

MINI BUDGET FOR GROWTH, OR BLOWING THE BUDGET?

4 OCTOBER 2022



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Pierce "Mini-Budget" Breakfast Review Seminar – Economic Impact

October 2022

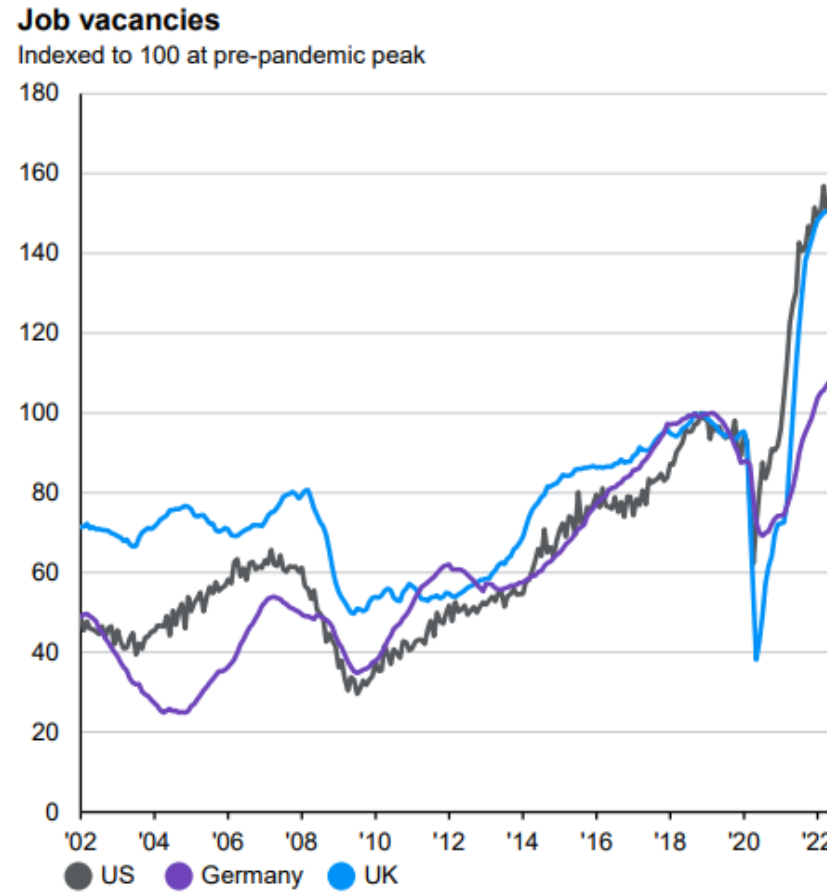
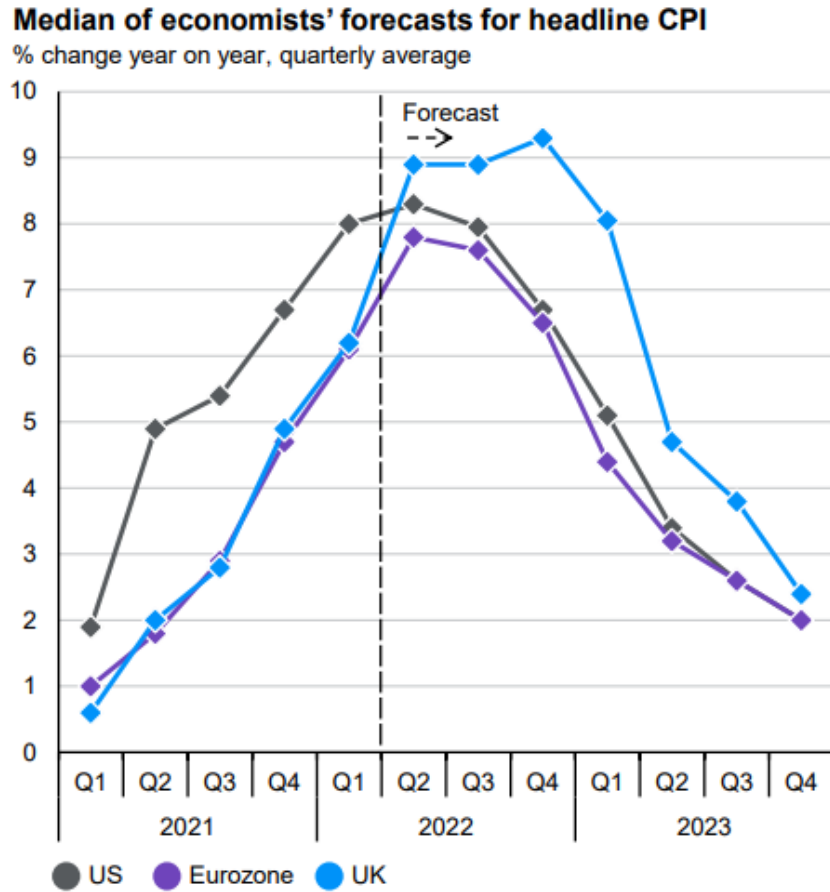
Inflation



Weaker Economic Growth

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Inflation is close to peaking



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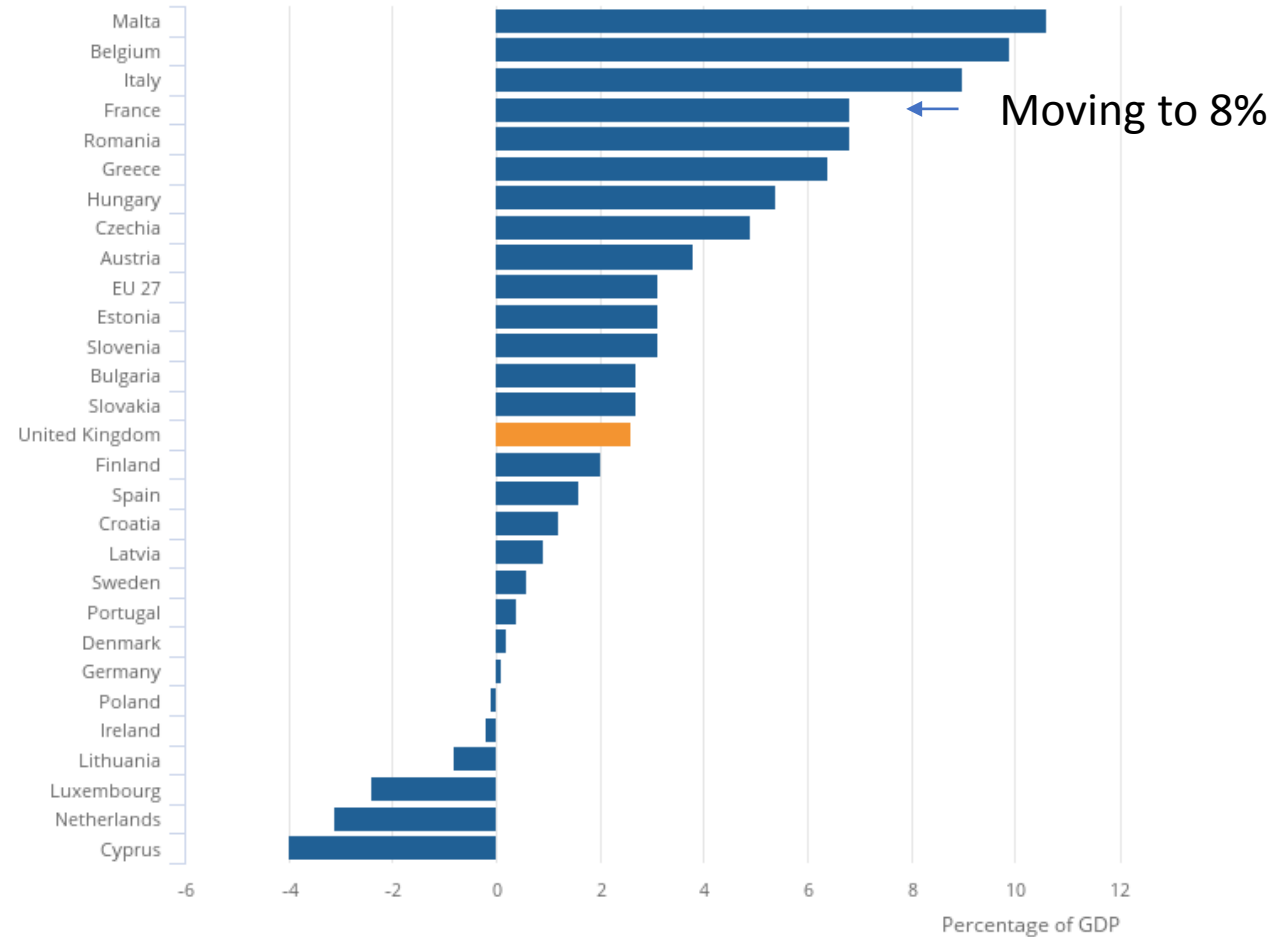
Source: (Left) Bloomberg, BLS, Eurostat, ONS, J.P. Morgan Asset Management. CPI is consumer price index. (Right) BLS, Deutsche Bundesbank, ONS, Refinitiv Datastream, J.P. Morgan Asset Management. UK vacancy data is a three-month average as published. Past performance is not a reliable indicator of current and future results. *Guide to the Markets - UK*. Data as of 30 June 2022.

J.P.Morgan
ASSET MANAGEMENT

Figure 5: UK deficit as a percentage of GDP in Quarter 1 2022 is slightly lower than the EU average

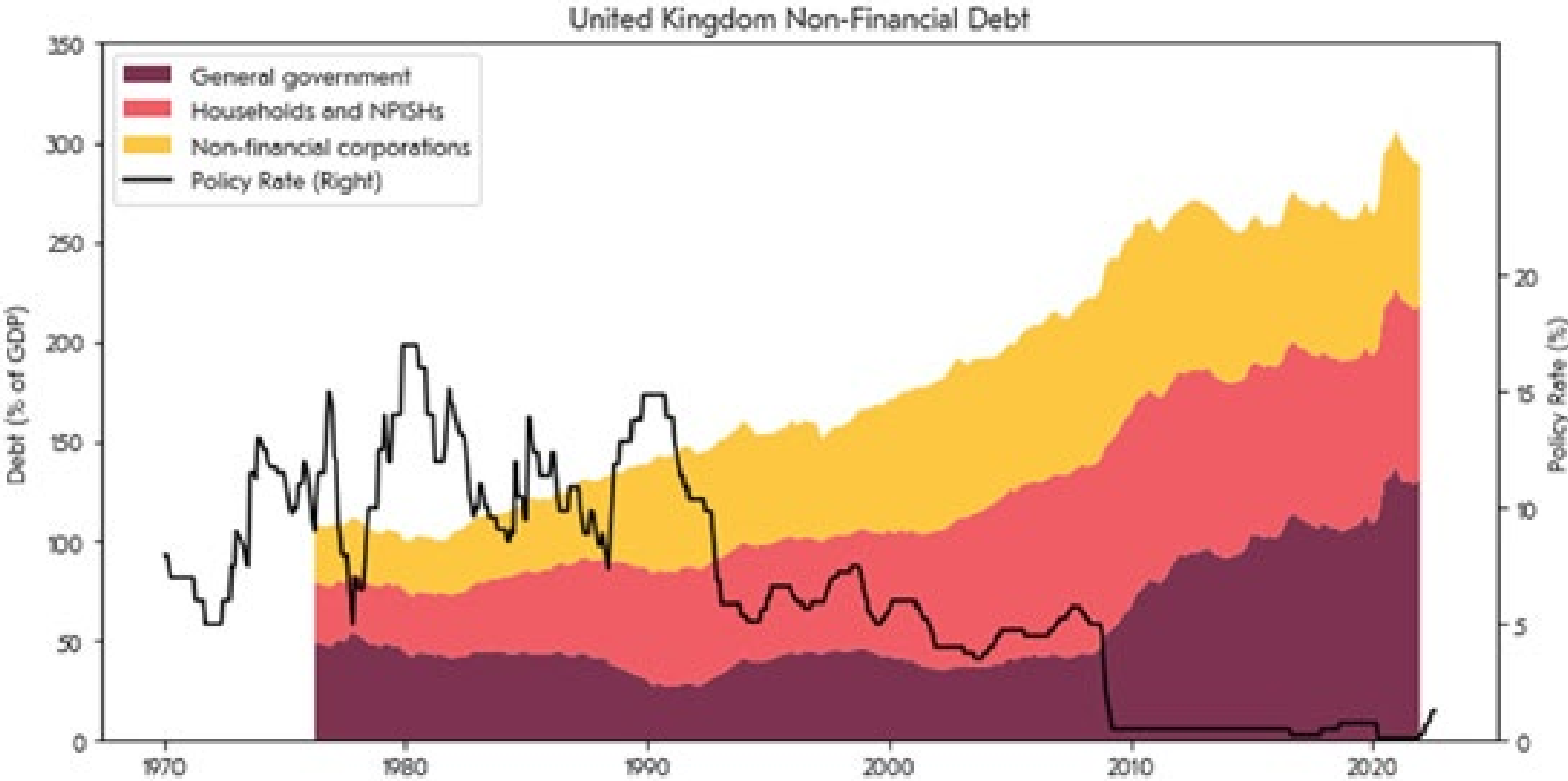
General government deficit (net borrowing) as a percentage of GDP, UK and EU member states, Quarter 1 (Jan to Mar) 2022

UK Deficit



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UK Debt

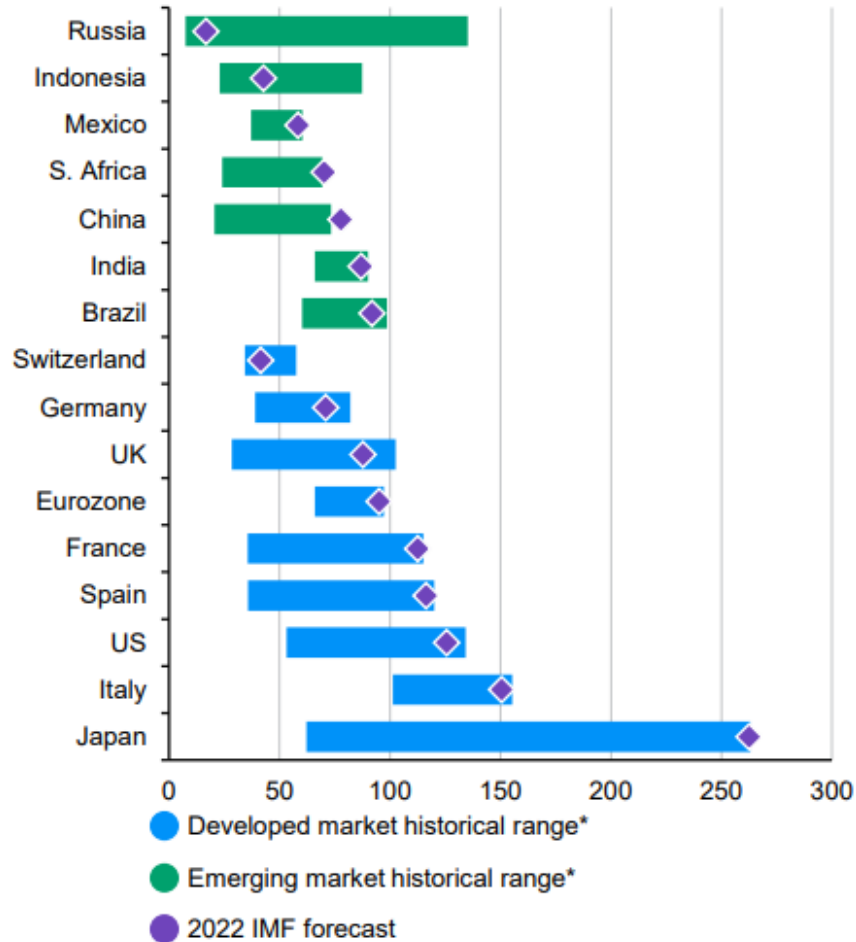


Source: Bank of International Settlements

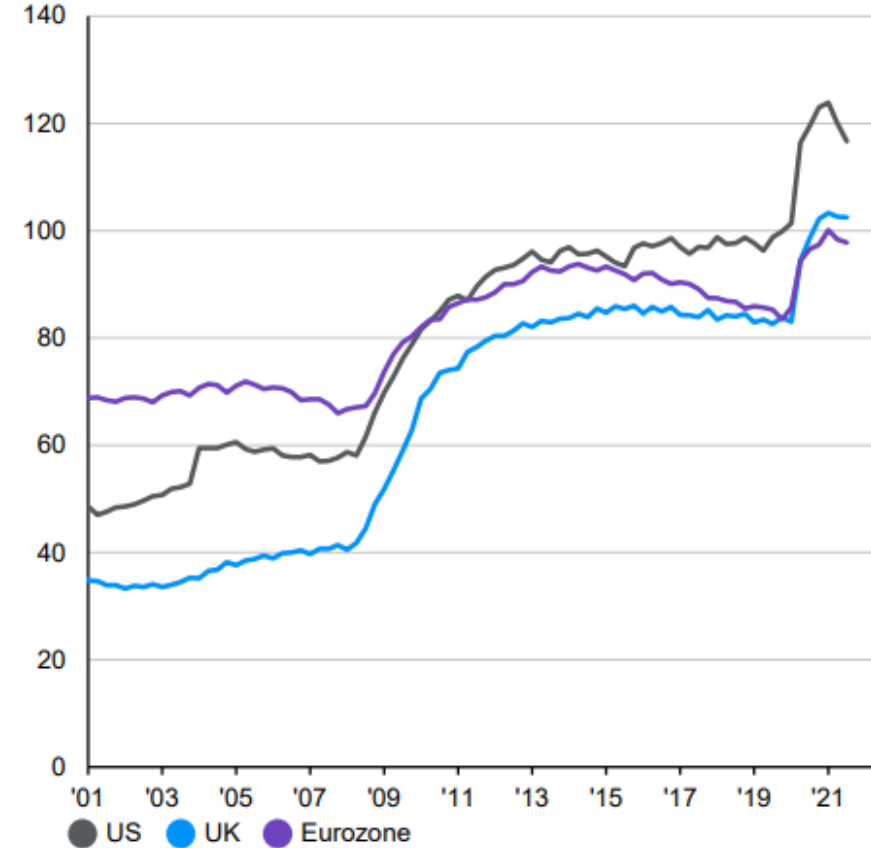
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Global Debt Levels

Government gross debt to GDP ratios by country
% of nominal GDP



Government debt to GDP ratios
% of nominal GDP



Source: (Left) IMF, Refinitiv Datastream, J.P. Morgan Asset Management. *Historical ranges are since 1990 or more recent, depending on data availability up until the end of 2021. (Right) BIS, Refinitiv Datastream, J.P. Morgan Asset Management. Debt is gross debt to GDP. Past performance is not a reliable indicator of current and future results. *Guide to the Markets - UK*. Data as of 30 June 2022.

Information you need to be aware of

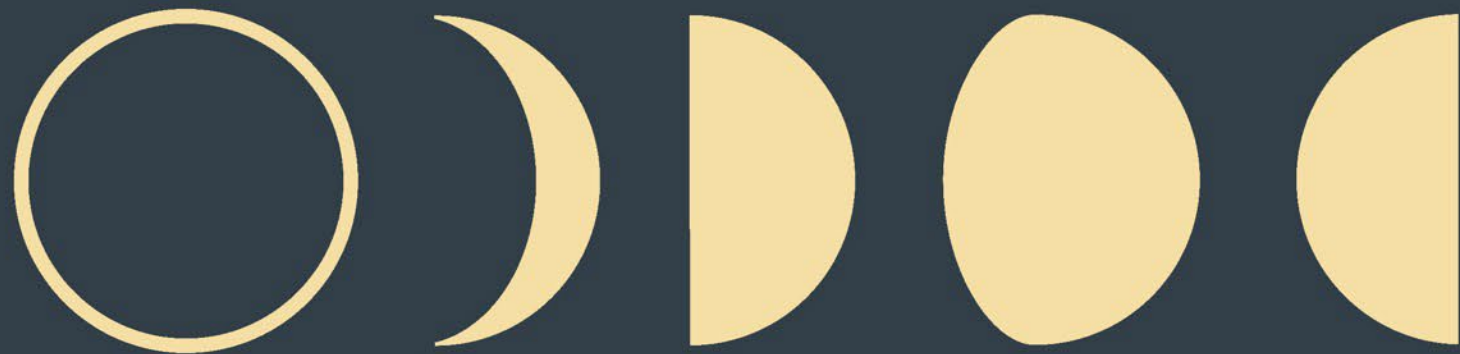
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REMUNERATION PLANNING

KEY HEADLINES

IMPACT ON REMUNERATION PLANNING

KEY HEADLINES FROM THE MINI BUDGET

INCOME TAX - FROM APRIL 2023

- ~~Abolish Additional Rate of income tax at 45%~~
- ~~Abolish Additional Dividend rate of 39.35%~~
- Basic rate of income tax to be cut to 19% from 20%

NIC & NATIONAL INSURANCE LEVY

- National Insurance Levy of 1.25% scrapped from April 2023
- From 6 April 2023:
 - Employers Class 1 NIC 13.8%
 - Employees Class 1 NIC 12% and 2%.
- From 6 November 2022:
 - Class 1A & 1B NIC – down to 14.53%.
 - Class 4 NIC will – down to 9.73% and 2.73% for the 2022-23.
 - Class 1 NIC rates for annual employees down to 12.73% and 2.73%.

STILL 7 RATES OF INCOME TAX...

- 0% - savings up to £5k / dividends up to £2k
- 7.5% - dividends
- 19% - general income
- 32.5% - higher rate dividends
- 40%- higher rate general income
- 38.1% - additional rate dividends
- 45%- additional rate general income

IMPACT ON REMUNERATION PLANNING

NET INCOME

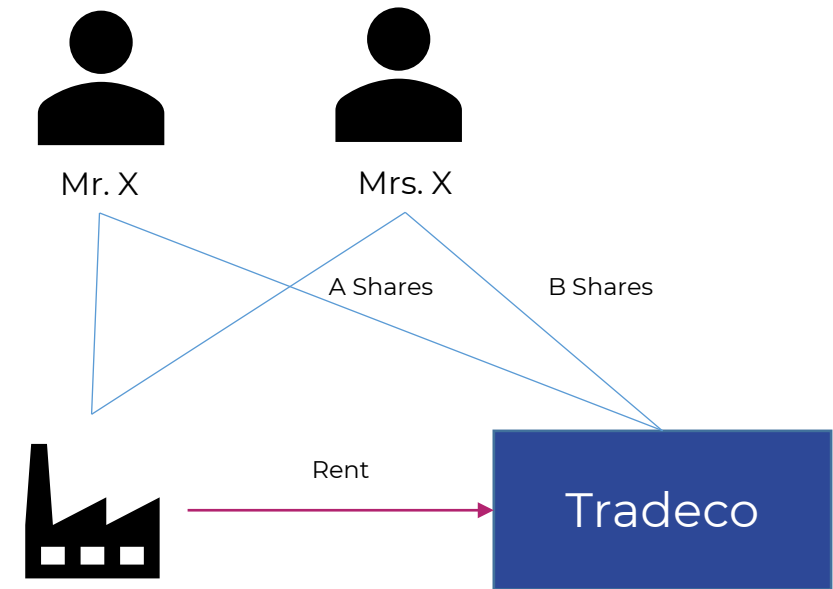
	2022	2023 PRE BUDGET	2023 POST BUDGET	2024	CHANGE
	50,270	37,846	37,647	38,583	737
SALARY	100,000	66,689	65,869	67,426	737
	200,000	117,161	115,091	117,898	737
	50,270	44,647	44,763	44,865	218
SALARY / DIVIDENDS*	100,000	76,386	76,118	76,544	158
	200,000	131,359	130,192	131,485	126

* at same cost to company as salary

IMPACT ON REMUNERATION PLANNING

OPTIMAL STRATEGY FOR 2024
£98k for £100k cash

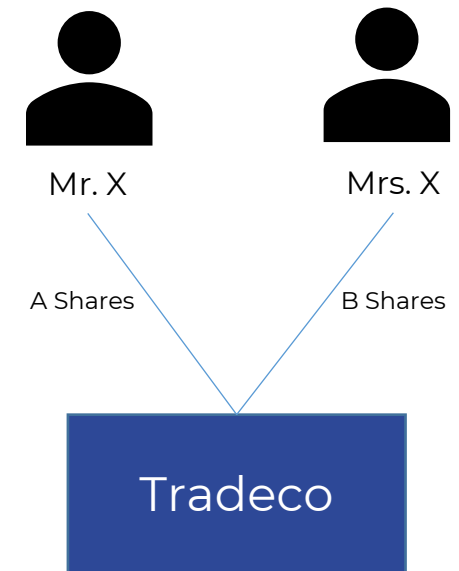
	Mr X	Mrs X	Company	
Salary	12,570	12,570	-25,140	
Rent	35,700	35,700	-71,400	
CT Saving			17,566	
Additional Dividend	2,000	2,000	-	4,000
	8,513	8,513	-	17,026
Less: Income Tax	-	9,550	-	9,550
Total	49,233	49,233	-	100,000
Take Home		98,466		



IMPACT ON REMUNERATION PLANNING

OPTIMAL STRATEGY FOR 2024
£98k for £100k cash

	Mr X	Mrs X		Company
Salary	12,570	12,570	-	25,140
CT Saving after NIC				4,000
Additional Dividend	2,000	2,000	-	4,000
	37,430	37,430	-	74,860
Less: Income Tax	- 3,240	- 3,240		
Total	48,760	48,760	-	100,000
	97,520			



SEIS – TAX EFFICIENT INVESTMENTS

Investment incentive to encourage individuals to invest money into new, riskier start-up companies.

KEY BENEFITS

- Income tax reduction - **50% of the amount invested.**
- Gains on disposals - **exempt from CGT**
- Reinvested gains exemption against 50% of the subscription
- Losses on disposals of SEIS shares are allowable for CGT purposes and **eligible for share loss relief.**
- SEIS investments should qualify for **IHT BPR after two years' ownership.**

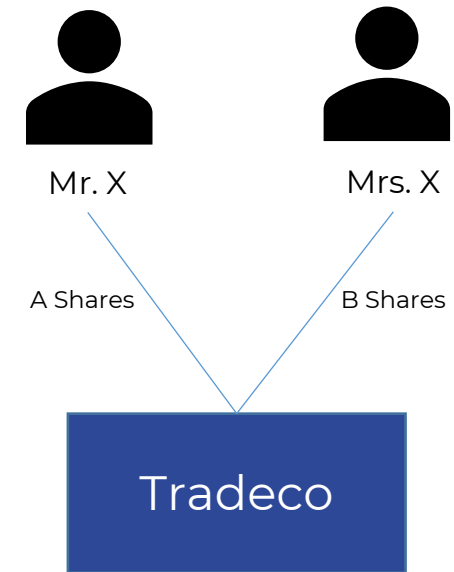
THE SEIS LIMITS HAVE INCREASED FROM APRIL 2023.

- Investor limit has been doubled to £200,000.
- Companies will be able to raise up to £250,000 - a two-thirds increase.

SEIS INVESTMENT PLANNING

OPTIMAL STRATEGY FOR 2024
£154k in wealth for £150k cash

	Mr X	Mrs X	Company	
Salary	12,570	12,570	-	25,140
CT Saving				4,000
Additional Dividend	2,000	2,000	-	4,000
	62,430	62,430	-	124,860
Less: Income Tax	- 11,365	- 11,365		
Less: SEIS	- 22,729	- 22,729		
Add: SEIS Relief	11,365	11,365		
Total	54,270	54,270	-	150,000
		108,541		
Asset Holding	22,729	22,729		



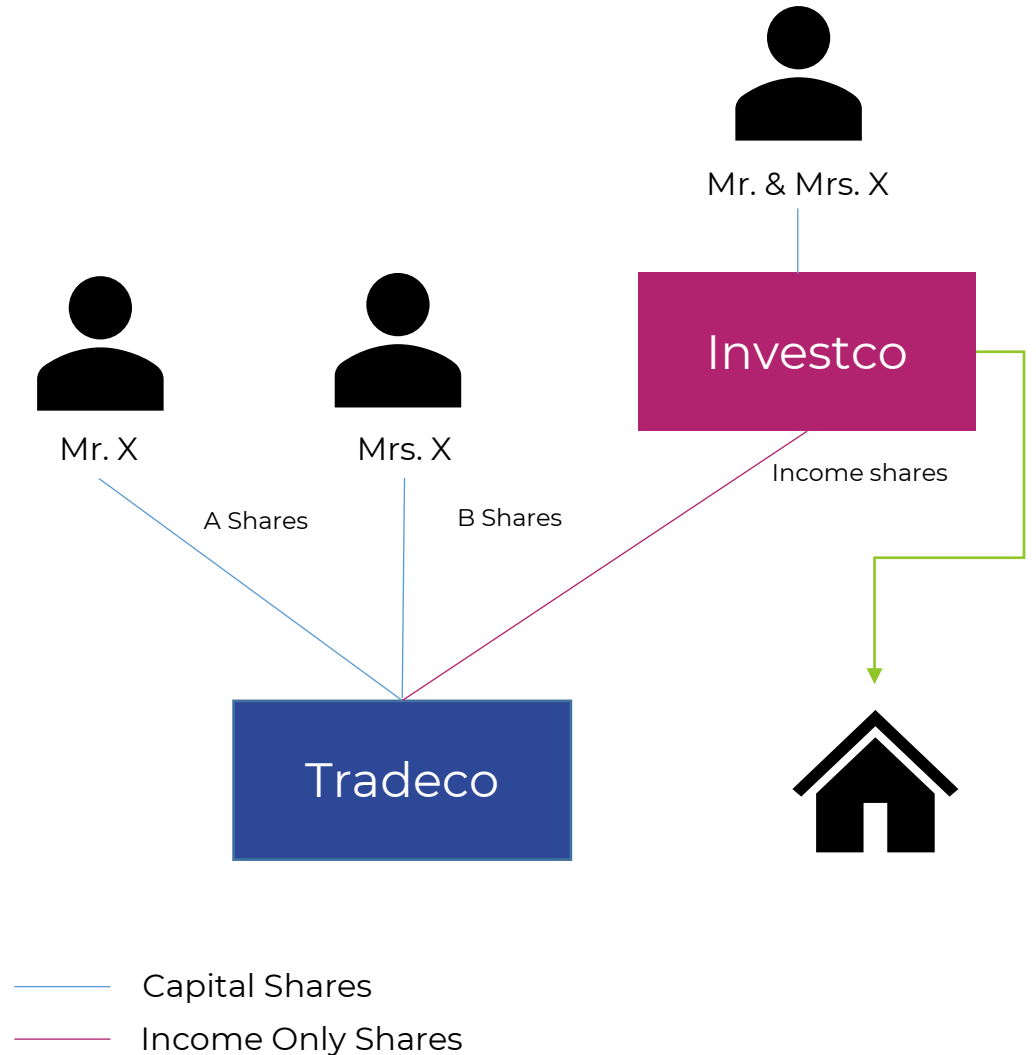
HYBRID OWNERSHIP STRUCTURE

KEY STEPS:

- Split shares into A, B and C Ordinary shares.
- C Ordinary shares = only income and voting rights.
- Investco acquires the C Ordinary shares in Tradeco.
- Dividends can be paid to Investco to fund future investment activity.

TAX IMPLICATIONS:

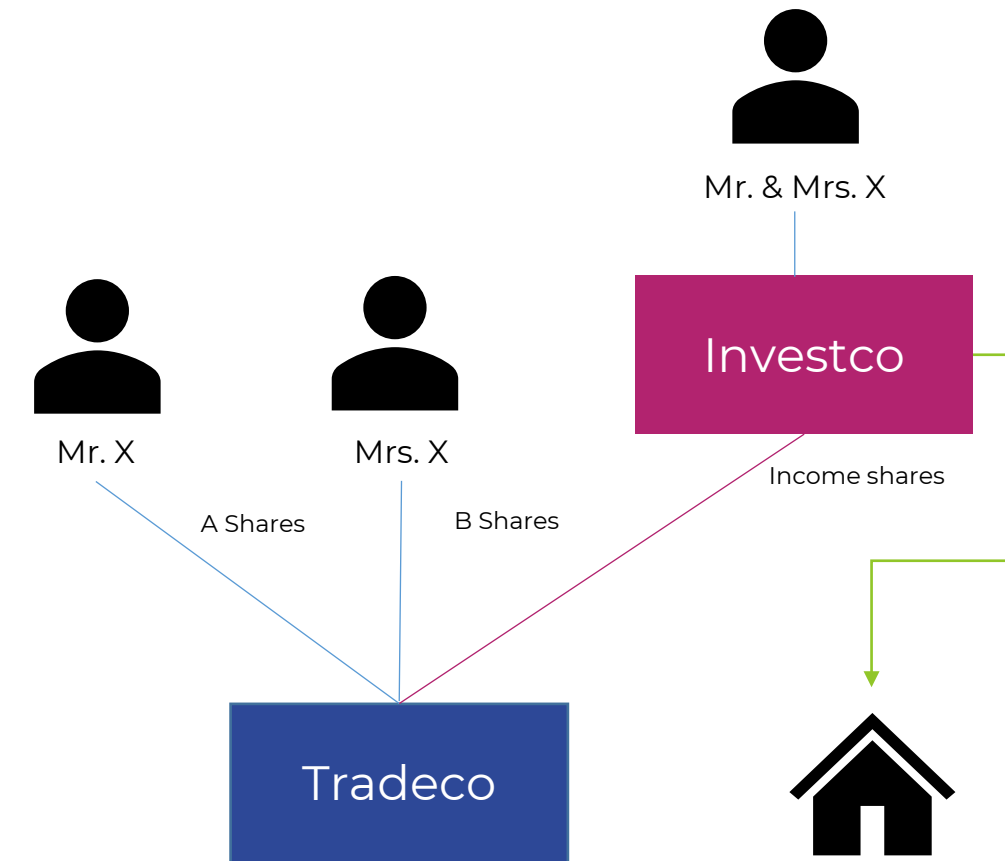
- + No tax charge on establishment.
- + No corporation tax on dividends received by Investco.
- + Tradeco remains “clean” – without investment assets.
BADR and BPR should remain.
- + **Tradeco can be sold personally by Mr & Mrs. X = cash realisation at 10% CGT rates.**



HYBRID OWNERSHIP STRUCTURE

	Mr X	Mrs X	Investco
Salary	12,570	12,570	
CT Saving			
Additional Dividend	2,000	2,000	200,000
	62,818	62,818	
Less: Income Tax	- 11,491	- 11,491	-
Less: SEIS	- 22,982	- 22,982	
Add: SEIS Relief	11,491	11,491	
Total Cash	54,406	54,406	
		108,813	
<u>Asset Holding</u>	<u>22,982</u>	<u>22,982</u>	<u>200,000</u>

Total cash extraction = £354,000
 Cash cost = £350,000
 Income Tax = £0



— Capital Shares
 — Income Only Shares

EMPLOYEE INCENTIVISATION

KEY HEADLINES

PROVIDING SHARES TO EMPLOYEES

WHAT ARE THE IMPLICATIONS?



Company issues shares for free to an employee



Employee subject to income tax on market value of the shares



For listed companies or where “trading arrangements” exist, PAYE/ NIC would be due

Assuming the shares have a market value of £100k, providing these as a gift to an employee could result in an income tax charge on the employee of **£45k**.



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WHAT ARE THE ALTERNATIVES?

OPTIONS

EMI OPTIONS

CSOP OPTIONS

Grant/ exercise of options	No Tax / NIC	No Tax / NIC
Vesting conditions	Yes	Yes
Dilution of equity	Yes	Yes
Payment of dividends	No	No
Sale of shares	CGT - BADR	CGT
Limit	£250,000	£60,000

SHARES

ORDINARY SHARES

GROWTH SHARES

Grant of Shares	Tax / NIC	No Tax / NIC
Forfeiture restrictions	Yes	Yes
Dilution of equity	Yes	No
Payment of dividends	Yes	Yes
Sale of shares	CGT - BADR	CGT
Limit	n/a	n/a



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EMPLOYEE INCENTIVISATION

COMPANY SHARE OPTION PLAN (“CSOP”) LIMITS HAVE INCREASED

From April 2023, qualifying companies will be able to issue up to £60,000 of CSOP options to employees, double the current £30,000 limit.

- Beneficial if company does not qualify under the EMI scheme/outgrown the EMI limits.
- PLCs and larger companies already granting options under a CSOP can benefit from £60,000 limit, allowing these companies to offer larger awards to employees.

KEY ADVANTAGES OF SHARE OPTION SCHEMES

ADVANTAGES OF SHARE OPTION SCHEMES

There are several tax advantages from implementing share scheme for both employers and employees:

TAX ADVANTAGES FOR THE EMPLOYER:

- **Corporation tax deduction** equivalent to the difference between amount paid by the employee and the market value.
- **Tax relief** on the set up and administrative costs can be deducted to reduce the taxable profits of a company for corporation tax purposes.

TAX ADVANTAGES FOR THE EMPLOYEE:

- **No Income tax and National insurance** is payable upon the grant or exercise of qualifying options;
- When the employee sells the options, there will be **capital gains tax due**. Employees may benefit from Business asset disposal relief (BADR) to reduced the CGT rate to 10% from 20%.
 - **EMI holders should automatically** qualify if held the options for 2 years
 - CSOP holders will need meet usual conditions – i.e. **hold at least 5%**.

IR35 Changes

IR35 off-payroll working rules introduced in 2017 and 2021 to be repealed from April 2023.

- **Simplifies rules for businesses** – Income tax/NIC risk transferred back to worker
- **IR35 has not been repealed** - but means workers will once again be responsible for determining their employment status and paying the appropriate amount of tax and national insurance contributions.
- **Contracts should still be reviewed** - to protect worker interests

CORPORATION TAX

KEY HEADLINES

CORPORATION TAX MAIN HEADLINES

- Planned increase in corporation tax has been scrapped. **Rates will now remain at 19%.**
- **Annual investment allowance of £1 million** will be made permanent.
- **Super Deduction remains up to 31 March 2023**
 - 130% deduction for qualifying expenditure on new plant and machinery
 - Effective 25% corporation tax relief
 - Accelerate capital expenditure to make use of super deduction before 31 March 23
 - Make acquisitions through trading companies rather than holding companies
- **R&D changes effective for accounting periods commencing April 23**



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PAYE CAP – SME SCHEME

For accounting periods commencing on or after 1 April 2021. For 31 December year ends - FY22 will be the first year in which it applies.

PAYE Cap limits the amount of tax credit a company can receive at £20,000 + 3x PAYE & NIC for the accounting period.

- Credit < £20,000 = full credit available
- Any amount in excess of the cap is not lost – remains available as a loss for relief in usual way.

WHO IT AFFECTS:

- SME business with low or no payroll expenditure.
 - Typically software/construction industries - heavy reliance on subcontractors
- Planning to claim a payable R&D tax credit over £20,000.
- Recharging personnel costs between group entities.
- Subcontracting R&D work between related parties.
- Actively managing IP outside of the UK.

EXEMPTION:

An R&D tax credit claim will remain uncapped if:

1. The company's employees are creating / preparing to create IP; **and**
2. It does not spend more than 15% of its qualifying expenditure on subcontracting to or using employees of connected persons

REFOCUSING RELIEF TOWARDS INNOVATION

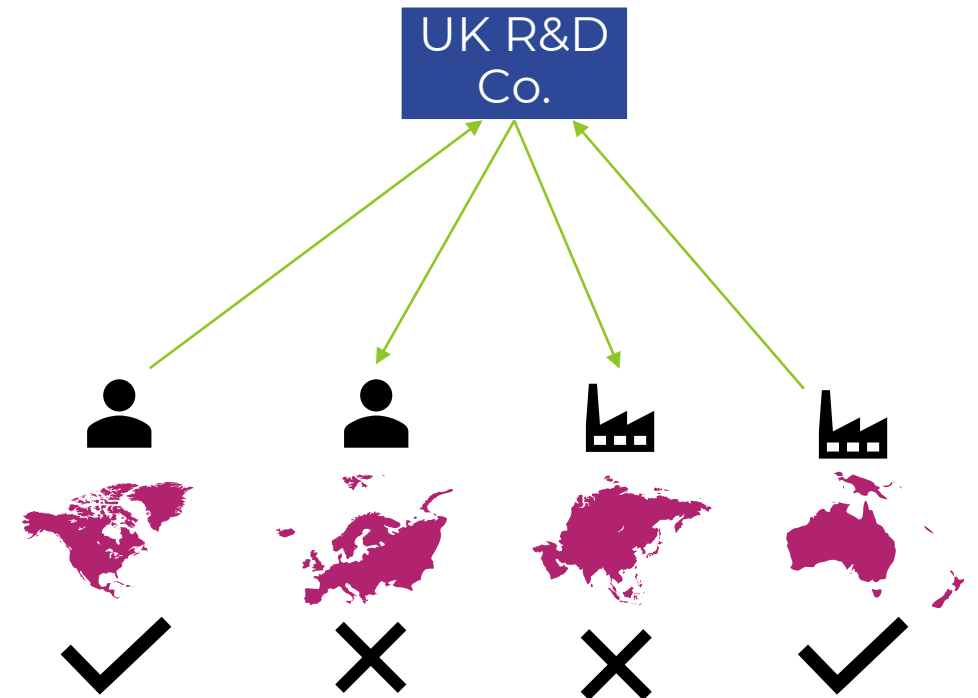
GREATER UK FOCUS

The Autumn Budget 21 announced changes for accounting periods commencing April 23:

Points to consider:

- Where companies subcontract R&D to a third party, they will in future only be able to claim relief for expenditure where the **third party performs the work in the UK.**
- Under both R&D schemes, where expenditure is incurred on externally provided workers (aka EPWs), they will only be able to claim relief where those workers are **paid through a UK payroll.**

This could significantly reduce the R&D tax credit claims for some businesses where, for example, they have overseas subsidiaries in key locations for specific labour markets.



ABUSE AND COMPLIANCE CONCERN

ABUSE OF CLAIMS AND COMPLIANCE MEASURES

Growing concern over abuse and boundary-pushing involving R&D tax reliefs.

HMRC's next steps to improve compliance include:

- All claims will have to be **made digitally**
- Digital claims will require more details – precisely what will be required is as yet unclear.
- Each claim to be **approved by a senior officer of the company**
- Companies will need to **inform HMRC, in advance**, that they plan to make a claim.
- Claims will need to include **details of the agent who has advised the company**

Not yet clear from the HMRC report when all these requirements are going to come into effect, but digital claim submissions will be put in place from April 2023.

- **R&D CLAIM SUSPENSION MEASURES**
- **FRAUD INVESTIGATIONS**
- **INCREASE IN ENQUIRIES**



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ENQUIRY LANDSCAPE

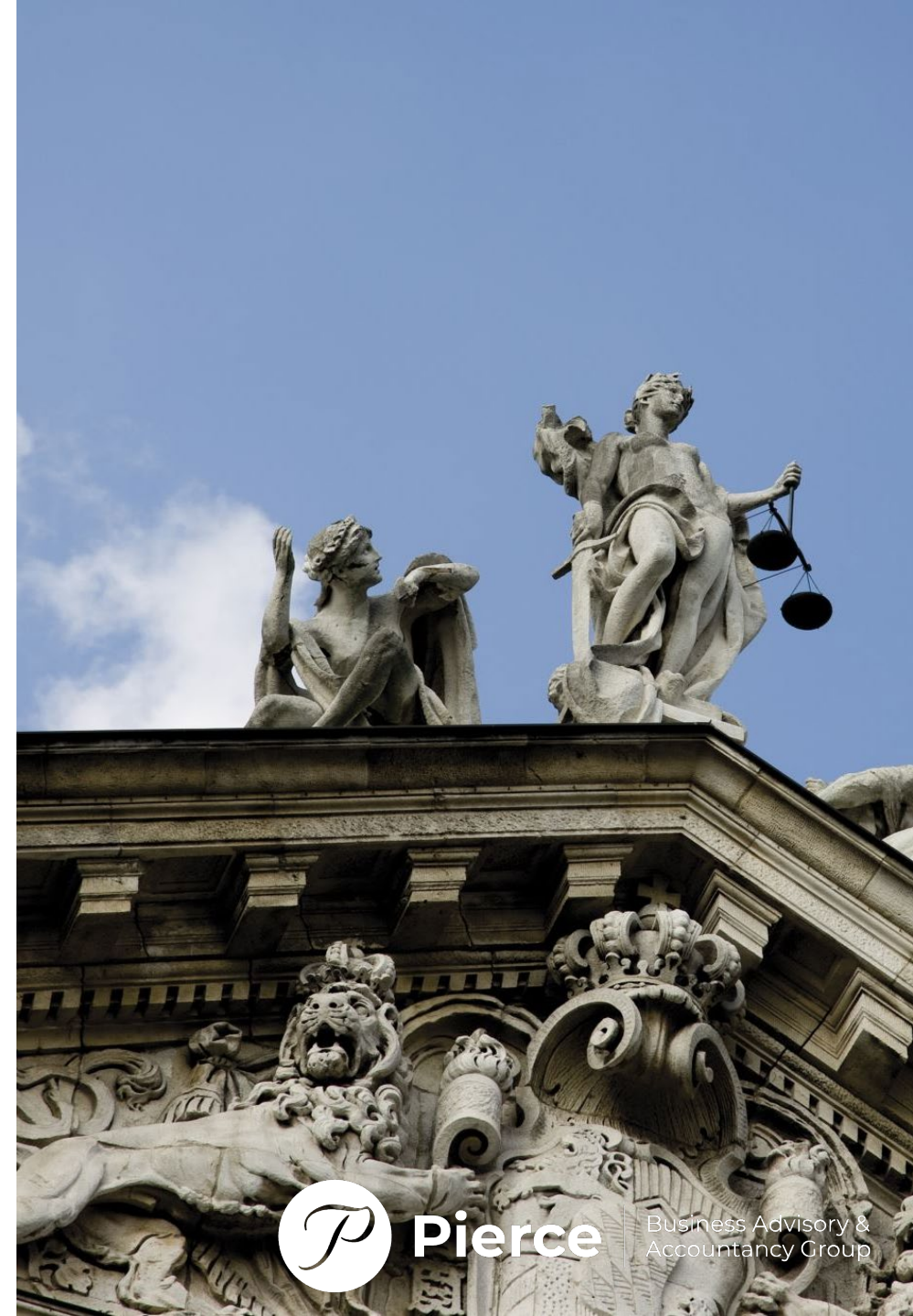
KEY THEMES

- Increase in number of enquiries by HMRC
- Scaling up of R&D enquiry team – expected to double.
- Willingness to pursue enquiries through the courts
- Number of convictions for fraud
- Enquiries launched after repayment

RECORD KEEPING

Retaining and cataloguing documentary evidence is critical:

- Support competent professional assertions
- Project timeline/milestones
- Activity documents – progress reports, meeting notes, sign off/authorisations
- Contracts with subcontractors
- Invoices/narratives – linked to projects



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INVESTMENT ZONES

To drive growth and unlock housing – Tax incentives for up to 10 years

- Accelerated tax relief on structures and buildings – 20%
- 100% allowances for plant and machinery
- Zero employer's NICs for new employees on salary up to £50,270
- No SDLT or business rates for newly occupied property

- Blackpool
- Greater Manchester
- Lancashire

Will this create new investment or simply attract from other areas?



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BUSINESS STRUCTURING

CAPITAL GAINS TAX LANDSCAPE



Buying and selling companies activity likely to slow down



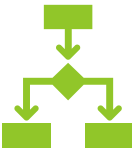
Hopefully will recover over next 12-24 months



Opportunity to review structure and medium-term plans



Shareholding between family members



Separate out non trading activities?



Family holding companies

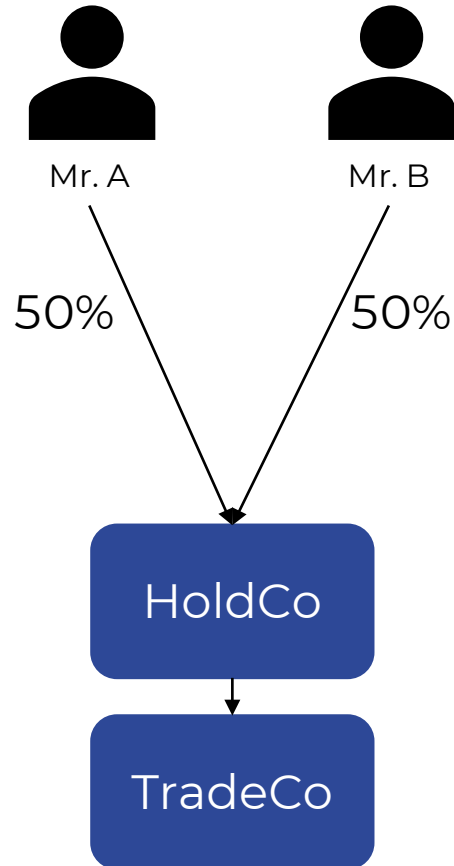


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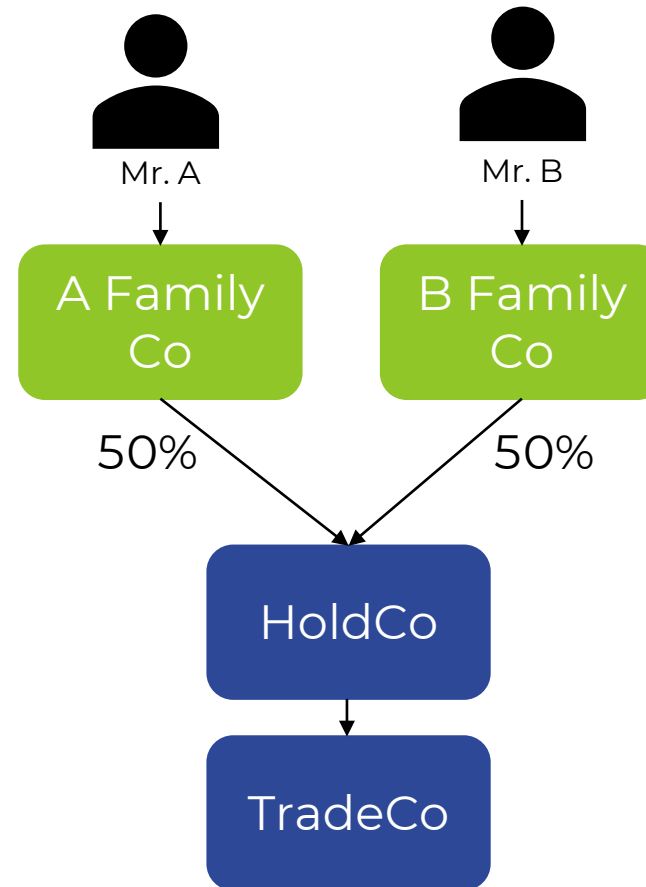
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FAMILY HOLDING COMPANIES

Before



After



BUSINESS ASSET DISPOSAL RELIEF

- Trading company or holding company of a trading group
- Shareholder must have held at least;
 - 5% Voting rights resulting in 5% of profits on winding up, and;
 - 5% of assets on a winding up, or;
 - At least 5% of the proceeds of sale of the whole company.
- Shareholder must be an officer or employee
- Rules to be satisfied for at least 24 months to the date of disposal

MAXIMISE RELIEF

- If shares likely to result in a gain of more than £1m consider transfer of some shares to spouse.
- Perhaps new class of shares with only 5% voting rights, rights to dividends. Capital rights could be greater than 5%
- Mr Williams owns 100% of Williams Engineering Ltd. Value of shares £1.8m
- Consider creation of new class of shares with 5% voting rights, rights to dividends, 45% capital rights.
- Transfer to Mrs Williams at least 24 months prior to sale. Ensure Mrs Williams is employed.

MAXIMISE RELIEF

- What if Mrs Williams already holds 5% of the share capital and is an officer or employee?
- Mr Williams could transfer shares to Mrs Williams immediately prior to sale
- Gifts to adult children should also be considered

“INTERNAL” SALES

- Family buyouts
- Flexible
- HMRC attitude changing
- Sale to an Employee Ownership Trust
 - Don't want to sell to 3rd party, risk of relocation, redundancies
 - Retain the business culture
 - Or simply the attraction of no CGT !!



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EMPLOYEE OWNERSHIP TRUSTS

- Allows majority shareholder(s) to exit the business by selling at least 51% of the share capital to an EOT.
- The purchase price is left outstanding as a debt owed by the EOT to the vendor shareholders.
- Existing reserves/future profits can be used to fund the purchase price.
- Alternatively EOT could obtain 3rd party financing

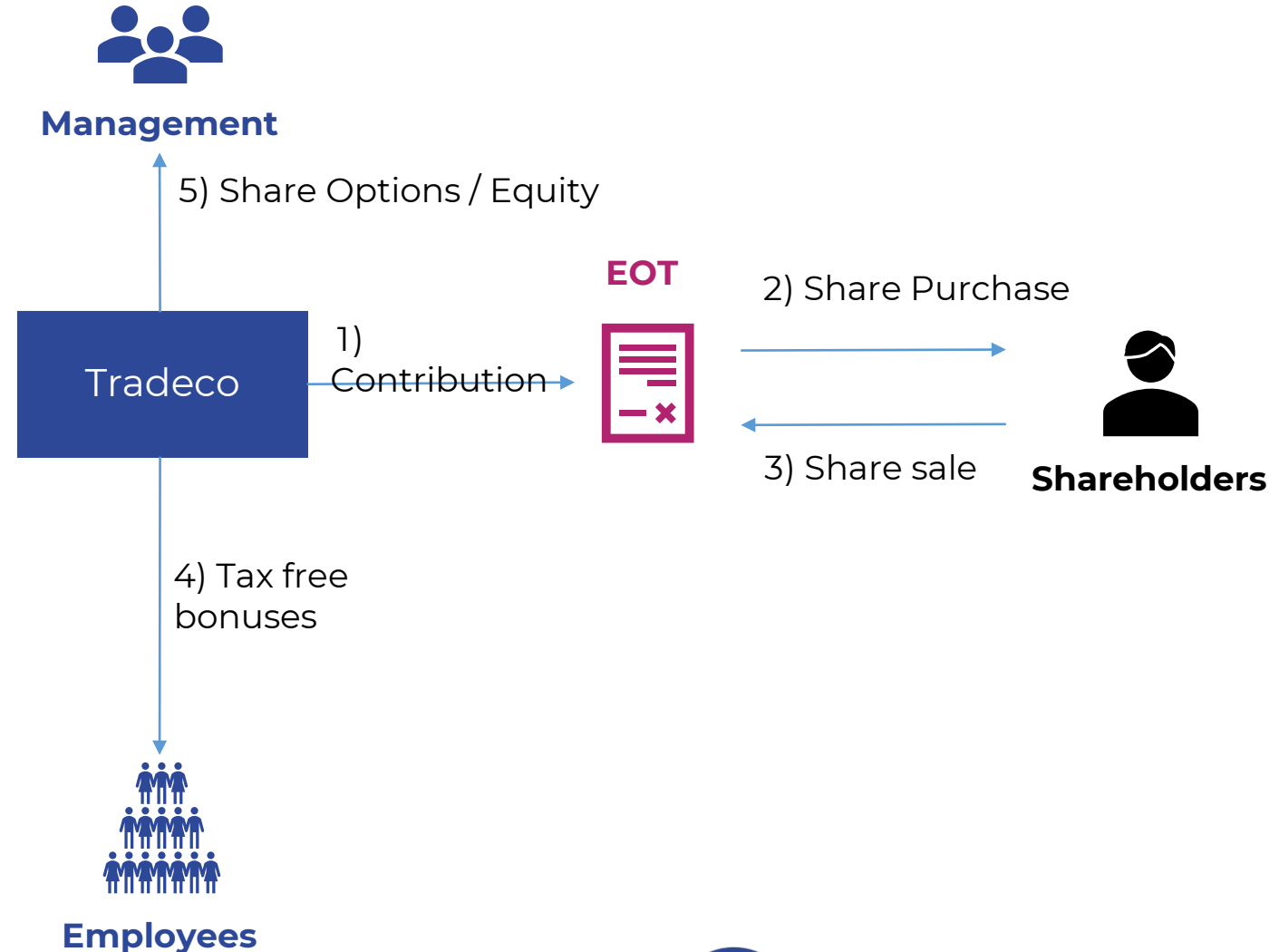
The key advantages of EOTs are:

- **No CGT for vendor shareholders** – tax efficient route to extract built up value
- Creates employee ownership structure to reward and incentivise staff
- Employees can **receive £3,600 bonus tax free** – although NIC still due
- There is an immediate purchaser for the trading company where previously the employees may not have had sufficient funds to acquire the business for an MBO
- Current shareholders **may remain as directors** and receive market rate salary

TYPICAL EOT STRUCTURE

KEY STEPS

1. Tradeco makes a contribution to EOT, alternatively EOT could borrow from third party lender.
2. The vendor receives initial day 1 cash for the share purchase.
3. Vendor sells a minimum of 51% of the equity in Tradeco.
4. Employees may receive tax free bonus of up to £3,600 per year.
5. Employees may be offered share options or equity as a wider/specific incentivisation package.



EOT IMPLEMENTATION

Sale to Employee Ownership Trust	
Valuation	Valuation based on independent valuation report and must provide EOT with a reasonable return on investment
Deal Structure	100% of deal value paid on completion or part deferred likely over a longer term
Funding for Deal	Funding on company's assets + Company's cashflow post completion
Legal protection for sellers on deferred payments	None – Selling Shareholders cannot take legal action against EOT for non-payment of deferred payments

Sale to Employee Ownership Trust	
Legal transaction	The following legal contracts/documents will need to be agreed: <ul style="list-style-type: none"> ▪ Share Purchase Agreement – including detailed warranties and indemnities ▪ Consultancy Contract for the directors involvement post sale ▪ Disclosure Letter – statement of what has been told the buyer, in particular any ongoing issues ▪ Shareholder/employee ownership agreements
Tax on sale of company shares	Capital Gains Tax (CGT) of 0% on entire consideration
Who runs the business post sale?	The existing management team overseen by the EOT board of trustees
(Assuming a majority or 100% share sale)	

EOT CONDITIONS

WHAT ARE THE QUALIFYING CONDITIONS WHICH MUST BE MET?

- **All employee benefit requirement:** all eligible employees should benefit from the EOT.
- **Equality requirement:** all eligible employees must benefit from the EOT on the same terms. This does not mean that all employees get equal amounts and it is possible to differentiate the size of awards by reference to remuneration, length of service and hours worked.
- **Controlling interest requirement:** the EOT must acquire and retain a “controlling interest” in the target company. i.e. more than 50% of the ordinary share capital.
- **Limited participator requirement:** broadly the number of people who are 5% shareholders and officers or employees of the company cannot exceed (40%) of the total number of employees of the company.
- **Trading requirement:** the company whose shares are being acquired by the EOT must be a trading company or the holding company of a trading company.

INHERITANCE TAX

- Rising tax take – more taxpayers being caught due to frozen allowances
- More reason to place trading company shares into trusts?
 - Particularly where gain not eligible for BADR
 - Where vendor would wish to gift proceeds post sale
- Investment companies
 - Growth Shares
 - Transfer up to £650k of value every 7 years
- Consider use of Family Investment Companies
- Wills to be reviewed
- LPA's in place?
- Inheritance Tax insurance



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THE ONLY CONSTANT IS CHANGE

- Review business structures
- Retain and incentivise key individuals
- Protect assets where possible
- Plan for sale / succession / pension / death





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