

# Investors' Guide to the United Kingdom 2011/12



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**Edited by: Jonathan Reuvid**

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# The Investors' Guide to the United Kingdom 2011/12

*Edited by*

**Jonathan Reuvid**

HSBC  Watson, Farley & Williams



**Legend  Business**

Independent Book Publisher

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Our worldwide client portfolio covers many industry sectors and we work closely with UK Trade and Investment.

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**Janelle O’Connell**, Calleija Jewellers, Australia

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**Asil Tan**, Director UK operation, Cimstone, Turkey

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## **2.4 COMPANY FORMATION – METHODS AND LEGAL IMPLICATIONS**

*Ian Saunders*  
*Artaius Limited*

### **REGISTRATION**

There is no formal requirement in the UK to register with a local commercial registry or the tax authorities before commencing business.

A person wishing to start a business in the UK has a choice between the registration of an incorporated vehicle (a company) or trading through an unincorporated vehicle (a sole trader or partnership). If a corporation is already operated overseas, then the owners and managers of that business also have the option to consider registration of that corporation as a branch or having a place of business in the UK.

### **Unincorporated Vehicles**

#### *(i) Sole Trader*

A person who carries on business as a sole trader is personally liable for all the debts and obligations incurred by his business; accordingly all of his business and personal assets can be called upon to meet payment of any liabilities incurred by his business.

*(ii) Partnership*

A partnership is usually governed by a written agreement, which binds the partners and is subject to the provisions of the Partnership Act 1890. With some exceptions, partnerships are limited to 20 partners.

The partnership has no separate legal entity and a trader who carries on business through this vehicle is jointly and severally liable with his other partners for all debts and obligations incurred by the partnership while he is a partner. Furthermore he is jointly and severally liable with the other partners for loss or damage to third parties by the wrongful acts or omissions of any partner in the ordinary course of the partnership business.

*(iii) Limited Partnership*

These are governed by the Limited Partnerships Act 1907. As long as there is one or more partners liable for all the debts and obligations of the partnership, the Act allows a partner to limit his liability to the amount contributed by him by way of property or capital on joining the partnership. Such a partner is not entitled to take part in the management of the partnership.

## **Incorporated Vehicles**

Corporations have distinct legal personality separate from that of their members. The different kinds of corporations are:

*(i) The Private Company Limited by Shares (“Private Company”)*

A Private Company is by far the most commonly used business vehicle in the UK. There is no statutory minimum capital requirement for a Private Company and trading can start immediately upon incorporation.

A private company is prohibited by law from offering any of its shares to members of the public, so no offer of shares of any kind can be made. It is the vehicle used mostly for owner/managed companies and new business start ups.

*(ii) Public company limited by shares (“PLC”).*

The minimum capital requirement for a PLC is £50,000. If contributed in cash, one quarter of the value of each issued share is required to be paid up in the PLC (effectively £12,500) for it to obtain a certificate to commence trading.

A PLC can, under strict procedures, issue a prospectus and offer shares to members of the public. Under further rules and regulations, larger PLCs can be admitted to the main index of the London Stock Exchange or one of the subsidiary markets.

*(iii) Private company limited by guarantee and not having a share capital.*

This vehicle is used chiefly by trade associations, clubs, charitable companies and management companies for apartment blocks. There is no share capital. Instead each member “guarantees” that in the event of the company being wound up it will pay a specified sum towards the funds. The articles of association govern the terms of membership of the companies.

*(iv) Unlimited companies, with or without a share capital.*

The members' liability is unlimited with this type of company. The chief advantage of this organisation is that accounts are not required to be submitted to Companies House and are thus not available for public inspection.

*(v) Limited Liability Partnership (LLP).*

Introduced on 6 April 2001, an LLP comprises a corporate entity distinct from companies incorporated under the Companies Act, but sharing many characteristics.

An LLP is a legal person quite separate from its members, with capacity to contract in its own name. Members of an LLP enjoy limited liability; they do not have to be employees of the LLP.

### LLP Incorporation

The LLP can be incorporated with a minimum of two members. They subscribe their names to an incorporation document. The LLP must carry on a lawful business with a view to profit.

An LLP must prepare and publish Accounts similar to those regarding a company and file an Annual Return accordingly. An LLP may change its name and registered office. Members may change.

Unless members agree otherwise, they share profits and losses equally and may all participate in managing the LLP. Members may enter into an agreement that, among other things, deals with profit shares, involvement in management and remuneration.

As with incorporating a company and settling its Memorandum & Articles of Association, those intending to incorporate an LLP and drafting a Members Agreement should seek expert advice at an early stage.

Members of an LLP are taxed as if the business was carried on by a partnership, rather than by a company.

*(vi) Community interest company. Community Interest Companies (CICS)*

CICS's are limited companies, with special additional features, created for the use of

people who want to conduct a business or other activity for community benefit, and not purely for private advantage. This is achieved by a "community interest test" and "asset lock", which ensure that the CIC is established for community purposes and the assets and profits are dedicated to these purposes. Registration of a company as a CIC has to be approved by the Regulator who also has a continuing monitoring and enforcement role.

### **Registration of a UK Establishment**

A UK Establishment is effectively an extension of an overseas company operating in the UK, and as such, the UK office is subject to UK Law. A UK Establishment is not a separate legal entity from the overseas company and any such contractual arrangements or liabilities entered into are binding to the overseas company.

A UK Establishment must have a trading address in the UK and present evidence of this for formation purposes. This is known as a branch.

The information needed on formation of a UK Establishment is as follows:

- the corporate name of the overseas company;
- its legal form, i.e. whether it is a private or publicly-quoted company, and its manner of limitation, i.e. by shares;
- the law under which the company is incorporated;
- the identity (name and address) of the authority in the home state responsible for keeping the records of the company;
- its registration number in the country of incorporation (if applicable);
- the objects of the company;
- the share capital of the company;
- a list of its directors (and if applicable, company secretary) and the home addresses, dates of birth and business occupation of such persons;
- the extent to which directors can represent the company, i.e. whether they can act alone or must act jointly;
- whether the company is a credit or financial institution;
- the address of the branch in the UK, the date on which it was opened and the business carried on by the branch;
- a list of the names and addresses of persons in the UK authorised to accept service on behalf of the Company in respect of business at the branch;
- a list of those persons resident in the UK and entitled to represent the company and whether any powers of representation are limited in any way;
- the address of its principal place of business in its country of incorporation.

The overseas company must, for registration, also submit a copy of its last filed accounts (if submitted in the home country) and a copy of its constitutional document. These must be certified by a notary and translated into English if necessary.

Although the accounts of the UK Establishment will not be required to be filed on public record at Companies House, the accounts of the overseas company will need to be so filed if there is requirement to publicly file the accounts of the overseas company in its home state. If accounts are not required to be publicly filed, a special set of accounts will need to be prepared and filed under the Companies Act 2006.

## **THE PROCESS OF FORMING A COMPANY**

### **Private Company Limited by Shares**

The great majority of companies formed in the UK are private companies limited by shares and the process of the formation of these companies will be examined first.

#### *(i) Company Name*

The proposed company name should be checked to ensure that it is not identical to an existing registered name or does not contain a word restricted or prohibited. The UK authority dealing with the registration of companies ("Companies House") maintain a list of already registered names and restricted words. This is available at their website [www.companieshouse.gov.uk/info](http://www.companieshouse.gov.uk/info)

The Companies Act 2006 imposes new rules on the identification of names as identical to existing names. Certain words (including "UK", "Services", "Holdings" and "International") are ignored when comparing names and the new name will not be allowed if a name is different from an existing company only by words or characters that are disregarded. For further information please see the Companies House website.

Care should also be taken to avoid clashes with companies of similar names. Although this will not prevent the registration of the name, a new incorporator may find a subsequent objection to the new name has been made and in such cases Companies House have power to direct a new company to change its name. In addition the new company could face a case of "passing off" if an existing company considers that their trade has been infringed.

New companies should also be advised to ensure their proposed name does not conflict with any registered trade or service marks. Further information can be obtained from the UK patent office at [www.patent.gov.uk/tm](http://www.patent.gov.uk/tm)

In addition, the Companies Act 2006 introduced new provisions allowing any person or company to object to a company name for "opportunistic registration" if the company's name is:

- a) the same as a name associated with the complainant in which he has goodwill;  
or
- b) so similar that its use in the United Kingdom would likely to mislead by suggesting a connection between the company and the complainant.

For further information please see: [www.ipo.gov.uk/cna](http://www.ipo.gov.uk/cna)

The company name chosen must end with the word “Limited” or “Ltd” and these words must not appear anywhere other than as the last word in the name.

### *(ii) Shareholders*

A private company limited by shares must have one or more shareholders who will be the owner of the business. The first shareholder(s) of the new company will be those person who subscribe for shares in the Memorandum of Association of the Company, which is a document required to be submitted for the incorporation.

Subsequent to the incorporation, the Directors of the company may allot further shares if so authorised by its Articles of Association.

The liability of any shareholder is limited to any amounts unpaid on the shares agreed to be taken.

### *(iii) Directors*

The Directors of a company will be those persons who consent to act as such on Form IN01 submitted with the incorporation papers. The directors are required to provide their full name and residential address, date of birth, nationality and business occupation. The directors can provide a non-residential service address, which if given, will be the address searchable by members of the public. The residential address will be kept privately by Companies House.

There is no restriction on non-UK residents acting as directors, but there may be restrictions on what work some nationals who are not based in the European Economic Area can do in the UK. For further information please see the UK Home Office website at [www.ind.homeoffice.gov.uk](http://www.ind.homeoffice.gov.uk)

A private limited company requires a minimum of one director. A UK or foreign registered corporation may be a director, but the Companies Act 2006 requires that at least one director must be an actual person.

The directors will be responsible for managing the business and affairs of the company. As such, they are required to act at all times in the best interests of the company and are regarded as the equivalent of trustees of the company’s monies.

*(iv) Secretary*

A Secretary, if appointed, will be responsible with the directors for ensuring that the company meets its obligations with filing accounts and returns etc in good time. The new companies act removes the compulsion for a private company to have a secretary but over half of companies retain a person to this role.

*(v) Registered Office*

A company incorporated in England and Wales must have a registered office in either England or Wales, a company incorporated in Scotland must have a registered office in Scotland and a Company incorporated in Northern Ireland must have a Registered Office there. A company is required by UK law to keep at its registered office registers of directors, shareholders, legal charges, debentures and minutes of directors and shareholders meetings. Certain of the registers must be made available for inspection by any member of the public who attends the registered office or another place given by the company. The registered office should therefore be a place that such inspection can take place and which any legal notice should be served on the company.

*(vi) Documents required by Companies House to form the company*

a) Memorandum of Association

This sets out the name of the company and lists the first shareholders of the Company (the Subscribers). It must be signed by these subscribers.

b) Articles of Association

These set out the rules for the running of a Company's internal affairs i.e. the rules for meetings of directors and shareholders and the relationship between the owners (shareholders) and managers (directors), transferring of shares etc.. There is a default set of Articles, which will be implied if no articles are submitted (called "The Model Articles"). These Articles are available to view from Companies House.

Company registration agents will be prepared to supply tailored versions of the Articles of Association for a proposed company for a small fee.

c) Form IN01

This sets out the details of the Directors and Secretary of the company, its registered office address and lists the first shareholders, the amounts paid for each share and the rights attached to the shares issued. It must be signed by these officers and also contains within a Statement of Compliance under the Companies Act 2006 which

must be signed by the subscribers to the Memorandum of Association or an agent for the subscribers.

d) **Cheque for Companies House fees**

Companies House require a cheque in the sum of £40 to complete the incorporation.

If the documents submitted are in order, Companies House usually issues a Certificate of Incorporation within four to five working days.

UK company registration agents can assist with the whole process of forming a company and can arrange for the relevant declaration to be carried out very simply. In addition, it is possible for agents with the necessary software to file private limited company incorporations electronically at Companies House. This speeds up the process still further and companies can now be formed usually within 24 hours. The Companies House fee for an electronic formation is reduced to £14.

The UK Government now offer an on-line incorporation service via their business link website. The price for incorporation is £18 and the service can be accessed via [www.businesslink.gov.uk](http://www.businesslink.gov.uk)

### **Public company limited by shares**

The process for forming a public company is very similar to that of forming a private company; the differences being:

#### *1. Company Name*

The name must end with the words “Public Limited Company” or “PLC”

#### *2. Shareholders*

A public limited company must have a minimum of two shareholders and must have an issued capital of £50,000 minimum.

#### *3. Directors*

There must be a minimum of two directors.

#### *4. Secretary*

There must be a Secretary appointed and such person must be qualified i.e. be a barrister, solicitor or advocate admitted in the UK, or be a qualified Chartered Accountant, Certified Accountant, Certified Management Accountant or Chartered Secretary.

The documents required to be submitted to Companies House for the formation

of the Company are the same as for a private company, but the Memorandum and Articles of Association must be suitable for the management of a public company.

In addition, following incorporation, a public company must undertake a further declaration that it has met the minimum capital requirements and that it has paid up its capital as necessary (one quarter of the nominal value of each share). It will then be issued with a further certificate allowing it to borrow money and trade.

## **STATUTORY REQUIREMENTS FOLLOWING INCORPORATION**

### **1. Registration with the UK Tax Authorities**

Within three months of the date of commencement of trading, the Company is required to register for Corporation Tax by the completion and submission to HM Revenue and Customs of a New Company Details Form (CT41g). This form is available from HMRC.

If the Company has any paid employees registration with HMRC is also required under the Pay As You Earn regulations.

The Company may also require registration under VAT (Value Added Tax) rules if its turnover reaches pre-set limits in any one year/month.

### **2. Accounts**

Companies are required to submit accounts prepared in accordance with the Companies Act 2006. Companies House and the UK tax authorities (HM Revenue and Customs) must receive these not later than 9 months following the company's year-end date. (6 months for public limited companies).

A company's year-end will be set automatically by Companies House as the anniversary of the end of the month of incorporation. i.e. a company incorporated at any time during, for example, June 2011 will have a year-end of 30 June 2012. A company's year-end can be changed by the submission of a form to Companies House and can be extended to a period of up to 18 months. However, directors of new companies should note that if this extension is made, the first set of accounts will still be due 21 months from the original incorporation date (18 months for plc's).

Civil Penalties are imposed by Companies House for the failure to file accounts on time. HMRC will also apply penalties if the Corporation Tax return and any tax due are not filed on time.

### **3. Annual Return**

Companies are required to submit an annual return to Companies House within 28

days of the anniversary of the date of incorporation. This return sets out the current business activities, details of directors and secretary, a statement of capital and details of the names of the shareholders of the company. A fee of £40 is payable to Companies House for this return. The fee can be reduced to £14 if the annual return is submitted electronically via Companies House web-filing service or via an agent with the necessary software. Failure to file the annual return can ultimately lead to the Company being struck-off the index of companies.

#### **4. Other documents**

The Companies Act 2006 specifies that returns shall be made to Companies House in the event that the company undertakes certain actions. For example the issuing of shares, changing the rights attached to shares, changes being made to the Articles of Association, the granting of a charge over the company's assets, changes to the details of any director or secretary or the resignation or new appointment of these officers. There are various time limits imposed for the submission of these returns and the officers of a company are advised to familiarise themselves with these requirements or to employ a local agent who will have the required compliance knowledge.

The management of a company's statutory affairs (such as the submission of annual returns and changes to shareholders and directors) is often carried out by specialist company formation agents, company secretarial service providers, solicitors or accountants.

#### **COMPANIES ACT 2006**

The Companies Act 2006 received Royal Assent on 8 November 2006 with the aim of cutting costs and red tape for businesses and in particular smaller companies. The idea was to make the law in this area more accessible and to allow easier changes to it where it no longer corresponds to modern business.

The act was brought into effect in stages ending on 1 October 2009. It is therefore fully in operation. Those familiar with older legislation may need guidance in respect of the new rules.

*Note: The information in this chapter is current as at June 2011.*

## **2.6 MONEY LAUNDERING REGULATIONS**

***Mark Saunders,  
Wilder Coe LLP***

### **INTRODUCTION**

In accordance with the requirements of the Second European Community Money Laundering Directive of 2001, the United Kingdom government introduced the Proceeds of Crime Act 2002 and the Money Laundering Regulations 2003 which came into force largely with effect from 1st March 2003. The legislation has since been updated and the latest rules are contained within The Money Laundering Regulations 2007.

The purpose of the Money Laundering Regulations is to implement a regime whereby those businesses and individuals operating within the “regulated sector” will report any knowledge or suspicions of money laundering they might have to the Serious Organised Crime Agency (SOCA)

### **WHAT IS MONEY LAUNDERING?**

Originally, Money Laundering legislation concerned itself primarily with identifying funds which are the result of terrorist activities or illegal drug trafficking.

However the scope of the legislation was widened to encompass the possession, dealing with, or concealing the proceeds of any crime. This obviously still includes terrorist funds, funds that may be used for terrorist purposes or the proceeds of

terrorism or illegal drug trafficking.

Money laundering involves the hiding, converting, transferring or taking out of the country of any criminal proceeds. It covers anyone who agrees to or is involved in helping, or suspects that are involved in helping another person to acquire, keep or use criminal property. It also includes anyone who themselves acquires, uses or possesses any criminal property.

Criminal property in this case includes anything, whether it is money or property, by which a person or company gains, either directly or indirectly, as a result of criminal activity. It is worth clarifying that this definition of criminal property also covers the proceeds of tax evasion, bribery or corruption.

### **WHICH BUSINESSES HAVE TO COMPLY WITH MONEY LAUNDERING REGULATIONS?**

The regulations define relevant businesses– being those businesses that have to comply with the money laundering regulations – as including: -

- banking generally;
- any business that accepts deposits;
- the effecting or carrying out of long term insurance;
- dealing in investments either as principal or as an agent;
- arranging deals and investments;
- managing, safeguarding or administering investments;
- advising on investments;
- the operation of a Bureau de Change;
- transmitting money by any means or cashing cheques which are made payable to customers.
- estate agency;
- casino operation;
- insolvency practitioners;
- those who offer tax advice;
- those who offer accountancy services;
- those who offer auditing services;
- those who offer legal services;
- those who offer services in relation to the formation, operation or management of a company or trust;
- those dealing in goods of any description where a transaction will involve the acceptance of a cash payment of 15,000 euros or more – this includes acting as an auctioneer.

It can be seen that the above list largely involves those individuals and businesses that are involved in financial transactions. Significantly, it includes banks, accountants, solicitors and estate agents, at least one of whom is likely to be involved in assisting any proposed new business within the United Kingdom.

## **REQUIREMENTS FOR BUSINESSES IN THE REGULATED SECTORS**

Businesses and individuals within these regulated sectors need to do the following

1. Appoint a representative who will be the money laundering reporting officer.
2. Train all employees in relevant positions in recognising and reporting money laundering. Those employees will be responsible for reporting to the money laundering reporting officer.
3. The money laundering reporting officer has a responsibility to report any knowledge or suspicion that a money laundering offence has been committed to the SOCA. This report has to be made no matter how small the amounts involved or how serious the offence appears to be.
4. In a situation where a report has been made the persons making the report must do nothing to help the suspected money launderer for a period of 7 days unless told to do so by the SOCA. This may result in any work on a particular transaction being suspended during this period. If nothing is heard from the SOCA at the conclusion of that period of 7 days, then the reporting business can continue to deal with the respective transaction. If the reporting business is in itself not involved in the transaction but has become aware of its suspicious nature and has reported it then they do not need to await any consent from the SOCA to continue working.
5. Maintain Identification Procedures in respect of every business and individual with whom they do business (see below).

### **“TIPPING OFF” AND FAILURE TO MAKE A REPORT**

The law makes it an offence to “tip off” a suspected money launderer that a report has been made or is contemplated to the SOCA. It is also an offence to fail to make a suspicious transaction report.

Further, it is an offence for any person who receives information in the course of their business within the regulated sector to fail to inform SOCA or their businesses money laundering reporting officer of that knowledge or suspicion that another person is engaged in money laundering.

The penalties for failure to report or tipping off can lead to prison sentences of up to 5 years and monetary fines.

## **IDENTIFICATION PROCEDURES**

Every business within the regulated sector will be required to maintain identification procedures with regard to every person and business with which they do business. This means that, as soon as is reasonably practicable after contact is first made with a business or individual, that this business or individual must produce satisfactory evidence of their identity and their residential or business address. This would usually require the provision of at least 2 documents.

For an individual the documents would include:

- In order to confirm identity – a current signed passport, a UK photo card driving license or a home office residency permit.
- In order to confirm address – a recent utility bill, local authority tax bill or bank or building society or mortgage statement. In some cases a visit to the persons home may establish proof of address.
- With regard to a corporation, a copy of the deed of incorporation would confirm identity and, if the entity is within the United Kingdom, this can be checked with details held at Companies House. In other nationalities if there are similar public registers then this information can be checked independently.

In order to obtain proof of address of a company then similar evidence to that above including utility bills or rent statements would suffice, or once again a visit to the company's premises.

In the case of unincorporated organisations such as trusts or partnerships, then a copy of the trust or partnership deed would be obtained and similar identification procedures to those relating to individuals carried out in respect of each trustee or partner.

Businesses within the regulated sector are required to maintain evidence of the identity checks they have made.

Checks should also be made against the databases of Politically Exposed Persons, Specially Designated Nationals and those on the Bank of England Sanctions Register. There are now a number of commercial agencies who carry out such checks electronically on behalf of Businesses in the Regulated Sectors.

## **PRACTICAL CONSIDERATIONS FOR THOSE CONSIDERING DOING BUSINESS WITHIN THE UNITED KINGDOM**

For anyone considering doing business within the United Kingdom it is almost inevitable that they will have contact and carry out business with one or more organisation within the regulated sectors. The most basic business functions such as opening a bank account or appointing an accountant or lawyer will require compliance with identification procedures.

Under such circumstances, therefore, each such business should be prepared to provide the identification evidence indicated above. Having such evidence readily available and having anticipated a need to provide it will greatly facilitate commencing business within the United Kingdom.

Secondly, in order not to arouse suspicion that any transaction taking place could conceivably be construed as money laundering it would be wise to be as frank and open as possible in relation to any business carried out. Details of the source of all funds being used should be freely shared and at no point in time should any doubt be allowed to enter into the details of any transaction. Most business and trading activities will be of a relatively routine and repetitive nature and should never cause a problem. It is likely to be the unusual or large transactions that might arouse doubt or suspicion.

A ready compliance with all United Kingdom taxation requirements would also be recommended, particularly those relating to employment tax – Pay As You Earn (PAYE) – which should be administered by all employers, and VAT.

## **TRADING IN THE REGULATED SECTORS**

If you are considering commencing a business within the United Kingdom that falls within one of the regulated sectors, then you will clearly need to comply with the requirements of the money laundering regulations.

Many of the regulated sectors have their own professional bodies or trade associations who will be able to advise on the specific requirements of the business sector in which the operations are planned to take place. In the case of any doubt advice should be sought at the earliest possible opportunity. In such cases professional advisors such as accountants or solicitors, who should all be well versed in the obligations of the money laundering regulations as they relate to their own activities, should be able to advise on how to proceed.

## **CONCLUSION**

Similar regulations to those being applied in the United Kingdom have been enacted throughout the world. The legislation continues to be developed and it is

## Money Laundering Regulations

important to keep abreast of these changes.

The international fight against terrorism and drug trafficking, which has provided the impetus for this kind of legislation, has caused it to be expanded to include all areas of crime in particular the areas of tax evasion and the 'cash' economy. However, compliance with these regulations should hold no fears for those involved in honest business activity and, although the cost of compliance in terms of time and money may initially seem great, the eradication of crime from business should result in a level playing field for all and greater integrity within the business environment worldwide.

## 4.1 FINANCIAL REPORTING AND ACCOUNTING: AN OVERVIEW

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This chapter provides an overview of the financial reporting and accounting requirements of the majority of entities carrying out trading or investment activities within the United Kingdom .

### INTRODUCTION

All entities carrying out business activities within the UK have an obligation to produce accounts summarising the entity's financial activities and results generally at least once a year. The accounts prepared normally cover a period of 12 months, though this can be varied to a maximum 18-month period. The period-end date to which these accounts are prepared is known as the accounting reference date (ARD).

The following chapter summarises the various financial reporting requirements and practical accounting issues faced by any entity looking to carry out its business activities in the UK.

### FORMAT OF ACCOUNTS

#### **Unincorporated entities: Sole trader/ Partnership**

There is no formal requirement for sole traders or partnerships to prepare annual

accounts in accordance with any pre-determined format. However, in submitting the annual tax return to HM Revenue and Customs (HMRC), it is expected that the entity is to provide backing accounts supporting the figures included in the tax return, and these accounts should be prepared in accordance with UK Generally Accepted Accounting Practice (UK GAAP) . As a bare minimum, the sole trader or partnership will be expected to submit a statement of income and expenditure for the year with their tax return, prepared in accordance with UK GAAP.

### **Incorporated entities: Companies limited by shares or by guarantee**

The most common types of entities are companies limited by shares incorporated under the Companies Act 2006. In terms of corporate financial reporting, the UK is currently undergoing a transitional phase in terms of its financial reporting requirements to the extent that it is aiming to achieve convergence with international reporting standards.

On 1st January 2005, it became compulsory for all UK publicly listed companies preparing consolidated accounts to prepare them in accordance with International Financial Reporting Standards (IFRSs). This requirement is not mandatory for non-public companies, though these may opt for early adoption, and therefore there is currently a divergence in accounting treatment across companies in the UK.

Statutory financial statements contain:

- (i) A directors' report;
- (ii) An auditors' report (unless the company qualifies for exemption from audit and takes advantage of that exemption);
- (iii) A profit and loss account;
- (iv) A full balance sheet, signed by a director of the company;
- (v) Notes to the accounts.

As for unincorporated entities, incorporated entities submit backing accounts with their annual tax returns.

### **Incorporated entities: Limited liability partnerships**

Accounting rules as applied to companies apply in the same manner to LLPs, where the format and regulations are as set out in the Companies Act 1985 (and 2006), as amended by the Limited Liability Partnerships Act 2000.

LLP accounts must include:

- (i) An auditor's report (unless the LLP is exempt from audit);
- (ii) A profit and loss account;
- (iii) A balance sheet, signed by a designated member; and
- (iv) Notes to the accounts.

In respect of taxation requirements, provided the LLP carries on a trade or profession and is not purely an investment vehicle, it is considered to be tax-transparent, i.e. the LLP itself is not taxed on its income or capital gains. Instead, the members are taxed on their share of the LLP's profits and gains, in accordance with normal partnership rules.

## **AUDIT REQUIREMENTS**

Of the different vehicles through which a business can be carried out in the UK, only limited companies and LLPs are required to have their financial statements audited.

### **Definition of an audit**

An audit includes an examination of the financial statements by a registered auditor who, on completing the audit, makes a written report to the shareholders. It also includes an assessment of significant estimates and judgement utilised by the directors in their preparation of the accounts, as well as the accounting policies adopted.

The examination is performed on a test basis on the basis of evidence relevant to the amounts and disclosures shown in the financial statements.

On completion of the audit, the auditor will provide an opinion as to whether the annual financial statements:

- (i) provide a 'true and fair view' of:
  - the state of the company's affairs at the balance sheet date; and
  - the profit or loss for the period under review;
- (ii) have been properly prepared in accordance with the relevant financial reporting framework; and
- (iii) have been prepared in accordance with the relevant legislative requirements. The auditor further provides their opinion as to whether the information in the directors' report is consistent with the financial statements.

Furthermore, the auditor will confirm that:

- (i) adequate accounting records have been kept;

- (ii) the financial statements are in agreement with the accounting records and returns;
- (iii) disclosures of directors' remuneration in accordance with relevant legislative requirements have been made; and
- (iv) all information and explanations required for the audit were received.

In giving an opinion, the auditors state that they would have performed the audit with a view to obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud, other irregularities or errors.

The opinion expressed within the audit report may be qualified should the audit uncover any areas of uncertainty or disagree with the directors' treatment of items within the financial statements, or encounter any deficiency in evidence required to support amounts and disclosures in the financial statements. The extent of disclosure included within the audit report would depend on the degree to which the shortcoming would affect the reader of the financial statements.

### **'True and fair' concept**

This concept is a statutory requirement and central to the whole process of financial reporting in the UK. While there is no definitive guidance on what constitutes a 'true and fair' view, "[i]t is inherent in the nature of the concept that financial statements will not give a true and fair view without containing sufficient quantity and quality of information to satisfy the reasonable expectations of the readers to whom they are addressed."

The 'true and fair' concept is essentially dynamic in nature, and constantly evolves in response to changes in accounting and business practice. These changes are constantly monitored, and codifications of such changes are contained within the Financial Reporting Standards (FRSs), Statements of Standard Accounting Practice (SSAPs) and International Financial Reporting Standards (IFRSs). For specialised activities such as charities and financial services, further guidance in the form of Statements of Recommended Practice (SORPs) are issued. While not statutory, the guidance provided in FRSs, SSAPs, IFRSs and SORPs is generally taken to be authoritative in the UK. Any departure from these principles would have to be clearly explained and justified in the financial statements.

Finally, to emphasise the fundamental nature of this concept to UK financial reporting, it is important for anyone involved in the preparation of financial statements to note that the 'true and fair' concept can override the application of all FRSs, SSAPs and IFRSs, and the reasons for the override need to be disclosed in the financial statements.

## Materiality

'Materiality' is an expression of the relative significance of a particular matter in the context of the financial statements as a whole. An item would be considered material if its omission would reasonably be expected to influence the decisions of readers of the financial statements.

## Exemption from an audit

A company or LLP may be exempted from the statutory requirement to have its financial statements audited if it fulfils all the exemption criteria laid down by statute. The entitlement to audit exemption is based on three criteria: turnover, gross assets and the size of the company. All criteria have to be fulfilled to qualify for audit exemption. As at the time of writing, the thresholds for audit exemption are as shown in Table 4.4.1.

**Table 4.1.1 Thresholds for audit exemption**

	<b>Single company/LLP</b>	<b>Group of companies*</b>
Turnover	< £6,500,000	< £7,800,000 gross** < £6,500,000 net**
Gross Assets	< £3,260,000	< £3,900,000 gross** < £3,260,000 net**
Size***	Small	Small

\* A company/LLP will constitute part of a group where there is common ownership and control across all companies/LLPs within the group

\*\* 'Gross' refers to the group's aggregate result, inclusive of intercompany transactions and balances. 'Net assets' comprise the group's consolidated results, i.e. exclusive of intercompany transactions and balances.

\*\*\* A 'small' company/ group is defined as one which fulfils at least two of the following conditions:

	<b>Company</b>	<b>Group</b>
Annual turnover	< £6,500,000	< £7,800,000 gross < £6,500,000 net
Gross assets	< £3,260,000	< £3,900,000 gross < £3,260,000 net
Average number of employees	< 50	< 50

Note that a subsidiary company or LLP contained within a group of companies which fulfils the above criteria will not be entitled to exemption from audit, regardless of its individual financial results, unless the group as a whole fulfils the small group criteria as detailed in the table above.

The following entities will not be entitled to exemption from audit, irrespective of size:

- Public limited companies;
- Banking or insurance companies;
- Registered insurance brokers;
- Companies registered with the Financial Services Authority;
- Companies where the Articles of Association specify that an audit is required;
- A member of a group of companies in which any member is:
  - A public company or entity which has publicly quoted shares or debentures;
  - Registered with the Financial Services Authority; or
  - A person who carries on insurance market activity.

Finally, shareholders controlling 10 per cent or more of any company can override the audit exemption size criteria rule by exercising their statutory right to require an audit.

## **PRACTICAL ACCOUNTING ISSUES**

Any entity intending to carry out business activities within the UK should also be aware of the following issues:

### **Filing Deadlines for Financial Statements**

Depending on the nature of the entity, financial statements must be filed with the relevant authorities within the specified timescales of Table 4.1.2.

**Table 4.1.2 Timescale for filing financial statements**

<b>Business vehicle</b>	<b>Filing authority</b>	<b>Filing deadline</b>
Sole trader/ partnership	No requirement to file annual accounts	
Company – private	Registrar of Companies	Within 9 months after the ARD
Company – public	Registrar of Companies	Within 6 months after the ARD
Limited liability partnership	Registrar of Companies	Within 9 months after the ARD

The filing deadline for companies and LLPs will change where the entity alters its ARD, for example, if a company changes its ARD, the filing deadline will be the later of the original filing deadline and 3 months after the application to extend the filing deadline. Late delivery of accounts to the Registrar of Companies will result in an automatic late filing penalty, and is, technically, a criminal offence for which directors can be prosecuted.

### **Filing Deadlines for Tax Returns**

All entities carrying out business activities within the UK are required to submit tax returns to the HMRC on an annual basis. Filing deadlines for submission of the annual tax return for the various entities are identified in Table 4.1.3:

**Table 4.1.3 Filing deadlines for tax returns**

<b>Business vehicle</b>	<b>Filing deadline</b>
Sole trader/partnership/LLP	By 31st January following the business's ARD
Companies	By 12 months following the business's ARD

### **Value Added Tax (VAT)**

In the UK, there is a tax imposed on consumer expenditure called Value Added Tax (VAT). Most business transactions involve the supply of goods or services and VAT is payable if the supply is made:

- (i) in the United Kingdom;
- (ii) by a taxable person; and
- (iii) in the course or furtherance of business and is not specifically exempted or zero-rated.

The regulation, monitoring and collection of VAT is currently undertaken by HMRC.

Forms detailing the breakdown of an entity's VAT liability must be submitted on a periodic basis to HMRC, as well as payment of net VAT due. An entity can opt to submit VAT returns monthly, quarterly or annually. Submission of the periodic returns is due by 30 days after the period-end. Payment of VAT is due 14 days after the submission deadline.

It is compulsory for an entity which makes taxable supplies exceeding £73,000 per annum to register with HMRC and submit VAT returns. Notification to HMRC must be made within 30 days of the end of the month in which the value of taxable supplies first exceeds £73,000.

The rate of VAT imposed on a supply depends on the type of supply made. There are three categories of supplies:

- (i) Exempt
- (ii) Zero-rated
- (iii) Standard-rated

The operation of VAT has become increasingly complicated over the years since its introduction, and it is important to seek professional advice in the following situations:

- importing and exporting goods or services
- supplies made by the entity are a mixture of different VAT categories
- retail schemes
- land and property transactions
- self-supplies

Finally, more detailed guidance on an entity's responsibilities under the VAT regime is contained on the website [www.hmrc.gov.uk](http://www.hmrc.gov.uk).

## **Payroll Taxes**

Any person looking to pursue business activities in the UK will encounter payroll taxes if they are looking to employ staff.

Payroll taxes are under the remit of the HMRC, who publish various booklets relating to how the system for collecting taxes is operated and the legislation which has to be complied with.

In brief, the employer is responsible for reporting, collecting and remitting

payroll taxes to the HMRC as well as operating the Department of Social Security's (DSS) sick pay, maternity pay and paternity schemes.

The employer must register with the HMRC to operate a payroll scheme. Upon registration the HMRC will provide the employer with guidelines on operating the scheme as well as copies of the necessary returns which have to be made to the HMRC over the course of the year.

Tax and national insurance contributions are payable to the HMRC by the 19th of the month following that in which the salaries were paid.

In most businesses, the directors, and often the employees, have benefits that are not immediately taxed through the payroll system in place. Returns detailing such benefits, and the national insurance contributions payable thereon are due on 19th July following the fiscal year in which the benefits are made available.

More detailed guidance on an employer's responsibilities for payroll operation is contained on the website [www.hmrc.gov.uk](http://www.hmrc.gov.uk).

### **Dividends and Distribution of Profits**

A company may distribute its available profits to its members (shareholders) by way of dividend at any point in the course of a financial year. Such distributions can only be made out of post-tax profits and must be in accordance with the rules and conditions laid down by the Companies Act 2006. The Companies Act does not provide who shall declare a dividend, and the usual practice in the UK is for the Articles of Association to specify that dividends be declared by the shareholders in general meeting. It is also possible to specify in the Articles that directors be given the power to declare dividends to the exclusion of general meetings.

An important point to note is that, before declaring an interim dividend, i.e. a dividend paid between annual general meetings, the directors must satisfy themselves that the financial position of the company warrants the payment of such a dividend out of profits available for distribution, that is, net accumulated realised profits. If the company does not have positive reserves at the time of declaration of the dividend, the dividend is deemed to be an illegal distribution, and the directors may be prosecuted under civil law.

The Companies Act imposes an additional capital maintenance requirement on public companies to ensure that the net worth of the company is at least equal to the amount of its capital. A public company can only distribute profit if:

- (i) at the time of the distribution, the amount of its net assets, that is the total excess of assets over liabilities, is not less than the aggregate of its called-up

- share capital and its undistributable reserves ; and
- (ii) the distribution does not reduce the amount of the net assets to less than the aggregate of the company's called-up share capital and its undistributable reserves.

A company should always prepare accounts reflecting its financial position at the date of the distribution of profits to avoid the illegal payment of dividends. For public companies, there is a statutory requirement that 'relevant accounts' be prepared to the date a distribution is made to ensure its legality. For private companies, there is no such requirement but, from a practical viewpoint, this requirement should be adhered to. Note that, even if the annual accounts prepared at a later stage show an insufficient figure of distributable profits, a dividend paid on the basis of the interim accounts will still be considered lawful.

## 4.2 BUSINESS TAXATION

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### INTRODUCTION

This chapter is divided into three parts:

- General Tax considerations relating to various types of business entity formed to trade in the UK.
- Information as to the types of income, the payment of tax, and the rates of tax applicable.
- A description of how taxable business income and gains are determined, and the deductibility of certain revenue and capital expenditure.

### GENERAL TAX CONSIDERATIONS ON UK BUSINESS FORMATIONS

In determining the method of trading in the UK commerciality must determine the vehicle to be used: corporate entity, branch, limited liability partnership (LLP) or general partnership.

Each type of entity has its own advantages and disadvantages. Below are some comments about the alternatives.

#### **Representative Office versus Permanent Establishment**

If the intention is not to create a taxable entity or legal presence in the UK, then

care has to be taken to ensure that any presence in the UK is purely representative without the creation of a permanent establishment (PE). The comprehensive list of double tax agreements (DTAs) between the UK and other trading nations will set out what establishes the creation of a PE, thereby bringing the foreign entity within the UK tax regime.

The basic difference between the two, and what establishes whether or not there is a PE, is whether the overseas entity is trading *with* the UK or trading *in* the UK. Under provisions contained in Corporation Tax Act 2010, non-resident companies are only liable to corporation tax in the UK if they carry on a trade through a PE. Otherwise they will be liable to income tax.

Under these provisions a company has a PE if it has:

- A fixed place of business in the UK
- A representative acting for the company who habitually exercises authority to contract business on behalf of the company.

If a foreign company has a PE it is chargeable to tax on the profits *wherever* arising, which are attributable to that PE.

The losses arising in a PE may be available for offset against the profits in the country of residence of the foreign parent company. As losses frequently arise in the initial periods of trading, foreign parent companies often operate through PEs here during the first periods of trading, with incorporation following at a later date. (See below)

Factors influencing the decision are complex and include the nature of the activities, the ability to enter into contracts or commit the foreign entity to a course of action. Care and advice are necessary.

### **Branch versus subsidiary**

The UK branch of a foreign company is taxable on the profits arising in the UK. The calculation is as for a separate entity (e.g. a subsidiary) so that transactions will need to be on a proper commercial basis. Profits arising in the branch can be remitted to the head office without restriction and without any form of withholding tax.

Branches come within the normal corporation tax methods of calculation, and so if the profits exceed a certain threshold the branch will be liable to pay corporation tax in four equal quarterly instalments. In assessing this, the number of associated companies on a world wide basis has to be taken into account. (See Figure 4.2.1).

If the UK entity is a subsidiary then, subject to the appropriate DTA, withholding tax might be applicable, but only on certain specific types of distributions. Thus there is no UK withholding tax on the payment of dividends.

There is little or no difference from a UK taxation perspective as a result of trading through either a UK branch, or a UK subsidiary.

In both cases the rules relating to thin capitalisation will need to be considered. (See Figure 4.2.2).

From a commercial perspective, a subsidiary is a separate legal entity in the UK and so, normally, any legal claims would go no further. A branch is part of the overseas entity and so any legal claims would ultimately rest with that entity.

### **Direct Investment versus holding company structure**

Direct investment through a branch, corporate entity or partnership is easy to establish and will normally be the preferred method. There are usually no adverse taxation consequences of any of these routes, and ongoing administration and compliance can be kept to a minimum.

Sometimes, however, a UK holding company route may be appropriate. This will depend upon the functions and activities of the UK business entity, the need for financing both in the UK and elsewhere, exit strategies, and the interaction with other non-UK entities.

### **Residence**

Liability to taxation in the UK will come with residence here. Incorporation in the UK or elsewhere does not determine the residence status of a company. A simple, accepted guideline is that residence is where the “central management and control” of the company resides. This is where the strategy and management of the company are formulated and actioned.

### **Value Added Tax (VAT)**

The harmonisation of VAT within the EU means that in general goods can be moved around the region without VAT consequences.

When goods are imported from outside the EU, import VAT is payable. From that point onwards the goods are freely moveable between EU countries.

Any business investing or trading in the UK will have to consider whether or not it has a ‘business establishment’ for UK VAT purposes. The rules for the creation of a “business establishment” are different from those used for determining the residence of the company. Other general VAT rules will also apply (see Chapter 4.3).

## **DIFFERENT TYPES OF INCOME**

The UK tax system works on the basis that each type of income is subject to specific rules as to how it will be calculated. The main types of income are set out below with a general description of the method by which they are calculated.

### **Companies and branches**

#### *Trading income*

##### *Introduction*

The starting point for the calculation of taxable business income is the profit shown in the accounts of the entity – the accounting treatment of expenditure is often the key to how the expense will be treated for taxation purposes. This will become more common in the future as international accounting standards become standardised on a worldwide basis.

The accounting profit is then adjusted to exclude certain expenditure not allowable under UK taxation rules, and the resulting figure is then reduced to take account of various taxation only allowances and reliefs that are not part of the accounting records. The calculations relating to general expenditure incurred in the UK apply whatever the nature of the entity in the UK. The treatment of charges from the foreign entity can differ in the UK depending upon whether the UK entity is a PE or a separate legal entity such as a limited company.

Some of the adjustments are set out below. This list is not exhaustive and advice should be taken in respect of any particular item of expenditure.

#### **Not allowed:**

- Entertainment;
- Certain legal and professional charges;
- Capital expenditure or depreciation (see comments on Capital Allowances below);
- General provisions in respect of any expenditure;
- Fines and illegal payments;
- Gifts.

#### **Allowed:**

- All employee costs in the form of wages and salaries for services rendered to the business are generally deductible. However, if the employee receives a benefit – under UK tax law this can be quite complex – the employee may

- suffer an additional tax charge and the employer an additional National Insurance (NI) charge.
- Accounts depreciation is replaced by Capital Allowances.. Under a complex but comprehensive system – allowances run from 10% up to 200% (225% from April 2012) depending upon the nature of the expenditure. Capital expenditure otherwise disallowed for taxation purposes might thus qualify as a deduction for tax purposes if it falls within the Capital Allowances regime.
  - Specific provisions for certain types of expenditure e.g. bad debts.

#### *Deduction dependent upon nature of UK entity*

- Although interest and royalty payments made by a UK Company will be deductible (subject to transfer pricing rules), payments to a head office by a PE will not be deductible. Relief could be obtained if the payments were to a foreign affiliate, in other words to a separate legal entity.
- Management charges can be deductible in the accounts of both a PE and a UK Company, subject to transfer pricing rules. In the case of a company the charge could be based upon the services provided by the offshore parent. In the case of a PE the allocation could be on a 'shared' basis of total costs, provided they can be shown to be used by the UK PE.

#### *Land and property*

Income from Land and Property is taxable under different sections of the Taxes Acts in the UK depending upon whether the property is situated in the UK or overseas. However the rules for calculating the profit are essentially the same.

Income and expenses from all UK sources are pooled and treated as a single rental business, and separately from the same in respect of overseas properties.

The calculation of the profits generally follows the rules for trading activities and accounts must be prepared on an accruals basis and in accordance with generally accepted accounting principles.

Where commercial properties are involved capital allowances may be obtained for certain capital expenditure, but no relief can be claimed for such expenditure on residential properties.

Certain other allowances might possibly be available for residential lettings, but this will depend upon the type of letting.

Losses from a commercial letting business can, in a company, be offset against other general income of the same or later accounting periods while the same trade is being carried on.

### *Interest*

Interest received is, as with other company income, usually taxed on an accruals basis. However certain types of interest under this heading have a different treatment. Care has to be taken on the receipt of interest to ascertain the correct taxation treatment. The company regime differs from that for individuals mentioned below.

### *Capital Gains*

Capital gains arising from the sale of assets are added to other profits of a company for the year in question, and taxed at the same rates.

In calculating the gain costs of purchase and sale can be taken into account. If there have been improvements to the asset after original purchase, and the improvements are still reflected in the asset at the date of sale, the costs of the improvements can be deducted from the sale proceeds in calculating the gain.

The original cost, and any other allowable expenditure, is indexed upwards from the date the expenditure was incurred up to the date of sale. The date of sale is taken as the date of exchange of contracts which binds the seller and purchaser to the sale.

The indexation rates are announced monthly and are broadly the retail price indices.

### *UK Dividends*

With the abolition of the imputation system no refundable tax credit is now given at the shareholder level. Individual shareholders do receive a notional tax credit which covers their UK liability unless they are liable to the higher rates of income tax, in which case UK residents will have a further liability.

Corporate entities receive no credit, but no further tax is due.

## **Individuals and partnerships**

### *Income*

The income from a partnership is allocated to the partners in accordance with the partnership agreement. The income so allocated, from each source or type of income is then assessed on the individual partner – be it a company or an individual.

An individual's income is calculated in the same way as a company's, where there is a 'trading' element. The calculations and points made above with reference to Trading Income, Land and Property are therefore the same for individuals.

The other types of Income and Capital Gains are dealt with differently, as set out below.

### *Interest*

In the main, for individuals, interest and other investment income will have been received after deduction of income tax at 20%. The income is assessed on an arising basis and not an accruals basis used for companies. Individuals liable at the higher rates of income tax of either 40% or 50% will have to pay the difference.

### *Capital Gains*

The basis of calculation of the gain arising is exactly the same as for companies. However there is now no relief due in respect of indexation.

The tax is charged at a flat rate of 28% of the gain, with a reduced rate of 18% for basic rate taxpayers. Higher rate tax payers will have to pay 28% on whole of their capital gains. A special reduced rate of 10%, known as Entrepreneurs' Relief, will be payable on the first £10 million of gains made in a taxpayer's lifetime, where the gain results from the sale of qualifying business assets. Thus the disposal of all or part of a business, or the disposal of shares or securities in an unlisted company, or the disposal of assets following the cessation of a business should all qualify for Entrepreneurs' Relief. There are a number of conditions which need to be met in order for Entrepreneurs' Relief to apply and these need to be checked carefully beforehand.

### *Land and Property*

As indicated above profits are calculated in the same way for companies and individuals. However if losses are incurred they are treated differently. The company position is as set out above. For individuals the losses, if they arise from the letting of commercial properties, can be offset against other property income of that year. Alternatively they will be carried forward and used against future income from the property business.

Where the losses arise from residential lettings they can only be carried forward, and not offset against other income.

### *Dividends*

Dividends from UK companies and qualifying unit trusts received by a UK resident are deemed, for taxation purposes, to have had notional tax of 10% deducted before receipt. If the individual is not liable for income tax at the higher rates the notional credit covers any liability due.

However, if the individual does not pay income tax, no refund of the notional tax can be obtained.

If income tax is paid at the highest level of 50%, a further 36.11% tax will be due on the net dividend received.

## PAYMENT OF TAX

### Companies

The corporation tax liabilities of companies are payable 9 months and 1 day after the end of the accounting period. Accounting periods generally run for a period of 12 months to the same accounting date each year. If the accounting period is extended or shortened special rules apply to the method of calculation of profits, capital allowances etc., and adjustments will be made to the tax payment dates.

Large companies pay corporation tax on account in quarterly instalments based upon an estimate of the current year's corporation tax liability.

The basic definition of a large company is one with profits in excess of £1.5 million. Various rules apply to companies in the first years in which they come within the large company definition to ascertain in which accounting period they have to start the quarterly payments.

When there are associated companies, the £1.5 million lower limit is divided between the number of companies. Associated companies include overseas companies so in large groups it is possible that the quarterly instalment procedures will apply at much lower profit levels.

### *Applicable tax rates*

**Table 4.2.1 identifies the rates that apply to all income and gains.**

	<b>Taxable profits/gains</b>	<b>Tax Rate</b>
Small Profit Rate	£0 – £300,000	20%
Main Rate	> £1,500,000	26% reducing to 23% over the three years ending 2014

If profit is above the Small Profit Rate maximum of £300,000, but below the Main Rate threshold of £1,500,000 a marginal calculation applies to the excess over £300,000. The effect is to bring the tax at £1,500,000 back to 26%. The result is that tax in the margin has an effective rate currently of 27.75%

The Small Companies Rate threshold of £300,000 is divided between all associated companies. Thus if there are four associated companies each would be entitled to £75,000 of profit taxable at the 20% rate before going into marginal calculations. Associated companies include both UK and overseas companies.

## **Partnerships (General or LLP)**

### *Applicable tax rates*

Tax on partnership income is based upon the profits allocated to each partner. Each partner is responsible for his/her own tax liability.

If the partner is a limited company the rates are as shown above for Companies.

If the partner is an individual the rates are those applying to individuals as set out Table 4.2.2 below:

**Table 4.2.2 Tax rates applying to partners who are individuals**

<b>Taxable Income</b>	<b>Tax Rate</b>
Up to £35,000	20%
Between £35,000 and £150,000	40%
Above £150,000	50%

Each partner will be entitled to offset their personal allowances and reliefs against their allocated share of the partnership profits if their total income is below £100,000 per annum.

### *Payment of tax*

In respect of trading income from a partnership the tax is payable twice yearly, on 31st January within the year of assessment, and on 31st July following the year of assessment. The year of assessment runs from 6th April in one year to the 5th April in the following year.

### *Special rules apply on commencement and cessation of trade*

Once the trade is running the tax payments paid on account are based upon the profits earned in the previous year.

As tax payments made in January and July are likely to be estimates of the final liability for a particular tax year adjustments are made to correct these payments on account in the following January .

The result of this is that where profits of a business are rising the January payment will always be the greater of the two. If profits are falling, so that it is expected that the tax due will be less than that paid for the previous year, claims to reduce the payments on account can be made. However, if the calculation is inaccurate, leading to an underpayment of tax, interest will be charged. In extreme cases of abuse of the system penalties can also be imposed.

## CAPITAL ALLOWANCES

The UK system of Capital Allowances is comprehensive and covers the majority of assets from general plant and machinery (which includes fixtures, fittings, computers etc.), to intangible assets, patents, research and development expenditure etc.

The allowances are based upon the cost to the entity, and where connected parties are concerned (e.g. acquisitions from the Head Office in the case of a PE, or from a parent in the case of a separate company) the cost to the UK entity will broadly be as defined in Table 4.2.3.

**Table 4.2.3 Cost basis for capital allowances**

	Acquired from:	
	Head Office	Foreign associate
Plant and machinery	Market value	Lowest of actual cost, book value or market value
Intangible assets	Book value	Market value

The main rate of annual Writing Down Allowance is 20% reducing to 18% for accounting periods ending after April 2012, and another rate of 10%, reducing to 8% for accounting periods ending after April 2012 for assets classified as long life assets (ie assets which it is reasonable to expect will have a useful life of more than 25 years) and also for assets that are integral to buildings at the time of purchase.

In addition an Annual Investment Allowance of 100% is available for expenditure on plant and machinery incurred up to a maximum of £100,000, reducing to £25,000 for accounting periods ending after April 2012 in any one year.. Any excess expenditure, over £100,000 (or £25,000 after April 2012) will then qualify for Writing Down Allowances.

There are also unlimited 100% capital allowances available for expenditure on certain environmentally friendly projects such as natural gas and hydrogen refuelling equipment, low emission motor vehicles, waste water recovery and re-use systems, and certain heating, lighting and air flow energy saving technologies.

Although not necessarily a capital allowance relief, there are special allowances available to companies for expenditure on research and development. Dependent upon the size of the company, under the special Research & Development allowances relief of up to 200% (or 225% after April 2012) of qualifying revenue expenditure can be obtained. This relief is normally given by way of a deduction against taxable profits.. In some cases, where the company has losses and is

therefore unable to obtain immediate corporation tax relief, cash credits can be paid to the company instead.

## **LOSSES**

Trading losses are calculated in the same way as trading profits. Capital Allowances can increase losses or change a profit into a loss.

Once determined a loss can be utilised in a variety of ways. Examples are:

- Offset against total profits, income and gains of the year in which the loss arises.
- Offset against total profits, income and gains of the year prior to the year in which the loss arises.
- Carried forward indefinitely against profits of the same trade arising in later accounting periods.
- Surrendered to other UK group or consortium companies in the year in which the loss arises to be offset against the income and gains of those companies in the same year.
- The surrender to other group companies can include surrenders between PEs and subsidiaries.

Where a company is acquired with losses arising from trading activities, care has to be taken to ensure that those losses are available to the new owners of the company. Consideration has to be given to the way in which the trade will be carried on after the change of ownership in order to preserve the availability of those losses.

## **ROLLOVER RELIEF**

Where a business disposes of a qualifying business asset (see below) and reinvests the proceeds in another qualifying asset, within certain timelimits, the capital gain arising on the sale can be deferred until the sale of the second asset. Rollover can continue being applied on all subsequent sales, providing the proceeds are further reinvested in qualifying assets, until the final sale without reinvestment takes place.

The main qualifying asset types are listed in Table 4.2.4, as follows:

**Table 4.2.4 Types of asset qualifying for rollover relief**

<b>Class</b>	<b>Asset</b>
1A	Land and buildings
1B	Fixed plant and machinery
2	Ships, aircraft and hovercraft
3	Satellites, space stations and spacecraft
4	Goodwill

Other, less common assets are also included.

### **THIN CAPITALISATION**

Funding of a UK company must also be on a commercial basis, or adjustments can be made under the Transfer Pricing rules (already mentioned) or, where the UK company is a 75% (or greater) subsidiary of an overseas company, under the rules relating to thin capitalisation. There are requirements for appropriate debt/ equity ratios, and of course if the lending is intra group, on the interest rates applied.

UK companies do not pay corporation tax on the receipt of foreign dividends from companies situated in most jurisdictions. However dividends received from what are known as Controlled Foreign Companies, ie companies resident in low tax rate countries, will suffer corporation tax here, with relief being granted for any foreign with-holding and underlying taxes incurred .

The reason for the legislation is to stop excess leveraging of a company allowing the profits to be extracted by way of interest charges. At the moment parts of the legislation are under review and discussion to ensure that they are in line with EU tax harmonisation rules generally.

### **STAMP DUTY LAND TAX/STAMP DUTY**

A Stamp Duty Land Tax (SDLT) is chargeable on land and property transactions in the UK.

As with Corporation Tax and Income Tax in the UK SDLT is a self-assessment tax and the obligation to notify the Inland Revenue that a transfer has taken place falls on the person paying the tax – the purchaser.

Under the predecessor Stamp Duty rules the tax was payable on the completion of the contract. This gave rise to various arrangements to postpone payment. As a result, although the SDLT is also payable on completion of the contract there are provisions which charge the tax on substantial completion of the contract. Under English Law this could be on the exchange of contracts. Substantial completion is

not defined but is in broad terms when receipt of most of the consideration, taking possession of the property, and the entitlement to receive the rents or profits from the property.

### **Rates of Tax**

The rate of SDLT depends upon whether the property is residential or commercial.

The rates of tax applied to a transaction are not incremental. If the price is within one of the segments shown below in Table 4.2.5, the whole of the transaction is subject to tax at that rate, e.g. if the residential value is £125,000 no tax is payable, if the value is £125,001 the rate on the whole is 1%, or £1,250.01.

**Table 4.2.5 Rates of stamp duty land tax (SLDT)**

<b>Residential property</b>	<b>Non-residential or mixed property</b>
Consideration %	Consideration %
Up to £125,000 0	Up to £150,000 0 or 1%
£125,001 to £250,000 1	£150,001 to £250,000 1
£250,001 to £500,000 3	£250,001 to £500,000 3
£500,001 -£1,000,000 4	Over £500,000 4
Over £1,000,000 5	

A slightly higher threshold applies to the lowest level of SDLT in respect of residential property purchases in areas classified as 'disadvantaged'.

Where transactions are linked the aggregate consideration determines the rate of the tax payable.

SDLT is additionally payable on lease premiums, and also on the net present value of the rent payable under the terms of the lease.

## 4.3 VALUE ADDED TAX (VAT)

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### INTRODUCTION

VAT is relevant to every single business in the UK. The majority of businesses have to become VAT registered, and charge VAT on the sales they make, but there are some entities that do not need to register. However, these businesses will still pay VAT on their expenditure and, because they are not registered and able to reclaim this VAT from the tax authorities on their VAT returns, this tax payment will become an additional cost to the business.

VAT is an EU tax, so is therefore adopted by tax authorities in all EU countries. The legislation is intended to be consistent in all countries, although there are variations on a number of issues which mean, for example, that certain sales might be exempt from VAT in one country, but subject to tax in other countries.

This chapter gives a brief summary of the key parts of the VAT system that could be relevant to a business that is investing in the UK. There are many special rules and schemes that cannot be covered in the chapter but further information can be obtained in a wide range of VAT notices published by HM Revenue and Customs, which administers VAT in the UK. The best contact point for information on VAT is to telephone HMRC's National Advice Service on 0845-010-9000. Further information is available on their website at [www.hmrc.gov.uk](http://www.hmrc.gov.uk)

## **SALES SUBJECT TO VAT AND DIFFERENT RATES OF VAT**

The basic concepts of VAT in the UK are as follows:

- it is chargeable on a supply of goods or services in the UK;
- the supplies must be made in the course of business ie not as a hobby etc;
- the tax is charged by VAT registered businesses but is effectively borne by the general public who buy goods and services but are unable to reclaim the VAT they are charged on these purchases;
- a business that is VAT registered is able to reclaim the VAT it pays on its expenditure (known as input tax) – but only if these expenses relate to its taxable rather than exempt sales.

There are three rates of VAT in the UK:

- *standard rate of VAT* – in accordance with EU law, this rate must be between 15% and 25%. The UK rate has been mainly set at 17.5% in the last 20 years, which is one of the lower rates of VAT in the EU. However, it increased to 20% on 4 January 2011, a rate that appears likely to be permanent for the next few years at least.
- *reduced rate of VAT* – charged at 5%. The application of the 5% rate tends to be fairly limited, the most common example being that 5% VAT is charged on gas and electricity bills for domestic consumption.
- *zero-rate of VAT* – 0%. If a business has all or mainly zero-rated sales, then it will be classed as a 'repayment' trader as far as VAT is concerned. This is because it will not charge VAT (output tax) on its income, but can still reclaim VAT (input tax) on its related expenses. Examples of business entities that usually reclaim rather than pay VAT include farmers, grocers, retailers of children's clothes, new house builders.

A business might receive income that does not involve a supply of either goods or services in the UK. In such cases, the income is classed as being 'outside the scope of VAT.' Examples include donations to a charity, most grants received by a charity or non-profit making body and, more commonly, sales of services to overseas business customers that are treated as being made in the country where the customer is based.

## **EXEMPT SALES**

Some supplies made by a UK business are exempt from VAT. Common examples include:

- Many land related transactions – for example, property rental is exempt from VAT unless the landlord has made a special election with HMRC to charge VAT. However, this opportunity is only available in relation to commercial property.
- Insurance
- Postal services
- Betting, gaming, lotteries
- Finance
- Education
- Health and welfare
- Burial and cremation
- Subscriptions to trade unions and professional bodies
- Sport, sports competitions and physical education.

There are other categories of exempt sales in the legislation but the ones listed above tend to be the most common examples.

An important point to recognise with the VAT system is that just because a business category is listed as being exempt, it does not mean that every single supply linked to that heading will be exempt. To give a simple example, supplies of education tend to be exempt if provided by a school or non-profit making body but subject to VAT if provided by a commercial company.

## **OUTPUT TAX**

When a business makes a sale to a customer that is subject to VAT, then tax is usually added to the net price of the goods or services being supplied. However, in some cases, the price of goods or services might be set at a price that is dictated by the market, and this price will need to include VAT if the sale in question relates to a standard rated supply. For example, retailers tend to set their prices based on the competition they encounter from similar outlets.

The general principle is that a business will declare any VAT it charges on its sales on a quarterly VAT return. So VAT never belongs to a business, it is collected from customers on behalf of the tax authorities and paid over to the authorities when each VAT return is submitted.

Some businesses have special schemes for calculating output tax:

- A business that sells second-hand goods can account for VAT on the margin it makes on the sale, rather than on the full selling price. So if goods are bought for £200 and sold for £300, then the £100 profit margin will be

treated as VAT inclusive.

- Retailers can use a number of special schemes, to recognise the fact that it is not practical for them to issue a tax invoice for every sale that is made.
- There is a flat rate scheme available for both farmers and small businesses which means that a percentage of total business income is paid in VAT, as opposed to the VAT shown on an invoice.

## **INPUT TAX**

As explained above, a VAT registered business can claim the VAT it pays to suppliers on its expenditure, as long as the expense in question relates to a taxable part of the business, and is not related to any sales that are exempt. So to give a simple example, if a firm of accountants pays £10,000 plus VAT for an advert in a national newspaper, then it will reclaim the VAT element as input tax on its VAT return. But an insurance broker placing an advert in the same newspaper to promote its activities will not be able to reclaim VAT on the expense. This is because insurance services are exempt but accountancy services are taxable.

Input tax cannot be reclaimed on non-business or private expenditure. There must be a clear link between the taxable business and the expense. If an expense is partly used for business and partly for private purposes, then the input tax claimed must be apportioned on a fair and reasonable basis.

## **REGISTERING FOR VAT**

The UK has one of the highest VAT registration thresholds in the EU. A business can make annual taxable sales of £73,000 before it needs to become VAT registered. This is a very generous limit when it is recognised that many EU countries adopt a zero threshold. The £73,000 limit is also available to an overseas business trading in the UK, although there are plans to introduce a zero registration threshold for an overseas business after August 2012.

It is also possible for a business to register for VAT on a voluntary basis e.g. if it is making mainly zero-rated sales and wants to reclaim input tax.

The technical phrase in the legislation is that a 'taxable person' needs to be VAT registered if he exceeds the relevant threshold. A taxable person can be:

- an individual – sole trader
- partnership
- limited company
- limited liability partnership
- a club, association or other unincorporated body

An important point to recognise is that all activities of a person are included within a VAT registration, rather than one particular business. So if John trades as a plumber during the day and an accountant in the evening, then VAT would be relevant to both of his activities if they were within the same legal entity.

## **RECORD KEEPING**

Every VAT registered business must keep records that enable it to accurately calculate the amount of VAT that it owes on its quarterly (or monthly) returns. These records will include purchases and sales books, invoices, bank statements, takings records for retailers and cash books.

If a business makes a ‘careless’ error on a VAT return, it could be liable to a penalty if this error is an underpayment and is not disclosed to HMRC before they discover it. The penalty for an underpayment that has been deliberately made by a taxpayer will attract an even higher penalty. The onus is on a VAT registered business to submit accurate returns and pay its tax on time.

HMRC carry out routine VAT visits to review figures declared by a business on its returns. These visits are also intended to help a taxpayer with his VAT accounting issues, possibly identifying expenses where he is entitled to reclaim VAT but has not done so in the past.

## **INTERNATIONAL TRADE – SELLING GOODS**

A UK business that sells goods to other VAT registered businesses in the EU will not charge VAT. This assumes that two important conditions are met:

- the business acquires the VAT registration number of the customer and shows this number on its sales invoice;
- the business also holds proof that the goods in question have left the UK – this evidence could be commercial paperwork or transportation documents. It is important that this evidence is retained in the event of a routine VAT visit by HMRC.

A sale of goods to a private individual in another EU country will generally charge standard rated VAT, unless the goods in question are specifically exempt or zero-rated e.g. books or children’s clothes. However, a business selling goods to private individuals in another EU country needs to be aware of the fact that it might need to register for VAT in that country (and submit VAT returns and pay tax to the authorities in that country) if its annual sales of goods in that country exceed:

- 35,000 Euros; or
- 100,000 Euros

Each EU country makes its own decision whether it adopts the higher or lower threshold – in the UK, the limit is £70,000 if an EU business sells goods into the country because we are not in the Euro zone.

The above process is known as the 'distance selling' rules and is intended to create a level playing field across the EU, so that there are no big VAT advantages to be gained by setting up in business in a country with a low rate of VAT.

Another important point to be aware of is that in the case of goods being zero-rated when they are sold to a VAT registered business in another EU country, they are not actually escaping a charge of tax. The business receiving the goods must declare the VAT on its own VAT return (Box 2 of the return is described as 'acquisition tax') but it can usually claim the same amount of tax as input tax in Box 4 of the same return.

A sale of goods to a customer outside the EU is always zero-rated, irrespective of the status of the customer.

## **SELLING SERVICES TO AN OVERSEAS CUSTOMER**

The VAT rules for selling services to an overseas customer tend to be very complicated, although have been simplified in the last two years. As a basic principle, if a service is being sold to a business customer outside the UK, then no VAT is charged. There are exceptions to this statement – for example, a service relevant to UK land (e.g. an architect invoicing a customer in Germany) will be subject to VAT because the sale is deemed to have taken place in the UK where the land is based. The same principle applies to construction services e.g. the services of a plumber, electrician, or bricklayer – it is where the land or building is based that is the deciding factor.

In contrast, the sale of many services to a non-business customer based outside the UK will be subject to UK VAT. There are a number of important exceptions if the customer is based outside the EU – for example, an accountant will not charge UK VAT for services rendered to an American individual for e.g. completing his UK tax return.

If a UK business sells services to an EU business customer without charging VAT, then the customer will account for the VAT on his own VAT return by doing what is known as a reverse charge calculation. This is similar to the entry for acquisition tax explained in the previous section, but entries are made in Boxes 1 and 4 of the VAT return, as opposed to Boxes 2 and 4. To ensure this process has been

carried out correctly, the UK business making the sale must complete a quarterly return known as an EC Sales List (ESL). The ESL records the VAT registration number of the EU customer, and the value of sales (invoiced rather than paid) during each calendar quarter.

## CONCLUSION

For many UK businesses, VAT accounting is straightforward. However, the experience of the author over many years has established that there are three particular aspects of the tax that produce numerous complications and problems, and where special care is needed:

- *land and property transactions* – particularly in relation to the situation where landlords can choose whether income from a property is exempt or subject to VAT (known as the ‘option to tax’ regulations);
- *international transactions* – as explained above, the rules concerning the buying and selling of services across borders can be particularly complicated;
- *partial exemption* – relevant to input tax recovery for a business that has some taxable income and some exempt income. The issue here is defined in the legislation as ‘partial exemption’ and produces a range of pitfalls and planning opportunities where care and attention to detail is very important.

The key theme about all of the three issues above is that large amounts of VAT are usually involved, so advance planning and specialist advice is crucial.

# 4.4 KEY BUSINESS TAXATION PLANNING POINTERS

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## **INTRODUCTION**

This Chapter carries on from the overview in Chapter 4.2 and sets out planning pointers, both in terms of taxation savings and also in avoiding an increased charge. It describes the taxation consequences of various courses of action.

## **TAXATION CONSEQUENCES OF OPERATION VIA A UK RESIDENT COMPANY**

- i. Profits will be liable to Corporation Tax (CT).
- ii. The gain on the eventual sale of shares in a UK company is likely to be exempt from UK tax, if held offshore.
- iii. In several jurisdictions the sale by the resident company of shares in a non-resident company (e.g. UK company) will be exempt. In most jurisdictions individuals would have a liability.
- iv. The timing and manner of repatriation of profits can be flexible and assist in planning in the offshore jurisdiction.
- v. European Union (EU) parent companies might be able to claim that the UK

- loss-making subsidiary should be included in local tax consolidations.
- vi. Disclosures by UK companies are limited to the activities of the company itself. In the case of a Permanent Establishment (PE) the UK Inland Revenue might require information about non-UK transactions to determine and agree liabilities to CT.
  - vii. Royalties and interest paid by a UK company to overseas associates are tax deductible if on arms-length terms. These payments made by a PE to its parent/head office are not deductible.
  - viii. Any problems, if applicable, in setting up a PE and subsequently incorporating it are avoided. These might include a tax charge in the foreign jurisdiction on the transfer of assets from the PE to a foreign subsidiary. Generally there are no UK tax consequences on the incorporation.

## **KEY TAX PLANNING ISSUES**

### **Purchase of shares**

The acquisition of the shares of a company means that the purchaser inherits all of its assets and liabilities – both known and unknown. The company is a continuing legal entity and a change in its ownership does not affect its obligations from the past.

Because of this the purchaser normally requires the vendor to give indemnities in respect of the company's current and past liabilities, as well as future liabilities that may arise as a result of the acquisition.

It should be noted that the acquisition of the company means that there is no uplift in the value of the assets held by the company. Any gains on those assets remain in the company and will only be taxable on the company when they are sold. This inherent gain and contingent tax liability needs to be reflected in the price paid for the shares.

However, if the vendor of the shares is non-resident at the time of the sale, no capital gains tax will be payable by him on the disposal and any inherent gains in the company's assets will only be of concern in assessing the price to be paid for the shares.

### **Purchase of business assets**

The purchase of the business assets from a company, as opposed to buying the company itself, does mean that they are purchased free of liabilities. The purchasing company will also have acquired the assets at current value and so there will be no inherent gains to take into consideration in the future. This can be an

advantage where the assets might have to be sold prior to any future disposal of the company.

### **Tax grouping**

The association of companies can have an effect in the UK on the rate of tax payable by both resident companies and branches. There are different types of tax grouping in relation to trading profits and capital gains, and also the surrendering of losses between companies with economic interests such as where a company is owned by a consortium.

Association normally comes from common control of companies. Thus if the same individual, or group of individuals, has control of companies those companies, for UK taxation purposes will be associated (and connected). This has effect in the following ways:

- Transfers of assets between associated companies must be at an arm's length value. Where this does not happen the Inland Revenue can deal with the calculation of tax as though it had been at arm's length by substituting the open market value for the actual transfer value.
- The number of associated companies will affect the application of the Small Profit Rate of corporation tax (on profits up to £300,000). The limit of £300,000 will be divided between the number of associated companies.

Grouping comes from direct shareholdings of one company by another. The share percentages of such holdings are followed through.

If, for example, Company A held 80% of the ordinary capital of Company B, which in turn held 90% of the ordinary capital of Company C, then A would be held to have an interest in 72% (80% x 90%) of C.

If the percentages held are 51% or more, the companies are deemed to be a group for Capital Gains Tax purposes.

If the percentages are above 75% the companies are deemed to be a group for all UK corporation tax purposes.

The effect of a 75% grouping is to allow:

- Transfers of assets within the group without taxation consequence and without the need for open market values to be used.
- Trading Losses and Capital Losses to be surrendered between group companies, so that the tax rates can be averaged for best effect.

### **Transfer of a UK Permanent Establishment to a UK Company**

As mentioned in Chapter 4.2 it can be advantageous, if losses are expected in the initial trading periods, to start trade through a UK PE so that the losses can be utilised in the overseas jurisdiction (subject to the taxation laws in that jurisdiction). When the entity becomes profitable the UK trade can then be transferred to a UK company.

The usual route would be for the foreign parent to incorporate a company in the UK and then transfer the trade and assets from the PE at the appropriate time.

Using the group rules mentioned in 6.3.3 above the transfer in the UK would be achieved without adverse taxation consequences. Consideration, however, would also need to be given to whether the transfer triggered any offshore liability in the foreign parent's jurisdiction..

Frequently any losses incurred in the UK branch can also be carried over into the newly incorporated subsidiary for use against its future profits. resulting in those losses being utilised twice, once in the overseas parent and once in the newly incorporated UK subsidiary.

### **Sale of a UK Permanent Establishment**

Unlike the situation in respect of the sale of the shares of a UK company, as mentioned previously, the sale of the assets (including goodwill) of a branch or PE of an overseas company trading in the UK will trigger a tax liability.

The foreign parent company will therefore be taxable at 26%, reducing to 23% over the four years ending 1st April 2014, on any capital gain generated from the sale of assets owned by its UK PE, subject to indexation relief (see Chapter 4.2).

### **Controlled Foreign Companies (CFC)**

When considering the best structure, overseas investors will need to take into account the use of low tax rate intermediate countries for functions such as, holding, trading, financing or management.

Using such countries complicates the structure and there will need to be detailed consideration of CFC rules in all countries affected by the structure.

In using such low tax rate jurisdictions transfer pricing legislation will also become a factor for consideration (See below).

### **Investment in UK properties**

If property is acquired in the UK by a non-resident individual, or a non-resident company, for rental return purposes coupled with capital gain on disposal the taxation position differs in terms of rates applying.

An individual, even though non-resident, will be taxable at the rates set out in Chapter 4.2. Thus the highest rate could be 50 %.

A non-resident company, however, pays tax on this type of income at a flat rate which is currently 20%.

Special administrative provisions apply in both cases in that, if there is not a collection agent in the UK, tax will have to be deducted at source on the gross rental paid by the tenant. The individual or company recipient would then have to claim a refund in respect of any expenses available to offset against the income.

### **Repatriation of Profits**

In general there are few UK taxation implications on the repatriation of profits to the parent company or head office.

There are no taxes on distributions so a remittance of retained profits, in any form, does not attract a liability.

There is no withholding tax on UK dividends paid to offshore individual shareholders.

As mentioned in Chapter 4.2 there is a notional tax on dividends and for non-resident individuals this is deemed to cover their UK liability.

Non-resident companies receiving dividends from UK resident companies are similarly protected from additional UK tax.

Under the provisions of certain tax treaties a refund of 50% of the tax credit can be paid where the shareholder is a company holding 10% or more of the UK Company.

However other provisions provide, in most cases, for a 5% UK tax to be deducted from the grossed up dividend (the cash dividend plus the tax credit refund). The effect of this is to almost cancel out the benefit of the refund – probably leaving the refund at only 0.2% of the UK companies pre-tax profits.

### **Transfer Pricing**

The UK legislation relating to transfer pricing can impact on any transaction carried out between the UK entity (whatever its nature) and any foreign associated entity. The rules are similar in most jurisdictions and any resulting double taxation can usually be resolved under the provision of double Taxation Agreements that may be in force.

The broad implication is that any transaction between a UK entity and its associated foreign entities will be on normal commercial terms and that no tax advantage will be obtained by the pricing method used. If it is not, the legislation allows adjustment to recalculate profits to what they would be under an 'arm's

length' transaction. It also allows for the charging of penalties of up to 100% of the tax due.

The adjustments to recalculate the profits only apply if UK profits are understated. There is no adjustment if they are overstated.

Transactions which could therefore be affected include:

- Sales of products
- Services provided
- Financing
- Licensing
- Management fees
- Property leases and other transactions

The onus, under UK compliance rules for the submission of returns, is for the UK taxpayer to confirm that all related party transactions are carried out on an arm's length basis.

In cases where the transfer pricing determination of arm's length transactions might be very complex it is possible to agree arrangements and methods in advance under Advance Pricing Agreements with the Inland Revenue.

## **4.5 FINANCIAL OUTSOURCING**

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### **INTRODUCTION**

The term “outsourcing” is now commonplace in the world of business today, and there are some good reasons why this is the case.

Successful businesses are able to innovate and adapt to market conditions. This requires a sharp focus on the key drivers that underpin the business. This is the central role of the senior management team, who will possess the skills to achieve this.

Increasingly, other non-core activities are seen as an unwelcome distraction that may divert attention away from the growth of the business. Company directors must not, however, ignore their legal responsibilities, or the broader needs of their stakeholders.

Therefore it has become more common for companies to identify these areas and outsource work to external service-providers. Thus they are able to fulfil all of their duties while retaining focus on what is truly important.

### **THE BENEFITS OF FINANCIAL OUTSOURCING**

There are many benefits in choosing to engage an external provider. Firstly, and perhaps most importantly, a UK-based outsource partner will be able to provide

complete peace of mind that the business is UK tax-compliant. The regulatory regime has been strengthened in recent years and the cost of non-compliance has risen sharply. There are now myriad penalties and surcharges for late or incorrect filings for Income Tax, National Insurance, Corporation Tax, and Value Added Tax. These administrative matters can no longer be left at the bottom of the “in-tray”- it has become too expensive to do so.

A financial outsourcer will often be the client’s primary source of pro-active advice to save money for the business. For example, there are many tax concessions and schemes available to businesses which can reduce or defer tax liabilities. This requires an up-to-date knowledge of the UK tax regime. It is virtually impossible to recruit individual staff members who possess all of this technical knowledge.

When a business first invests in the UK, it may also be difficult to hire the right calibre of finance staff. The UK business will be in its infancy, and comprise little more than a business plan, an outline sales contract and a lease agreement. It is likely that executives will be asked to fulfil a number of roles in this embryonic stage. An investor must consider they are able to attract the right type of person, possessing the right skill-sets at this point in time. Every new business venture will require a certain amount of low-level processing work, together with a certain amount of technical expertise. At the same time, the business will benefit from more circumspect financial advice. Outsourcing can deliver all of these features, and can do so economically.

It is also often very difficult for an overseas business to adequately assess the suitability of candidates when recruiting for UK financial controllers. Furthermore, it can be even more difficult to cover for staff illness and holidays. Outsource businesses naturally assume responsibility for such issues, and provide automatic cover so that the service continues without interruption.

Furthermore, most outsourcers operate web-based systems, allowing businesses to access their own financial records remotely and in real-time. This provides an added layer of visibility and accountability.

UK employment law is covered in the next chapter, Chapter 4.6, but there is an obvious contrast between the legal responsibilities of being an employer, and the contractual terms of an outsource agreement. Many providers are regulated by professional accountancy bodies. In addition, agreements with outsource providers can incorporate quality-control assurances, and of course ensure that the service-provider is legally accountable. This provides a level of assurance that cannot be matched by employing staff directly.

Employment law is complicated and employees, including part-time staff,

receive additional legal rights after one year's service. Restructuring and redundancy must therefore be handled very carefully if time-consuming and costly legal disputes are to be avoided. Outsourcing allows a business to "buy-in" a variety of skills as and when needed, and allows onerous employment law to be side-stepped.

## **WHAT FINANCIAL SERVICES CAN BE EFFECTIVELY OUTSOURCED?**

### **Setting Up of a Company:**

- Formation of a UK business entity e.g. Private Limited Company with an agreed name.
- Dealing with all the statutory formalities including –
- appointment of Directors and Secretary (if required);
- provision of a Registered Office address;
- preparation of Annual Returns;
- maintenance of statutory books.
- Registering a company for Value Added Tax.
- Registering a company for Pay As You Earn taxes (this is a method of collection of Income Tax and National Insurance earned through employment).
- Arranging for UK Contracts of Employment to be prepared.
- Advising on appropriate accounting software and financial reporting.
- Preparing a Chart of Accounts.
- Compiling a business plan incorporating budgetary forecasts.
- Setting up credit procedures.
- Introduction to UK banks and assessing the formalities of opening a bank account.
- Introduction to Insurance brokers to ensure relevant insurance policies are in place.
- Introduction to marketing and PR consultants.
- Introduction to solicitors and HR professionals to draw up terms and conditions, apply for work permits etc.
- Treasury control – Internet banking, issuing and signing cheques on behalf of the company. Organising cheque signatories and procedures.

## **Once a Company is Established:**

Acting as Administrative Office:-

- Stock and order processing.
- Pre-sales credit control.
- Preparation of sales invoices.
- Sending sales invoices to customers.
- Post sale credit control.

Maintenance of all Accounting records:-

- Sales Ledger (Accounts Receivables).
- Purchase ledger (Accounts Payable).
- Nominal ledger.
- Inventory control.
- Bank reconciliations.
- Payroll processing.
- Submission of VAT returns.
- Agreement / reconciliation of supplier statements.

Production of Management Information

- Weekly management information and flash reports.
- Monthly Management Accounts.
- Production and interpretation of Key Performance Indicators.
- Comparison of actual results with forecasts.

Liaison with Overseas Holding Companies

- Preparation of Accounts in accordance with overseas Head Office timetable and accounting policies.
- Reporting in depth using any format required on any accounting matters, complying with International Accounting standard.

Liaison with Government Bodies

- Dealing with all statistical returns for VAT purposes (EC Sales Lists,

IntraStat).

- Dealing with all PAYE returns.
- Dealing with Corporation Tax Returns.
- Dealing with data as required by UK Data Protection Act.

Liaison with Statutory Auditors and Tax Advisors:-

- Prepare Year End file in format preferred by UK firms of Chartered Accountants.
- Provision of additional information and explanation to auditors.
- Ensuring that all group audit timetables are adhered to.

## **CONCLUSION**

Outsourcing in the UK is a growing service industry, offering skills to businesses at an economic price, which those organizations could not readily acquire or control independently without incurring a significant financial and time cost.

The result is a fixed overhead that leaves the company free to concentrate upon their core activities knowing that the administration and financial side of the business will run smoothly, seamlessly and efficiently.

## **4.9 UK TAXATION FOR FOREIGN NATIONALS**

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### **INTRODUCTION**

This chapter deals with the UK taxation implications for a foreign national coming to the UK to live and work. The UK tax year is rather unique; it starts on 6th April and ends on 5th April. There are three personal taxes to which an individual may become liable; Income Tax, Capital Gains Tax and Inheritance Tax. In addition another liability known as National Insurance is likely to be due, and is based on an individual's salary. In order to determine the UK taxation treatment of an individual it is necessary to consider three basic principals: residence, ordinary residence and domicile: these are discussed in detail below.

### **RESIDENCE**

The term "Residence" is not defined in UK tax law despite being the starting point for determining any liability to UK tax. Over the years the UK Revenue have built up a system based on statute and decisions of the courts (case law). The result of this is that we now have established practice, which deals with this. Residence is where an individual is physically present, at any one time. There are two basic tests

which have up until recently been used to determine residence for tax purposes: 1) firstly being present in the UK for more than 183 days in a tax year (6th April to the following 5th April); or 2) for those not considered resident under the above rule, there is a second test, which is being present in the UK for more than 90 days per year on average over a period of four tax years. Those to whom the above tests apply are considered tax resident from the beginning of the fifth tax year.

The UK Revenue authorities have recently published a practice note, HMRC 6, which suggests that they will no longer be relying on the aforementioned tests alone but will in future want to see evidence of an individual's lifestyle change in support of a claim of non residence or residence.

The UK Revenue has stated that normally they only look at midnights in the UK. However it would be dangerous to rely on this, as the statutory position is that both days of arrival and departure should be counted (*Wilkie v IRC 32 TC 495*) there is a more recent case which highlights this point. (*Gaines-Cooper V Revenue 2007 STC 23*)

### **Dual Residence**

It is possible for an individual to be tax resident in more than one country at the same time, looking at the individual residence rules for each country, in which case it is necessary to consider whether there is a double tax treaty between the United Kingdom and the relevant country. This can be a very complex matter and is not dealt with in the chapter; further specific advice should be sought on this.

### **Ordinary Residence**

Again there is no statutory definition of "ordinary residence"; the UK Revenue look at a combination of statute and case law. Taking one year with another, ordinary residence is determined by where the individual is usually resident. Normally, the UK Inland Revenue will look at the individual's residence history in the previous three years, and if this has been in the UK he will be regarded as ordinarily resident here from the fourth year. However, when an individual comes to the United Kingdom, and plans to stay here for more than three years, he will be considered ordinarily resident from the outset. The Revenue authorities litigated this point recently; in the most recent case they argued that the initial period of normal residence should be two tax years.

Although the stated aim is to have a statutory test for Residence, both on arriving in and departing from the UK, none has so far been forthcoming, although one has now been promised for April 2012.

## **Domicile**

This term is also not defined in UK tax law. It takes its meaning from general law. It looks for what is considered to be the “mother” country from where the individual hails. There are three types of domicile: origin, dependence and choice.

### *Domicile of Origin*

This is the domicile that is acquired at birth, being that of the individual’s father, unless the parents were unmarried or divorced during minority, in which case it is the domicile of the mother or the parent with whom they lived.

### *Domicile of Dependence*

During an individual’s minority, a domicile of dependence can displace a domicile of origin if the parents adopt a new country as their “mother” country and settle there; or, as mentioned, if the parents separate or divorce.

### *Domicile of Choice*

It is possible to shed one’s domicile of origin in favour of a domicile of choice, by taking various steps. It is not a straightforward matter to shed one’s domicile of origin, particularly if it is a UK domicile of origin. This is really a whole subject on its own and beyond the scope of this chapter. However, specific advice on this issue should be sought.

### *Deemed Domicile*

If not originally domiciled in the United Kingdom, see above, an individual may be deemed to be domiciled for inheritance tax purposes only, if they have been tax resident in the United Kingdom *at anytime* in 17 out of the last 20 tax years. Specific advice should be sought on this aspect.

## **INLAND REVENUE FORMALITIES**

Upon entering the United Kingdom it is necessary for the individual to establish whether or not they have a liability to tax and to notify their existence to the UK Inland Revenue. There are two forms, which should be completed:

- Form DOM1:- if the individual is claiming that they are not domiciled in the United Kingdom and have income or gains arising abroad;
- Form P46:- for an employee who has just commenced work in the United Kingdom.

It is suggested that professional assistance be obtained when completing these forms; once residence, ordinary residence and domicile position has been established any liability to tax can be calculated.

## **INCOME TAX**

Individuals who are resident, ordinarily resident and domiciled in the United Kingdom are liable to Income Tax on their worldwide income on an arising basis. However those individuals who are considered resident and ordinarily resident, but not domiciled, in the United Kingdom will only be taxed on UK source income on an arising basis whilst income from abroad will, initially anyway, be taxed on a remittance basis.

From 6th April 2008 changes were made to the remittance basis of taxation. Thus if an individual from abroad has been resident in the UK in more than 7 out of the last 10 years, and is non-domiciled or not ordinarily resident, then he/she will only be able to continue using the remittance basis for their overseas income on payment of an additional tax charge for the year of £30,000 (£50,000 if resident here for 12 out of the last 15 years after 6th April 2012), unless the unremitted overseas income and capital gains is less than £2000. It is best to take advice on this before becoming resident in the United Kingdom. Non-UK residents are still liable to income tax on UK source income usually on an arising basis, for example, on rental income from a UK property or a salary from a UK company.

Individuals taxable in the United Kingdom will be entitled to a personal allowance of £7475 for 2011/2012, unless claiming the remittance basis, but this will be subject to a restriction once gross income exceeds £100,000.

The tax rates that apply after that are shown in Table 4.9.1.

**Table 4.9.1. Income tax rates after the first £7,475**

<b>Income</b>	<b>Tax Rate (%)</b>
Up to £35,000	20
Between £35,000 and £150,000	40
Above £150,000	50

The above rates apply for the year ended 5th April 2011.

## **CAPITAL GAINS TAX (CGT)**

The charge to capital gains tax relies on individuals being resident or ordinarily resident in the United Kingdom, in which case they are liable to Capital Gains Tax

on their UK gains on an arising basis. If individuals are also domiciled in the United Kingdom they will be liable to CGT on their worldwide gains on an arising basis. However, individuals who are considered resident or ordinarily resident but not domiciled in the United Kingdom will be taxed on gains from abroad on a remittance basis, but now for a limited period only. As with income tax, from 6th April 2008 changes were made to the remittance basis of taxation here as well, so that if an individual from abroad has been resident in the UK in more than 7 out of the last 10 years, and is non domiciled or not ordinarily resident, then he/she will only be able to continue using the remittance basis for their overseas gains on payment of the additional tax charge for the year of £30,000 (£50,000 if resident here for 12 out of the last 15 years from 6th April 2012), unless the unremitted overseas income and capital gains is less than £2000. This is a one off annual payment covering both income and gains. It is suggested that before coming to the United Kingdom advice is taken on mitigation strategies. There are various exemptions available; the most common ones are listed in the following sections.

### **Annual Exemption**

Each tax year an individual is entitled to an exempt amount of capital gains, which are not taxable, currently £10,600 (2011/12).

Any unused exempt amount cannot not be carried forward to a future year. However if the remittance basis is claimed, this allowance is forfeited.

### **Entrepreneurs' Relief**

Capital Gains Tax is charged at a flat rate of 28% of the gain with a reduced rate of 18% for basic rate tax payers. Higher rate tax payers will now have to pay 28% on the whole of their capital gains. A special reduced rate of 10%, which is known as Entrepreneurs' Relief, will be payable on the first £10 million of gains made in a taxpayer's lifetime, where the gain is made on qualifying business asset disposals. Thus the disposal of all or part of a business, or the disposal of shares or securities in an unlisted company, or the disposal of assets following the cessation of a business, should all qualify for Entrepreneurs' Relief. There are a number of conditions which need to be met in order for Entrepreneurs' Relief to apply and these need to be checked carefully beforehand.

### **INHERITANCE TAX (IHT)**

The charge to Inheritance tax is dependent upon where the asset is situated and the domicile of the individual or trust concerned; residence or ordinary residence is not relevant. A charge arises on all gifts of UK-sited assets whether or not the

individual is domiciled in the United Kingdom, subject to various exemptions discussed below.

Additionally, those individuals and trusts that are either actually domiciled or deemed domiciled in the UK are liable in respect of gifts of their worldwide assets.

Lifetime gifts to individuals and a limited number of trusts are not immediately chargeable to tax, but are considered “potentially exempt” subject to the transferor surviving for seven years from the date of the gift. If death occurs within the seven-year period following the gift then any tax due (payable by the donee) is reduced using a sliding scale shown in Table 4.9.2. Lifetime gifts to most trusts are chargeable to inheritance tax at a maximum rate of 20%.

**Table 4.9.2 Sliding scale of tax reductions of inheritance tax**

<b>Death in Year (Following Gift)</b>	<b>Percentage Reduction in Tax due on gift</b>
1-3	0%
4	20%
5	40%
6	60%
7	80%
8	100%

Any gift made is accumulated with earlier gifts made in the previous seven-year period in order to calculate the tax due. There are a number of specific exemptions available to offset against any gift before charging it to tax. The most common ones are:

- Annual exemption. Total gifts of up to £3,000 annually are exempt. Any unused exemption may be carried forward one year only.
- Small gifts to individuals. Gifts totaling £250 to an individual per year are exempt.
- Spouse exemption. Gifts to a spouse who is domiciled in the United Kingdom are unlimited. However gifts to spouses who are not domiciled in the United Kingdom are limited to £55,000.
- Regular gifts of income. Taking one year with another, regular gifts made out of excess income are exempt.
- Business property. Gifts of business assets such as an unincorporated business or shares in a “family” company are exempt in full. Personally

- owned assets used in a business may qualify for 50% relief.
- Agricultural property. This is a similar relief to business property relief.
- Gifts in consideration of marriage. Gifts may be made to the bride or groom, the amount that is exempt depends on the relationship to the couple as shown in Table 4.9.3.
- Lifetime exemption of £325,000 known as the “nil rate band”
- The transferability of the unused portion of the “nil rate band” of a deceased spouse by the surviving spouse.

**Table 4.9.3 Tax exemptions depending on relationship to married couple**

<b>Relationship to Couple</b>	<b>Exempt amount</b>
Parent	£5,000
Grandparent	£2,500
Remoter Ancestor and otherwise	£1,000

**Tax Rate**

Lifetime chargeable transfers in excess of any available exemptions and the “nil rate band” of £325,000 are chargeable at 20 per cent. The rate upon death is 40 per cent. Advice should be sought before making any gifts so that all the taxation consequences may be considered, including capital gains tax and stamp duty land tax (a tax on transactions and documents).

**NATIONAL INSURANCE**

This is a social security tax payable on earnings. Contributions are payable by both employees (primary) and employers (secondary). An individual, who is an EEA national and continues to pay social security taxes in another EEA country in respect of earnings, will not be liable to National Insurance in the United Kingdom. However if the individual ceases to pay contributions in another EEA country then he/she will immediately become liable to pay National Insurance in the United Kingdom. Non-EEA nationals will normally have a 12-month period before they have to pay National Insurance contributions in the United Kingdom.

Non-UK employers are not liable to pay secondary National Insurance contributions where they do not have a permanent establishment in the United Kingdom. However, where employees of the non-UK company are seconded to the United Kingdom to work for its UK subsidiary and are still being paid by their non-UK employer, then the UK subsidiary may be liable to pay the secondary contributions.

Contributions for 2011/2012 for employed earnings are shown in Table 4.9.4. Contributions are also payable by self-employed earners.

**Table 4.9.4 National Insurance contributions 2011/2012**

	<b>Employee (%)</b>	<b>Employer (%)</b>
£139 for employees and £136 for employers to £817 per week	12	13.8
Over £817 per week	2	13.8

### **UK INCOME TAX RETURNS**

UK income tax returns are issued annually on 6th April for filing at the latest by the following 31st October for paper returns, or the following 31st January for electronic returns. The forms are on a self-assessment basis subject to audit by the Revenue at any time within twelve months of the filing deadline.

### **PAYMENT OF UK TAX**

Payment of any tax liability calculated to be due is normally made on 31st January following the year of assessment. However, in certain circumstances where insufficient tax is payable at source during the tax year, the UK Revenue require payments on account to be made equal to the previous year's liability, in two equal installments, on 31st January in the tax year and 31st July following the tax year. For example, for 2011/12 payments on account would have been due on 31st January 2012 and 31 July 2012 with any balance being due on 31st January 2013 together with the first installment for the following year. Late payment of tax carries interest currently at 2.5 per cent per annum, and a surcharge of 5 per cent if the final tax due for a year is not paid by 28th February following the filing deadline, in this example 28th February 2013, with a further 5 per cent surcharge becoming due if the tax remains outstanding by 28th August.

### **REMUNERATION PACKAGES**

The UK Revenue have developed a very wide definition of earnings over the years to include most forms of remuneration and benefits in kind, which are subject to income tax and national insurance contributions when payment is made. Many benefits such as company cars now carry a charge to national insurance as if they

were salary for earnings purposes (see above). It is still possible, however, to remunerate employees with share options and share incentives tax effectively using:

- approved share options- subject to a maximum value of £30,000;
- approved savings-related share option schemes- subject to a maximum of £250 per month;
- Enterprise management incentives- subject to a maximum value of £120,000, per employer, available to smaller companies only.

Non-tax effective schemes such as unapproved share options and “phantom” share schemes, are available but the profit that the employee derives from them will be subject to both income tax and national insurance.

It is common for employees “seconded” to the United Kingdom to be provided with rent-free accommodation. This is subject to both tax and national insurance. The cost in terms of tax and national insurance can be expensive where the value of the property involved is in excess of £75,000. In this situation the benefit in kind is calculated by taking the value of the property when first provided to the employee and treating the excess over £75,000 as an interest free loan to the employee. The benefit is calculated on this amount at the official rate of interest, currently 4.00 per cent(2011 /12). Any costs paid by the employer and 20 per cent of the value of any furniture supplied in the house are also considered a taxable benefit. This benefit is then added to the employee’s salary and taxed at their highest rate. Thus a 50 per cent taxpayer will then pay tax of 2.00 per cent of the value of the house in excess of £75,000; so for a £500,000 property the tax due will amount to £8,500, with £2,176 national insurance due by the employer, plus any tax and national insurance contributions due on the running costs of the house paid by the employer.

It may be possible to structure the secondment to avoid these charges and it is essential to seek advice early, as once the employee is on the ground in the UK it is likely to be too late.

### **Dual Contracts**

It is still possible to have dual contracts for employments where the duties are performed both in the United Kingdom and abroad. One contract should be for the UK duties, which would be taxable in the United Kingdom and the other contract would be for duties performed abroad. If the employee is domiciled outside the United Kingdom and the contract for the non-UK duties is with a non-UK

company with the salary being paid abroad and not remitted to the United Kingdom, no UK tax will arise. These arrangements will now have to take account of the new taxing rules, introduced from 6th April 2008, for individuals who have been resident in the UK for more than 7 out of the last 10 years. It should be noted that HM Revenue and Customs have formed a special unit to scrutinize the efficacy of these types of contract.

### **Taxation in country of origin**

Individuals should always remember that although they have become resident in the UK and liable to tax here, their country of origin (for example, United States) may still tax them on the same income. It is therefore essential to ensure that any planning takes account of this. It is pointless avoiding tax in the United Kingdom when the same income is taxable in the home country. The most important thing to bear in mind in situations where taxation arises in two countries is to ensure that credit for the tax paid in the United Kingdom can be obtained against the same income taxable in the home country.

Employers are required to deduct tax and national insurance from salary and certain benefits in kind as they arise under what is known as Pay As You Earn (PAYE). These deductions are then paid to the Inland Revenue on a monthly basis by the 19th of the month following payment.

### **Trips to the home country**

Employees working in the United Kingdom, who are not domiciled in the United Kingdom, may for the first five years after arrival be entitled to have trips to their home country paid for by their employer tax free. Additionally, if the employee is in the United Kingdom for 60 days or more it may also be possible for their spouse and any children under the age of 18 to travel to and from the UK tax-free, but these trips are limited to two per person in a tax year. There are a number of specific rules that need to be considered in order to gain this relief.