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Answer-to-Question-_1_

REPORT FOR ADRIAN CHARL

From: Christina Powley
Date: 5 May 2021
Re: Expansion of C

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1. Introduction

As per your letter of 15 April 2021 we will consider the options to expand CC on your return.

2. Abbreviations used

LLP	Limited Liability Partnership
CGT	Capital Gains Tax
IT	Income Tax
BADR	Business Asset Disposal Relief
PRR	Private Residence Relief
NIC	National insurance contributions
CAs	Capital Allowances
IHT	Inheritance Tax

VAT	Value Added Tax
SDLT	Stamp Duty Land Tax #
SRT	Statutory Residence Test
CC	Charl Communications
PA	Personal Allowance
MV	Market Value
BA	Balancing Allowances
BC	Balancing Charges
TNR	Temporary Non-residence
TWDV	Tax Written Down Value

3. Executive Summary

- You will likely qualify for split year treatment under Case 4 or 8 of the SRT and thus will only be taxable from 1 August 2021.

- To fund the purchase of the specialist equipment we would suggest disposing of your Morovan House as no UK CGT or Morovan CGT. You should do this prior to 1 August 2021 to avoid CGT.

- We would not reccomend selling your shareholding Morodby Communications Inc as you will be caught by the TNR and taxable to CGT in the tax year you return.

- To limit you peronsal liability we would reccomend incorporating and setting up a limited company. Transferring the capital allowances at the TWDV to avoid any balancing charges or allowances.

- Give further consideration to gift relief and incorporation relief as may mitigate CGT on incorporation.

- Transfer the cost of the Stock at the lower of cost and price actually paid to avoid additional income.

- Loan the money to the company to purchase the £25,000 equipment and have this repayable to you on demand tax free.

- Take a salary from the company of up to £8,788 to avoid any Class 1 NICs and Class 2 Secondary NICs.

- Have the retained profits to be paid to you in the form of dividends as these are taxable at lower rates.

- Charge the company rent for use of your property a method of extracting funds.

- Notify HMRC within 3 months of chargeability.

- The limited company can then be sold and you will qualify for BADR only giving CGT liability of £50,000 approximately.

- If you were to dispose of the property you retained at around the same time of disposal you may benefit from BADR on the sale of the business premises as an associated disposal.

4. Expansion of CC

4)a) Returning to the UK

We understand you will be returning to the UK on 1 August 2021, and from this point on will remain UK resident for at least the next 5 years.

You may be aware if an individual is UK resident they will be liable to UK tax on their worldwide income and gains.

However, the SRT (the legislation used to determine an individuals residency position in the UK), allows a tax year to

be split into a 'UK part' for which an individual is taxed as a UK resident and an 'overseas part' for which the individual is taxed as a non-UK resident.

On the basis you are likely to return to the UK on 1 August 2021, split year treatment may apply to your circumstances. However, there is a certain criteria which you must meet. If you return to the UK on 1 August 2021 and then remain in the UK from thereon in you would likely have spent more than 183 days in the UK, which would automatically make you UK resident and thus subject to UK tax on your worldwide income and gains.

However, as mentioned above it may be possible to split the tax year into periods of non-UK residence and UK residence under cases 4 to 8 of the SRT split year treatment.

You note in your letter of 15 April 2021 that you do not have much involvement in the the business of Charl Communications at the moment and it is Bill Davies who runs the day to day running of the business. However, I note from the letter that when you return to the UK on 1 August 2021 you plan to be a lot more hands on and be working full time in the business.

On this basis Case 5 may apply. Case 5 is where an indiviaul is starting 'full time' work in the UK. As you mentioned you will be a lot more involved and a more direct hands on approach. Thus if this is likely to be the case from when you return to the UK on 1 August 2021 it is from this point your UK residence will apply.

In addition we note you have a home in the UK and in Morova. We understand you do not want to sell your home in the UK, however as part of the expansion of the CC you would like to purchase a premises in the UK costing £200,000 and then purchase equipment of £25,000.

I note from exhibit B that the Morovan House is an asset you may consider disposing of when trying to find funds to utilise the funding of the expansion.

If you were to dispose of this property prior to returning to the UK on 1 August 2021, then Case 4 of the SRT split year treatment may also apply. Case 4 applies when an individual is starting to have their only home in the UK. As you do not want to dispose of your UK home it is likely when you return to the UK on 1 August 2021, that this case will likely apply as this will be your only home. I assume you have no other homes or accessible accommodation and your UK home is not being let on a full term basis.

Please note there will also be some CGT considerations and anti avoidance provisions which need to be considered also which I will discuss further below.

Taking into consideration the above you could split the 2021/22 tax year, which runs from 6 April 2021 to 5 April 2022 into a portion of non-UK residence and UK residence.

The non-UK residence part would run from 6 April 2021 to 31 July 2021. During this part, only your UK sourced income will be subject to income tax in the UK (you would still receive a PA of £12,500 and a AEA of £12,300) as you we assume you are a British Citizen. In addition any disposals during the non-UK resident part would not be subject to CGT in the UK, subject to certain anti-avoidance provisions which I will discuss further below.

The UK residence would then begin from 1 August 2021 to 5 April 2022. Any income and gains during this period are generally taxable in the UK. Please note split year treatment applies automatically so no claim is needed on your UK tax return.

b) Funding the expansion of CC

The planned expansion of CC will require:

- £25,000 equipment
- £200,000 premises

Total funds needed

We note you wish to own the premises personally, do not wish to take any loans and do not want to dispose of your UK home. We note no VAT will be charged on the premises.

b)i) Sale of Morovan House

To fund the purchase you may wish to consider disposing of your Morovan House.

The Morovan House was purchased on 1 December 2017. It was agreed by HMRC on 1 November 2017, you were non-UK resident from this point on. Since 1 November 2017 you have no returned to the UK and thus non-UK resident as follows:

- 2017/18 (Split year from 1 November 2017)
- 2018/19
- 2019/20
- 2020/21
- 2021/22 (If split year applies as above non-UK res from 6 April 2021 to 31 July 2021)

When you left the UK you did not own the Morovan House and thus did not own this asset whilst UK resident. This is an important point which I will discuss below.

Assets which you acquire and dispose of whilst non-UK resident will not be within the scope of UK CGT, unless it is UK land and buildings and/or if you are under the scope of the TNR rules.

We note you did not purchase the Morovan property whilst UK resident and this was only purchase whilst you were non-UK resident. If you were to dispose of the Morovan Property for the MV of £250,000 whilst non-UK resident i.e. before you return to the UK on 1 August 2021, this should not be within the scope of UK CGT and you should not be caught under the TNR rules.

In addition we note from your letter Morova does not charge any CGT on any asset disposals. Thus the gain of £100,000 (see appendix 1) will not be taxable in Morova either. Thus the net proceeds you receive are the £250,000.

This £250,000 could be used to fund the expansion of CC.

If you disposed of the Morovan property on or after 1 August 2021, this is likely to be caught under UK CGT, and the gain likely to be taxable at 18%/28%. We would not advise this.

b) ii) Disposal of shareholding in Morodby Communications Inc

We note as part of the divorce settlement in May 2017 you received the shares in Morodby Communications Inc.

As you had decided to separate on 1 November 2016, any transfer up the end of the tax year i.e. to 5 April 2017 would have been at nil gain nil loss, i.e. the base cost of the shares would have been £25,000. However, the shares we transferred to you in May 2017 as part of the divorce settlement on 1 May 2017. Up to this date i.e. 1 May 2017 you are considered connected parties and thus the transfer of the shareholding would have been done the MV

i.e. the £50,000.

You owned these shares on prior to the date you became non-UK resident on 1 November 2017.

We note these shares current MV is £250,000. If you were to sell these shares whilst non-UK resident no UK CGT should be due.

However, we note you intend to return to the UK from 1 August 2021. As I eluded to earlier there are certain anti avoidance provisions which would bring any gains on these disposals into charge if you are a temporary non resident.

An individual is regarded as temporarily non-resident if:

- The individual becomes non-resident (which you did from 1 November 2017 but owned the asset prior to leaving)

- the individual was UK resident for at least 4 of the previous 7 tax years immediately preceding the tax year of departure; (you were resident in the UK up to 31 October 2017 and prior tax years), and

- the period of non-residence is less than 5 years (you became non-UK resident on 1 November 2017 and will return on 1 August 2021, this is not 5 complete years).

It is likely you will be considered TNR and thus when you return to the UK and become UK resident again i.e from 1 August 2021 any capital gains made in the intervening period will all be taxed in the tax year of return i.e. 2021/22 tax year.

Therefore the gain on the disposal of the shares will be £200,000 (see appendix 2). You will receive an AEA of £12,300 leavin a taxable gain of £187,700 which is taxable at 10% up to the basic

rate band and then 20% thereafter. For simplicity we have assumed it will all be taxable at the higher rate of 20% giving rise to a CGT liability of £37,540.

The net proceeds £212,460 (£250,000 - £37,540). This would not give you sufficient funds needed for the expansion of CC.

You could consider delaying your return to the UK until 1 November 2022 in which case it will have been 5 complete years of non-UK residence, however, we understand this will not be the case as you will return to the UK on 1 August 2021. Thus we do not suggest disposing of the Morodby Communications Inc shareholding.

5) Incorporation

I note you wish to consider on how to reduce the risk of your personal risk exposure going forwards.

As you may be aware a sole trader is liable for the debts of the business to the full extent of his personal assets and can in the extreme case be made bankrupt.

However, if you were to consider incorporating your business to a limited company, and remained the sole shareholder and director of the company. generally the shareholders liability is normally limited to the amount, if any, unpaid on his shares. This would reduce your personal risk exposure for the future, however, we must consider the tax implications of incorporating.

Income Tax

The incorporation of the business CC will being about a cessation of trade for income tax purposes and the closing year rules will

apply. In addiiton any overlap reliefs will be relieved. However, we note you have a 31 March year end and thus it is unlikely you will have any overlap profits.

The adjusted profits for the year ended 31 March 2021 of £30,350 will be taxable on you personally which you would have to pay income tax and national insurance.

We note you also receive £19,000 of dividends from Morodby Communications Inc. However for the 2020/21 tax year it is unlikely these dividends will be taxable in the UK.

Thus your income tax liability for 2020/21 is likely to be in the region of £3,750. You will also have Class 4 NICs and Class 2 NICs due, which will amount to a total of approx £2,035. This will need to be paid as part of you self assessment tax return. Please see appendix 3 for calculations.

Capital allowances for plant & machinery

On the cessation of the trade as a sole trader where consideration is paid for the plant and machinery this disposal value is the lower of the

- cost; and
- actual consideration

Where the P+M is transferred to the company for no consideration the disposal value is the lower of:

- MV at the date of transfer;
- cost

It is likely will give rise to balancing allowances or charges.

Therefore, you could opt to pay £1 for the P+M however, this will only give you a lower base cost of the P+M once incorporated and thus larger gains for future disposals.

To avoid this a joint election can be made for the P+M to be transferred at the tax written down value to avoid any potential balancing charge on the cessation of the sole trader.

The capital allowance shows the special rate pool as being £25,382, once the election is made this transfer will not give rise to any balancing charges or allowances.

Again if the van and manager's car has had capital allowances claimed against them they will be transferred over a the TWDV.

Stock

On incorporation, the stock is deemed to be sold to the company for its MV. The MV is currently £25,000 and the balance sheet as at 31 March shows it as £20,000. To avoid additional income of £5,000 (£25,000 - £20,000) as the stock will be transferred between connected persons i.e. you will be the sole trader before and the sole director shareholder once the company is incorporated both you and the company can elect for the stock to be treated as transferred for the higher of:

- it's acquisition cost
- the amount the stock was sold for

It will only be possible where both the acquisition value and the actual selling price is less than the MV of the stock. In this scenario it is likely to be lower and thus this will not give rise to any further income for you on cesssation.

Capital Gains Tax

As the transfer to a limited company is taking place between connected parties the proceeds will be deemed to be the MV because the sole trasfer and the company are connected persons

- Goodwill

This will be transferred to the company at its MV. As it was not shown in the balance sheet as at 31 March 2021, it has been revalued and the cost associated with it will be nil. The transfer value will be £50,000 as this is the MV as at 31 March 2021.

- Plant & Machinery, equipment

There will be a capital gain of £15,000 on the specialist item as this is not exempt on the chattels rules as the MV and cost is both above the £6,000.

The remaining gains on the equipment will be exempt under the chattels rules as the cost and MV of the remaining equipment is below £6,000.

- The transfer or current assets such as stock, debtors is outside the scope of CGT, and thus no further impact.

Therefore based on the above total gains will be as follows:

Goodwill	£50,000
Gain on specialist equip	£15,000
Gains	£65,000
Less: AEA	(£12,300)

Taxable gain £52,700

This will be taxable at your marginal rate of tax at either 10% or 20%.
Please note you may qualify for BADR on the disposal of the equipment but unfortunately not on the transfer of the goodwill.

If you qualify for BADR the CGT on the gain is 10%. I will consider BADR further below.

There would be no capital gain on the business premises as you wish to keep the premises in your personal name.

There are relief available against the capital gain above. There are two relief which you may wish to consider:

1. Incorporation relief
2. Gift relief

There are certain conditions which you must meet to qualify for incorporation relief and these are:

- The business transferred must be a 'going' concern'
- All assets of the trader (except cash) must be trasnferred to the company to obtain the relief.
- The consideration paid to you by the company must be wholly or partly in shares.

We note from your letter of 15 April 2021 that you wish to retain the premises from which the business is to trader from in your personal name, i.e. outside the company, and on this basis you would not meet condition 2 outlined above for incorporation relief.

But this is something you may wish to consider further, and if so please do let me know.

The second relief mentioned above is gift relief. On the basis you wish to retain use of the premises, if you claimed gift relief you would be able to rollover the gain and reduce the base cost of the asset in the hands of the company. Please note this would not reduce the base cost of the shares as these would just be the nominal value received.

In essesnce the base cost of the goodwill would be nil i.e. £50,000 gain and then rollover the £50,000 gain agsint the market value. This would however, ptentially give rise to a bigger gain on disposal of the company as you will have nil base cost which we will consider further below.

VAT

No VAT needs to be charged on the transfer of a business to a company, as the incorporation will be a transfer of a going concern.

CC ie the sole trader must deregister within 30 days by sending a form VAT17. The new company should then register for VAT. The new company can elect to use CC's old VAT register number, but we would advise to use a new VAT number as it will have no history.

6. Funding the company

As you will be the sole director shareholder of the company you can then make a loan of the £25,000 to fund the purchase of the specialist equipment needed to expand the business.

This loan would then be outstanding on your directors loan

account and you could charge a nominal interest rate to the company.

This loand would be repayable to you on demand.

7. Purchasing the premises and holding in your personal name

As you will retain the premises you could also charge the company rent to use your premises this would be a method of extracting funds from the company.

Please note the purchase of the premises would incur SDLT charges as follows:

£0 - 150,000 - 0%
£150,000 - £250,000 - 2%

The premises of £200,00 would incur SDLT of £1,000.

8. Tax implications of operating through a limited company vs sole trasder

Sole trader

As a sole trader you pay tax on the trading profits and this would be at income tax rates.

In addition, you would also be liable to Class 4 and Class 2 NICs. Class 4 @ 9% above £9,500 and £3.05 per week for class 2 for profit above £6,345.

Limited company

A limited company would pay corporation tax on its profits at 19%.

Any salary paid to you would be tax deductible for corporation tax purposes. If a salary above £9,500 is paid to you then you would be subject to Class 1 NICs at up to 12% up the higher rate of £50,000 and then 2% above that.

The corporate would also be liable to play Class 1 secondary NICs at 13.8% on salaries above £8,788.

The profits retained in the business could then be drawn by way of dividends. As it is a close company as you will be the sole director shareholder you can pay dividends from the profits.

Dividends are taxable at 0%/7.5%/32.5%/38.1% depending on your marginal rate of tax.

You could charge the company rent for using the premises you retain, however this will be taxable on you personally.

You could also make pension contributions if you wish as this would be further deductions against your trading profits.

The purchase of the specialist equipment would qualify for the annual investment allowance (AIA) which would be offset against your trading profits. At present each company receives a £1mn AIA each year.

Tax difference

If you were to earn business profits of £100,000 taking into consideration any CAs claimed in the year the tax liability:

- As a sole trader

Business profit £100,000

Less PA £12,500

Taxsble £87,500

Tax liability

£37,500 @ 20% £7,500

£50,000 @ 40% £20,000

IT liablity £27,500

NICs

Class 4 £40,500 @ 9% 3,645

£50,000 @ 2% 1,000

4,645

Total tax £32,145

Net home pay = £67,855

N.B. We note that you also receieve dividends of £19,000 however, we have only focused on the profits ot the company.

- As a company

We would reccommend take a salary of £8,788 and the rest through dividends.

Corporation tax of £19,000 would be due, leaving £81,000 to distirbute out as dividends.

If you were to take a salary of £8,788 and then top the rest up through dividends you would also receive a £2,000 dividend allowance where dividends would be taxable at 0%.

The dividend tax rate would be 7.5% up to the basic rate band then 32.5% above this.

Administration of a limited company

- You must notify of chargeability to tax within three months of the first accounting period

- You must file accounts for 12 months and pay any corporation tax 9 months and 1 day following the end of the accounting period.

9. Selling the business

We note you wish to sell the business in 5 years time. On

disposal you may qualify for BADR on the sale of the business.

You would need to meet the following conditions:

- Own at least 5% of your personal unquoted trading company

- The company must be trading

- You must have been a full time employee

- Owned the shares for at least 2 years

- must be a material disposal

It is likely you will meet the above conditions and thus any gains on a subsequent sale of £500,000 should only give rise to a capital gain of approx £50,000.

This is because if you qualify for BADR gains up to £1,000,000 are taxable at a flat rate 10%. We assumed the shares were subscribed for £1 and thus neglgible.

The claim must be made on or before the first anniversary of the 31 January following the tax year of disposal. If you were to sell in 5 years time i.e. the 2026/27 tax year a claim must be made by 31 January 2029.