

If your start-up company becomes a successful and growing business, in due course you may be looking at an ‘exit’ by way of flotation or sale of the company, or possibly passing the business down to your children. Tax planning for these possibilities should begin when you start up the company. If you leave it until later, you may end up paying tax unnecessarily.

Capital gains tax (CGT)

What is it?

Capital gains tax will be charged on the ‘gain’ which is subject to tax when you sell your shares. From 6 April 2008, capital gains in excess of an annual allowance (currently £9,600 for individuals) of tax-free gains will generally be subject to tax at a rate of 18 per cent.

With effect from 6 April 2008, business asset taper relief has been abolished. However, a new entrepreneurs’ relief has come into effect to reduce the CGT rate to 10 per cent on the first £1 million of qualifying capital gains made by an individual during his or her lifetime on or after 6 April 2008. Subject to a one-year qualifying period of ownership, the relief applies:

- (a) to gains arising on disposals of the whole or part of a business; and
- (b) to gains on disposals by directors and employees of shares in a trading company (or the holding company of a trading group) where the individual

owns at least 5 per cent of the ordinary share capital of the company and can exercise at least 5 per cent of the voting rights in the company.

personal tax

Tax planning on start-up

In general, direct share ownership is preferable for a start-up as it is simplest. You may wish to consider whether to hold your shares in a UK resident trust or trusts for yourself and family. This will provide a number of options on disposal, and may also help in your inheritance tax planning in the future. It is however harder for trustees to take decisions which involve ‘risk’ and your start-up may need an entrepreneurial approach.

If a shareholder is a non-UK resident or has a non-UK domicile there may be other opportunities available, including offshore trusts and either temporary or permanent relocation abroad.

Enterprise investment scheme (EIS)

An individual who is subscribing for shares in a start-up company, but is not “connected” with the company for the purposes of EIS relief, can achieve tax-free capital gains and income tax relief if the company is and remains a qualifying company and the shares are held for a minimum of three years. Even if you are “connected” with the company, you can defer the tax on capital gains you have already made by making an investment in your company under EIS. The conditions to secure EIS relief are detailed; care and specialist advice should be taken.

Traps for the unwary

Capital gains tax can apply in unexpected circumstances on a disposal (including a gift) and is by reference to the market value of the shares even if the amount you receive is much less.

Special rules may apply in relation to shares obtained not as an investor or 'founder' but by reason of a person's status as an employee or director. The Income Tax (Earnings and Pensions) Act 2003 extends the range of circumstances in which shares are regarded as acquired by virtue of a person's employment or status as a director. In some cases, some or all of the growth in value of such shares can be taxed as employment income and not as a capital gain. If so, tax would apply at 40 per cent for a higher rate taxpayer and may give rise to NICs.

Inheritance tax (IHT) and wills

Inheritance tax is charged on the value of assets in your estate on your death, and on gifts made in the seven years before death. IHT is also chargeable on certain lifetime gifts, whenever made, such as gifts to a company or to trusts. At present no IHT is payable on the first £300,000 of a person's estate, but otherwise IHT is generally chargeable at 40 per cent on death and 20 per cent in respect of lifetime gifts, unless reliefs (such as business property relief) are available.

Your shares may qualify for business property relief if they are in a private trading company and you have owned them for two years. This relief will usually be available at 100 per cent (so that no IHT is payable) but can be discounted for a number of factors including the level of cash reserves in the company.

If your company is controlled by five or fewer 'participators' (broadly, shareholders and loan creditors) and the company makes a gift then this could lead to an immediate IHT charge at 20 per cent. In these circumstances IHT is charged proportionately amongst the participators.

It would be sensible to review your wills to ensure that your estate passes in the most IHT efficient manner, and that your shares in the company are left in a manner which will allow the company to continue to grow and be managed effectively, but also will protect your family. How will your family secure a sale of your shares if you die? Should you insure your life?

Extraction of income

Special rates of income tax apply to income from dividends, but in general if you are a basic rate tax payer a notional tax credit associated with the dividend will be sufficient to meet your tax liability. If you pay higher rate tax you will pay a further 25 per cent tax on the dividend. In general, no NICs should be payable in respect of income received by way of dividend but special rules (often referred to as IR35) apply to companies providing personnel to clients. Otherwise income or benefits in kind from the company will generally be taxable as employment income. Advice should be taken on the most tax-efficient mix of methods by which to extract income from the company, as special rules can sometimes apply.

Some steps to take:

- Don't overlook entrepreneurs' relief.
- Make a will and consider life assurance.
- Think about what should happen to the enterprise if you die young.
- Tend towards simplicity of ownership for shares in a new start-up.
- Be aware of the tax and asset protection benefits of family trusts once your business starts to mature.
- If you are non-UK domiciled, take specialist advice.

Rates of tax

Income tax (6 April 2008 – 5 April 2009)	
Personal allowance: £5,435	Nil
Taxable income: £0 - £36,000*	20%
Taxable income: over £36,000	40%
Dividend income where shareholder is basic rate taxpayer. Effective rate of tax (after taking into account a notional tax credit)	Nil
Dividend income where shareholder is higher rate taxpayer. Effective rate of tax (after taking into account a notional tax credit)	25%

* If earned income is less than £2,320, the first £2,320 of savings income is eligible for a 10 per cent rate.

Capital gains tax (6 April 2008 – 5 April 2009)	
Annual exemption	£9,600
Rate for gains in excess of annual exemption	18%

Inheritance tax (6 April 2008 – 5 April 2009)	
Nil rate band	£312,000
Combined threshold for married couples and civil partners	£624,000
Annual exempt amount (can be brought forward one year)	£3,000
Death rate	40%
Lifetime rate	20%

This version of LaunchPAD has been prepared while the Finance Bill is passing through Parliament and has been drawn up on the basis that the Bill will receive Royal Assent in the form in which it was initially published. Please note however that it is possible that changes may be introduced before the Bill becomes law.

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