personal service company.
4. Large companies can surrender their R&D loss for a capped tax repayment.

There continues to be differing rates of relief depending on the size of the company. A large company is one with more than 500 staff or with a turnover of more than €100m and balance sheet of more than €86m. These limits are twice the size of the normal "large" company limits for most other UK tax law.

SME companies, i.e. those that aren't large, can claim an enhanced deduction of 125% of a qualifying spend and continue to have the option to surrender an R&D loss for a repayable tax credit.

Large companies can claim a 30% enhanced deduction or, from 1 April 2013, a 10% above the line credit, which is repayable if certain conditions are met.

We have become aware of mid tier firms offering "free" R&D claims work to target clients of UK200Group members in an attempt to disrupt the incumbent advisers relationship with the client, so it is important that members remain proactive in identifying R&D claims for existing clients.

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UK200Group tax

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Moving the goalposts

I write this on the eve of a completion meeting, having helped yet another client sell his business. It should have been a straightforward exercise. My client is one of the most decent people I have met in business. The buyer is also someone I believe to be straightforward. Yet somehow in the last fortnight both have reached the point of pulling out of the deal and both are faced with much higher legal costs than they expected.

Both feel the other has moved the goalposts.

Some of this may have come from the Heads of Terms. Though never intended to cover every eventuality, what wasn't said in the Heads has taken on a significance far beyond what was intended when they were signed.

Another key factor has been the draft contract. The deal concerns the sale of the goodwill and trade of a business, plus stock. What should have been a relatively simple exercise in identifying a suitable agreement precedent, and then amending it for particular items in the Heads, has turned into a 70 page document which one solicitor described as something more suitable for selling a division of Coca Cola. What recommendations come from these observations? Firstly, ensure the Heads of Terms set out all matters that are key to both parties. It is worth taking time at this stage to document sufficient detail on the deal that both believe they have done.

Secondly, as the contract takes shape, the parties must immediately stop their respective lawyers and get them talking if they spot anything in the draft documentation that they believe was not intended when they signed the Heads. Document drafting should be suspended until points of difference are resolved. If all else fails, the parties will need to talk directly again to iron out areas of dispute.

This deal will close, but not without considerable effort on the part of the corporate finance advisors to keep it on track. M&A deals are often a roller coaster ride, and corporate finance specialists have a key role in keeping communication channels open to smooth out that roller coaster for clients.

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Unlocking the Value of Intellectual Property (IP)

How many businesses possess
- Contracts
- Secrets
- Technical knowledge
- Processes?

Is there any value in these assets? Are they recognised on the balance sheet? Could they be used to raise finance? Could they be used in strategic decision making? Well the answers to all these questions are, I guess, for most businesses: Maybe…

But does it really cause a problem?

In situations where there is neither a track record nor sufficient security, then EBITDA's do not work as a way of assisting in the raising of finance. In sales and acquisitions the seller and buyer would like to know how and where these values can be turned into a monetary value. In start-ups where equity is required, then a potential investor would like to know what value, if any, can be attached to these assets.

So, is there a way to value these hidden assets?

Software is available on-line to provide such a valuation. IP is not a single currency and a form of briefing tool is necessary to identify the values. A simple model is used to provide a profile detailing and describing the Innovation, the type, the benefits, market sectors, the development stage, registered rights and the intellectual assets. The software uses the information provided to project cash flow over the life of the IP. It then applies a "relief from royalty" principle and brings the value back to a present day estimate by discounting the cash flow, applying an appropriate tax rate and weighted cost of capital calculation tailored to the business and IP characteristics. Such valuations showing the potential of IP as an income source are increasingly recognised by banks in support of loan applications, equity investors and alternative lenders. Without such a valuation it is really difficult to raise funds in this way.

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A new legal landscape

The Jackson Reforms talk about, as did Woolf, the principle of access to justice but many worry that it will mean legal representation will be priced beyond the reach of many.

The worry is that we will see an increase in the unrepresented party referred to as the Litigant in Person (LiJ). But as with any change which people consider a threat there are those that see an opportunity.

The plight of the LiJ manifests itself in all areas of the legal process and not least because the LiJ does not understand or know the legal process. Some legal firms are now looking at, as with other areas of legal provision, at forms of commoditised support package. For a fixed fee firms can provide an appraisal process to assess the merits of a case, an overview of presentation and brief explanation of process such as how to present a legal case bundle. This might be a fixed time period, some also are considering a telephone support (time limited) system. Much of this could be handled by paralegals suitably trained and directed. It maybe that there is an opportunity for the on-line provision no different to firms who charge fees for checking and completing Government forms.

This is not a suggestion of a loss leader but a cost effective provision of a legal support system which would bring in income to those inventive firms which they would not otherwise receive. There is always the upside that should the LiJ's circumstances change they would have an existing relationship with a legal provider and it would follow they would be the first port of call for a paid for premium service.

This may not be how Jackson envisaged driving down the costs of litigation but the LiJ and support for them may well be one of the consequences. The fear might be that if legal firms do not provide such a service unregulated providers may well step in to fill the gap.

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Prest and the Press

High profile divorce cases are good copy for our Press corps. The best ones can contain a heady cocktail of opulence, infidelity, intrigue, often with exotic locations, complex business structures and overt tax avoidance as essential elements of the mix. It is high octane, page 3. manna from heaven for the broadsheets in today's challenging media environment.

Hence the recent case of Petrodel Resources Limited and others v Prest which hit the headlines. Unfortunately the broadsheet reportage is not as robust and responsible as it once was, and it can descend into the salacious and sensational. So here, the post case headline was that this was the end of the cheat's charter and it was hailed as a great victory for wives.

The reality may be somewhat different. The essence of the case was whether the Court, in ancillary proceedings, can treat the assets of a company of which a spouse is the sole controller as being assets to which that spouse is "entitled" for the purposes of Section 24(1) MCA 1973. In the initial proceedings the husband was ordered to transfer properties owned by his UK companies and also properties and shares held overseas. The judge indicated that he could not pierce the corporate veil because there had been no impropriety (thus affirming the long established principle in Saloman v Saloman which was upheld in the recent Ben Hashem case) but he could take action under Section 24 of the MCA.

The company successfully appealed on the basis that there had been no impropriety. These structures had proceeded the marriage. Mrs Prest then appealed to the Supreme Court on the basis that she could not enforce the original Order and the husband had not shown the slightest intention to comply with any part of it.

The issues would bring to a head once more the tension between the Chancellery Division, which would uphold the veil of incorporation, and the Family Division, which had sought to look beyond it in the interests of justice.

Lord Sumption found that:

1. The corporate veil could not be pierced, just because the company might be the alter ego of one of the parties.

2. It could be pierced if there was abuse or wrong doing.

3. Concealment - the company is acting as a Trustee for an individual.

4. Evasion – where the company structure is being used to evade a liability or legal right against the person in control of it – not possible in the Prest case because the structure was in place beforehand.

Lord Sumption argued that the corporate veil could only be pierced if there was no other remedy and only when one party is evading an existing legal obligation. In fact the case actually enhanced the principle of the corporate veil and limited the situations where it might be broken.

Indeed much hinged on the obstructive conduct of Mr Prest. Had he engaged with the Court and offered good reasons why the properties had been transferred into Trust and shown that he had divested himself of all beneficial interest in these properties, then the corporate veil might not have been broken.

It was confirmed that Section 24 did not give power to invade company assets and Mrs Prest only succeeded because the Court found that the assets were beneficially owned by Mr Prest.

Unfortunately, these findings do not make headlines unlike the end of the cheat's charter.

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Back to basics?

CEOs fail for many different reasons. Some are just unlucky. Some are sunk by their lack of ambition, muddling along rather than going all out for success. This usually means that a company will inevitably fail to make the tough choices and the significant investments that would make winning even a remote possibility.

Many are brought down by making a strategic error, of which there are six common varieties.

- Do-It-All strategy, shorthand for failing to make real choices about priorities.
- Don Quixote strategy, unwisely attacks the company's strongest competitor first.
- The Waterloo strategy, pursues war on too many fronts at once.
- The Something-For-Everyone strategy, tries to capture every sort of customer at once, rather than prioritising.
- The Programme-Of-The-Month goes for whatever strategy is currently fashionable in an industry.
- The Dreams-That-Never-Come-True strategy, never translates ambitious mission statements into clear choices about which markets to compete in and how to win in them.

A good strategy has five components all designed to shorten the odds of success by helping managers make the right choices. The first two are closely intertwined.

- Figuring out what winning looks like and which markets to play in. Sometimes the goal is global domination, sometimes local; sometimes just one category of consumer for a brand, other times many.
- Figuring out how to win the company's distinctive strategy in any market it is trying to dominate.

This in turn will be heavily influenced by the fourth and fifth components:

- Identifying, and playing to, the company's unique strengths relative to its competitors, and identifying those things that need to be managed for the strategy to succeed.

The mirror image of the fifth component is deciding what not to manage.

Question: What helps?
Answer: a slimmed-down strategy-review process.

Replace needlessly sprawling bureaucratic meetings with agendas that focus upon the most important questions, and remember that no strategy lasts forever.

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Do you know the Sweet Spot of your business?

Many of us think about doing SWOT analysis in our planning, but how many of us target the real issues that affect our business. I have been privileged to work with UK200Group Business Strategy Panel Chair, Nick Mayhew, on an extension of the basic SWOT analysis model and have found people not only receptive to the idea but embracing it with an enthusiasm I don't often see.

SWOT analysis in an organisation analyses strengths, weaknesses, opportunities and threats to the organisation and often that finds its way into their business plan but used no further. The Sweet Spot SWOT goes 2 steps further.

Firstly it looks at the strengths and reduces these to focus on the Sweet Spot strengths. We have all come across the shot in sports such as cricket, golf or tennis where we hit the perfect shot. They say that is the sweet spot, so where in your business do you find a similar thing happening? Is it your customer service, your product or your branding?

Instead of looking at all of the many weaknesses that an organisation has, this model focuses on the critical limitations you may be facing. Areas such as skill gaps, cash or production breakdowns would be considered here. Opportunities again should be narrowed to reflect only on those that are the low hanging fruit. This way you focus on those opportunities that are less risky.

Finally you review your threats by carrying out a risk review or Failure Mode Effect Analysis on them. This highlights those risks to your business that are potentially the most

damaging so that you can do something about them.

Once you have these areas identified action plans can be drawn up. How do you use your strengths to maximise your opportunities; and to overcome your threats? How do you ensure your critical limitations don't spoil your opportunities or combine with the risks to bring the business down?

It is then critical that the action plans are implemented and monitored to ensure that the organisation continues to move forwards.

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UK200Group business recovery & insolvency

Buying back the assets – not always the simplest solution!

Although liquidating and buying back the assets can be a simple way of dealing with an insolvent company, it is not always the best solution for the directors or shareholders.

In February I was introduced to a company which manufactured sandwiches and distributed them via a van sales operation to retail outlets on a sale or return basis. The company was losing money, had breached its overdraft limit and was running out of cash. The company had assets worth £20,000 on liquidation and liabilities of £180,000 (£92,000 owed to the bank). On the face of it liquidating and buying back the assets would seem the obvious solution. However, doing so would have serious consequences for the directors who had given personal guarantees to the bank. The directors, who were in their mid to late 50's, had no funds to either settle their guarantees or buy back the assets and so faced losing their house and well as their income were the company to fail.

Having discussed the options available, a Company Voluntary Arrangement ("CVA") was the preferred solution as it would enable the company to continue trading and service the banks debt which was secured by a debenture. However, for a CVA to work the company had to be profitable and be able to make income payments. Working with the company's accountant, a plan was put in place to rationalise the business and return it to profitability. The plan involved reducing production and deliveries from five to three days a week thus saving significant costs without unduly affecting turnover.

Support of the bank was vital and so with the director I met with the bank manager and presented an outline of the CVA proposal. The bank indicated their support and so the CVA proposal was developed further. As the proposal was being finalised the directors were advised to speak to the main trade creditors. Although these meetings were uncomfortable for the directors, the creditors involved appreciated the fact that the directors had taken the trouble to see them and this helped gain their support. At the formal meeting of creditors the CVA was approved by all the creditors who voted.

The CVA was structured so that the company will pay income payments for a period of five years based on what it can afford to pay having taking into account the servicing of the bank debt. In fact during the five year period the company's loans and overdraft will be repaid in full so that at the end the company will be debt free and the directors will have time to generate funds for their retirement.

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Formal Insolvency is not always best

There are two tests for insolvency within the Insolvency Act 1986. Firstly, the Balance Sheet Test, i.e. the value of assets is outweighed by the level of liabilities. Secondly, the Cashflow Test, when a company is unable to discharge its liabilities as and when they fall due.

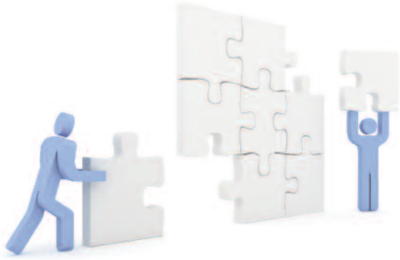
When faced with an insolvent position, many directors, based upon the advice of their accountants and insolvency practitioners, believe that they have little alternative other than to liquidate.

It is all too easy to default to looking at (in)solvency at an isolated date and conclude trading must cease either in order to facilitate an orderly wind down, or to enact the often much maligned pre-packaged sale.

But there are always mitigating factors to consider.

We were recently approached by directors who had also consulted another Insolvency Practitioner. The advice they had previously received was that they ought to cease trading, enter into administration or liquidation and then purchase the business as a going concern. This in itself is not always poor advice. However, in this instance it would have served little purpose other than to reduce the return to creditors, leave the directors with a sizable liability and generate largely unjustified professional fees.

The company in question had one pressing creditor but robust future cashflow because of a substantial order book



UK200Group business recovery & insolvency

and relatively loyal customer base. The company's assets were limited to cash at bank and a minor debtor ledger. The company had traded successfully for a number of years but had allowed rapid expansion which had led to an increase in overheads with no real benefit in terms of turnover.

The business was able to restructure so that overheads were reined back to previous levels and this allowed the debts to be discharged over a 9 month period. Not only was liquidation avoided, but so was a Company Voluntary Arrangement.

An informal repayment plan was negotiated with the creditors whereby they received 100 pence in the £. In the event of a liquidation the creditors would have received less than 50 pence in the £.

The lesson is to look at each matter on its merits and devise a pragmatic solution avoiding formal insolvency where possible.

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First steps to trading in the USA

Clients undertaking work in the US for the first time have a number of areas of tax to consider:

- Federal tax – this is normally easy because of the UK/US tax treaty. If they do not have a PERMANENT base in the US then they are normally outside of US tax, but will typically have to give customers a W8-BEN form (from www.irs.gov) saying that they claim treaty benefits to avoid withholding tax.

- State and city taxes – these are not covered by the tax treaty and each state has its own rules. We have seen clients working on site for clients in some states being pursued for state tax interest and penalties many years afterwards even though their projects were only a few months long. Naturally authoritative advice should be obtained from an adviser in the state concerned (or one of the higher cost inter-state firm), but a first step when looking at a potential project could be a discussion with the client's accountant to check if there are issues to deal with. This should not affect pricing as unilateral relief should be available in the UK for the state and city income taxes.

- Sales tax – this is an old-fashioned turnover tax, unlike VAT. Again, local authoritative advice should be obtained. Hopefully the answer will normally be that a UK company without a permanent base does not have enough "nexus" to be obliged to charge sales tax. Sales tax that is paid on goods and services will just add to the P/L expense.

- For VAT the outputs will be outside the scope, with no restriction on reclaiming input tax. Under the flat rate scheme the outputs are not to be included in turnover, and any local costs are outside of the reverse charge scheme. (NB this is because US is not in EU!)

This is intended as a quick "orientation", and specialist advice should be obtained in real situations.

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Remittance basis of taxation

Remittance basis of taxation is an alternative tax treatment that is available to individuals who are UK resident and not domiciled in the UK.

Individuals who are taxable on the remittance basis are still subject to UK tax on their UK income and gains in the normal way, but they are only liable to UK tax on any amounts of foreign income and gains that they remit to the UK.

How to claim the remittance basis of taxation

- On the annual tax return, there is the option to opt in and out on a yearly basis
- Individuals who have been resident in the UK for at least 7 of the previous 9 tax years will have to pay the £30,000 remittance basis charge (RBC)
- Loss of entitlement to the income tax personal allowance and to the annual exemption for capital gains
- From 6 April 2012, the RBC is £50,000 for individuals who have been resident in the UK for 12 out of the previous 14 tax years.

What is a remittance

A remittance is any money or other asset (e.g. property or investments) to which all of the following apply:

- It comes from foreign income and/or foreign gains
- It has not been taxed in the UK
- It is brought into the UK by the individual or for the benefit of a relevant person (which includes spouse, minor children and grandchildren and connected parties)

Money or property does not have to be physically remitted to the UK (e.g. paying for goods or services in the UK with a credit card which is linked to a foreign account containing foreign income).

- How to identify a remittance

Single account: If the individual makes a remittance from an account containing a single source of income for a single year, it is easy to identify what has been remitted (foreign employment income, foreign investment income).

This will be disclosed on their UK tax return and UK tax paid with credit given for any foreign tax paid.

Mixed fund: a mixed fund is a fund of money and/or other property which contains more than one type of income or capital including capital gains or income or capital from more than one tax year.

An example of a mixed fund is a bank account into which different types of income such as interest, dividends, earnings or capital have been paid. Income will be deemed to be remitted first.

"Pure" capital: any funds held outside the UK by a non UK resident – created on pre immigration planning which would require setting up of segregated accounts, usually a capital account and an income account in which interest on the capital is paid to avoid tainting of the funds. Another account can be set up with capital to be invested, which will contain capital and capital gains. No segregation is possible for gains. This account can include any inheritance received.

To avoid a UK tax charge

→Can remit "pure" capital
→Cannot remit foreign income
→Cannot remit foreign capital gains

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