

The Darling Duds of October

The 2007 pre budget report certainly caused a stir on 9th October. This was Alistair Darling's first announcement as the new chancellor and my partner David Convisser summarises the major changes on page 3 of this edition.

The change that has caused the largest number of calls to me was the decision to radically reform Capital Gains Tax. The well known indexation relief (frozen in April 1998) and replaced by taper relief are all swept away for disposals of assets occurring on or after 6th April 2008 along with the distinction between business and non-business assets. In it's place we have a flat rate of 18% tax on the difference between cost (including enhancements) and the net proceeds of sale. From a tax practitioners point of view this is welcome simplification but for the taxpayer there are winners and losers.

Which category you fall into depends on the nature of the asset you hold. Business assets previously had their gains reduced by 75% after two years ownership giving a top rate of tax at 10% - this was very popular amongst our commercial property landlord clients as the relief extended to their properties with unquoted trading tenants in situ. For non-business assets such as buy to let properties the gain was reduced by 40%, but only after 10 years ownership giving a minimum effective rate of 24%. These alterations in tax law will undoubtedly cause behavioural changes in investment markets as a more short-term view is taken on non-business assets.

However this brings me on to the key point of this article - so many have called suggesting that if they buy a property (and it could be any capital asset such as an antique) and they sell this after say 8 months then any profit will only be taxed at 18%. Now this would be true if we were dealing with the disposal of an asset held as an investment. What happens if that asset were held for the purposes of a trading venture?

A brief history lesson. There was no such thing as Capital Gains Tax

("CGT") until the 6th April 1965 when it was first introduced. Prior to then the Inland Revenue had to show that a transaction was an 'adventure in the nature of trade' before they could extract any tax. If the taxpayer could show he had a 'capital gain' then no tax was payable. Now most of you can probably guess where I am going with this! Those days are back again but now the Inland Revenue will be arguing for a trading transaction to collect income tax at 40% (and normally a further 1% National Insurance) rather than a measly 18% CGT.

My favourite case on this subject was decided on 8th March 1929 when a canny Scottish businessman by the name of Mr Rutledge managed to buy a million toilet rolls from Germany and sold them in the UK at a large profit. One has to admire his gall in arguing that this was a capital gain from an isolated 'one-off' transaction so no tax was due. The Judge said in deciding tax was due from a trade that "It is no doubt true that the question whether a particular adventure is 'in the nature of trade' or not must depend on its character and circumstances, but if—as in the present case—the purchase is made for no purpose except that of re-sale at a profit, there seems little difficulty in arriving at the conclusion that the deal was 'in the nature of trade,' though it may be wholly

insufficient to constitute by itself a trade."

So we have to look at all the facts surrounding a transaction to decide if it is an adventure in the nature of trade.

The 1986 case of Marson v Morton summarised 'The Badges of Trade'. If these are exhibited by a transaction then you know you are likely to be regarded as a trader so don't be too disappointed when HMRC tells you that 18% is not the correct rate of tax. The badges were comprehensively summarised in the case as follows:

- (1) That the transaction in question was a one-off transaction. Although a one-off transaction is in law capable of being an adventure in the nature of trade, obviously the lack of repetition is a pointer which indicates there might not here be trade but something else.
- (2) Is the transaction in question in some way related to the trade which the taxpayer otherwise carries on? For example, a one-off purchase of silver cutlery by a general dealer is much more likely to be a trade transaction than such a purchase by a retired colonel.
- (3) The nature of the subject matter may be a valuable pointer. Was the transaction in a commodity of a kind

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Review of the GE ISA portfolio

The last 12 months have proved to be a remarkable period for equity investment. More recently, the relatively calm spring months gave way to a sharp sell off in July as investors began to reassess the risk inherent within the global financial system. The key to understanding these events lies with the benign credit conditions that had helped fund the boom in global asset prices over the past three years. The low interest rate environment eased access to credit for many individuals with poor credit ratings. However, it became increasingly apparent that if interest rates were to rise many banks could be at risk from defaults and the collateral on which loans were secured could also fall in value.

This process has been most pronounced in the US where rising interest rates and falling house prices have resulted in profit warnings from a number of specialist sub-prime mortgage lenders and the near bankruptcy of industry leader Countrywide. In the UK banks became increasingly reluctant to renew credit lines, leading to a withdrawal of liquidity, a hoarding of funds and an increase in overnight funding rates. For institutions such as Northern Rock this meant higher costs in borrowing from the money markets and limited access to funds.

Although initially insulated from these events, equity investors began to feel the full impact towards the end of July. Markets fell sharply

Cautious Portfolio:	Balanced Portfolio:	Growth Portfolio:
Performance (31/10/06 to 31/10/07): +5.01%	Performance (31/10/06 to 31/10/07): +8.02%	Performance(31/10/06 to 31/10/07): 7.85%
Apcims Income: +3.7	Apcims Balanced: +6%	Apicms Growth: 7.8%

through early August, hitting a low point on the 16th before recovering as concerted central bank action pumped significant amounts of liquidity into the overnight money markets.

Volatility has subsequently continued with the US Federal Reserve compelled to cut the Fed funds rate by 75bp over the past couple of months and continue to provide liquidity as the market's lender of last resort. As a consequence equity markets have recovered much of their poise, reflecting investors' hopes that the Fed's proactive measures would prevent the US economy from slipping into recession and impacting global growth elsewhere.

Against this tough backdrop we have been successful, through our in-house fund research process, to select funds that deliver above average returns. Below I have shown the performance of the 3 models under which your PEP / ISA are managed versus the relevant benchmark:

Outlook

The future course of financial markets will be dictated by the extent of the slowdown in the Anglo Saxon economies and by its timing. A slowdown in the growth of developed economies should to a large extent be compensated for by the continued expansion of the emerging nations.

Developed stock markets are discounting this slowing of growth as they currently trade on valuations modest by historic standards. But it should be remembered that the bull-run enjoyed by all global equity markets is now in its fifth year and as such is at a mature stage.

The volatility which has characterised the last quarter looks set to continue as the full effect of the sub-prime crisis works through the financial system.

Sanjay Rijhsinghani - UBS

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which is normally the subject matter of trade and which can only be turned to advantage by realisation. For example, a large bulk of whisky or toilet paper is essentially a subject matter of trade, not of enjoyment.

(4) In some cases attention has been paid to the way in which the transaction was carried through: was it carried through in a way typical of the trade in a commodity of that nature?

(5) What was the source of finance of the transaction? If the money was borrowed that is some pointer towards an intention to buy the item with a view to its resale in the short term: a fair pointer towards trade.

(6) Was the item which was purchased resold as it stood or was work done on it or relating to it for the purposes of resale? For example, the purchase of second-hand machinery which was repaired or improved before resale. If there was such work done, that is again a pointer towards the transaction being in the nature of trade.

(7) Was the item purchased resold in one lot as it was bought, or was it broken down into saleable lots? If it was broken down it is again some indication that it was a trading transaction, the purchase

being with a view to resale at profit by doing something in relation to the object bought.

(8) What were the purchasers' intentions as to resale at the time of purchase? If there was an intention to hold the object indefinitely, albeit with an intention to make a capital profit at the end of the day, that is a pointer towards a pure investment as opposed to a trading deal. On the other hand, if before the contract of purchase is made a contract for resale is already in place, that is a very strong pointer towards a trading deal rather than an investment. Similarly, an intention to resell in the short term rather than the long term is some indication against concluding that the transaction was by way of investment rather than by way of a deal. However, as far as I can see, this is in no sense decisive by itself.

(9) Did the item purchased either provide enjoyment for the purchaser (for example, a picture) or pride of possession or produce income pending resale? If it did, then that may indicate an intention to buy either for personal satisfaction or to invest for income yield, rather than do a deal purely for the purpose of making a profit on the turn. If there is no income produced or pride of purchase pending resale, that is a strong pointer in favour of it being a trade rather than an investment.

I emphasise again that the matters I have mentioned are not a comprehensive list and no single item is in any way decisive. I believe that in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question – and for this purpose it is no bad thing to go back to the words of the statute – was this an adventure in the nature of trade? In some cases perhaps more homely language might be appropriate by asking the question, was the taxpayer investing the money or was he doing a deal?"

So there you have it property dealers and investors – cut the above summary out and frame on your wall – I have a feeling you may be referring to this again and again when deciding what the correct tax rate is for your latest disposal.

Watch for future updates on CGT in Genie. There does seem a chance that the Chancellor may give some additional relief to disposals of business assets because after all a 80% tax hike on a sector that Gordon Brown spent 10 years befriendng seems very harsh and appears to be collateral damage from the bombing of the Private Equity industry.

Colin Burns

Pre-budget report

The Pre-Budget Report on 9th October contained a number of major changes and surprises. The new provisions are subject to change in the Spring Budget and the Finance Act 2008 and this article will concentrate on arguably the two most important changes, namely Capital Gains Tax and the Residence and Domicile Review.

Capital Gains Tax

As mentioned in the lead article, with effect from 6th April, 2008, all gains made by individuals on disposals of assets will be taxed at a flat CGT rate of 18% regardless of how long the asset has been owned. Both business asset and non business asset taper relief will be withdrawn, together with indexation relief on assets held before the taper relief rules were introduced with effect from 6th April, 1998.

Under the present rules, business asset taper relief, which applies amongst others to shareholders of unlisted trading companies and landlords of commercial property occupied by unlisted trading businesses, reduces the effective rate of tax for higher rate taxpayers to 10% after 2 years. Non-business asset taper relief reduces the effective rate to 24% after 10 years.

The abolition of business asset taper relief will hit entrepreneurs and employee shareholders hard as it will almost double the amount of tax they pay when they sell their shares. It will also hit people who have already disposed of their companies, but who have deferred payment of CGT by exchanging their shares for shares or loan notes. Taxpayers in this position will want to consider realising gains in the current tax year to secure the lower tax rate.

By contrast, investors who hold non-business assets, such as quoted shares, investment company shares, second homes and buy to lets will benefit from an immediate reduction in their tax rate from 6th April, 2008 and may want to consider delaying any disposals until after 5th April, 2008.

However the withdrawal of indexation allowance will affect persons who acquired assets before March 1998. They will face an immediate increase in their chargeable gains and taxpayers in this position will want to carefully compare the tax charge before and after 6th April, 2008, to decide the optimal timing of a disposal.

It is interesting to compare the pre taper relief position and the post taper relief position by looking at a gain arising on the sale of a commercial property let to a trading company. In the example below, the loss of indexation relief and taper relief increases the tax by 108.8% by delaying a disposal until after 5th April, 2008.

Non-U.K. Domiciliaries

U.K. residents who are not domiciled in the U.K. can currently claim the remittance basis of taxation i.e. they pay income tax and capital gains tax in the U.K. in respect of foreign income and gains only to the extent that they are remitted to the U.K. capital. Capital losses on foreign assets are never allowed even if the proceeds are remitted.

The new rules will introduce a flat rate charge so that individuals seeking to use the remittance basis after they have been resident in the U.K. for seven years will have to pay an additional charge of £30,000 per annum. These individuals will also no longer be entitled to claim income tax personal allowances. An individual who elects not to claim the remittance basis will pay income tax and capital gains tax on an arising basis on their worldwide income and gains. For individuals already resident in the U.K. the seven year period will

already have started running although the additional tax will only be payable from 6th April, 2008.

Individuals who have been resident in the U.K. for longer than ten years may become liable to a greater additional annual charge and further consultation is taking place in this regard.

Changes are also being introduced from 6th April, 2008, to prevent taxpayers from relying on a loophole enabling them to make tax free remittances of income and to reduce the scope for the



alienation of income and gains through the use of offshore structures, such as companies and trust which convert taxable income and gains into non-taxable payments.

Residence

Under the current rules, an individual will be resident in the U.K. if he spends a sufficient number of days in the U.K. Previous HMRC practice was to ignore days of arrival and departure when calculating the number of days present in the UK. From 6th April, 2008, days of arrival and departure will be counted as days present in the UK for this purpose.

Further details of the above changes and draft legislation will be published in due course and it is important that you speak to your normal contact at Gerald Edelman if you consider that you may be affected by any of these changes.

David Convisser

	1998/99 Pre-Taper relief	2007/08 Taper relief	2008/09 Post-Taper relief
Cost of property	50,000	50,000	50,000
Indexation say	40,000	40,000	-
Sale Proceeds	90,000 340,000	90,000 340,000	50,000 340,000
Less: Retirement relief	250,000 (250,000)	250,000 N/A	290,000 N/A
Assessable Gain	£-	£250,000	£290,000
Tax Payable (assuming annual exemption used elsewhere)	£ Nil	£25,000	£52,200

A WELL TRIED TAX SAVING SCHEME

A long-standing method of reducing liability to Inheritance Tax is the 'back-to-back' arrangement whereby money is invested in an annuity which produces an income (part of which is free of Income Tax) which is used to pay the premiums on a life policy which is held in trust for the investor's beneficiaries, thus taking the value outside the investor's estate.

The purchase of the annuity reduces the investor's taxable estate by the amount invested (thus potentially saving 40% tax) and it is the premiums on the life policy which are regarded as gifts for the purposes of Inheritance Tax. However, these will normally be exempt because of the annual £3,000 exemption and the exemption for gifts out of income. The overall scheme, therefore, is extremely tax-efficient.

The main condition imposed by the Revenue is that the two parts of the transaction – the purchase of the annuity and the purchase of the life policy – should not be directly connected. Each must be bought independently on the open market, and the arrangement could fall down if for example the two insurance companies were members of the same group or if one were insuring the other's risks. Taking expert advice is essential.

Graham Thomas

AIM NOMADS

If they have not already, companies quoted on AIM will soon find that Nominated Advisers (Nomads) are taking a more active role in monitoring compliance following changes to the AIM laws that were brought in earlier this year.

The London Stock Exchange (LSE), earlier in 2007, introduced to the AIM laws, new rules for Nomads. These changes were brought in together with other changes to the AIM laws, most notably the introduction of a requirement for all AIM quoted companies to maintain corporate websites on which certain information is to be made available.

Previously, a Nomad was responsible to the LSE under the AIM laws for assessing the suitability of a company wishing to apply to have their shares quoted on AIM. However, the new rules organise these responsibilities in a clearer manner in which the eligibility criteria, ongoing obligations and disciplinary procedures that apply to Nomads are set out.

The changes were brought in primarily in order to improve the quality of Nomads in general and assuring that such organisations have the appropriate experience and number of qualified staff relevant for their role.

New Responsibilities

The key elements of the new rules are set out on a schedule which describes how the Nomad firm needs to assess the appropriateness of the AIM applicants. Their specific and ongoing tasks and responsibilities include the following:-

- Maintaining regular contact with the AIM company to ensure that the company continues to understand its obligations under the AIM rules.
- Ensuring that the Nomad keeps up to date with developments of the company.

- Reviewing in advance all notifications made by the AIM company for which the Nomad acts.
- Monitoring the trading activity of the AIM company's shares, particularly in cases where the Nomad is aware of unpublished price-sensitive information.
- Advising the AIM company on any proposed changes to the Board of Directors.

In addition to these tasks and responsibilities, the Nomad is formally obliged to notify the LSE of such matters. Furthermore, if a Nomad believes there has been, or could be, a breach of the rules for either the Nomad or the company then again notification needs to be made to the LSE.

Summary

Whilst the new rules are generally considered to reflect what should already be best practice by most Nomads, the changes formalise and make explicit what the LSE expects from the Nomads.

Consequently, the new rules are not expected to impact significantly on the management of AIM quoted companies but clearly some companies may see their Nomads take a more active role in monitoring their compliance to the AIM rules.

It is certainly the intention and expectation of the LSE that the new rules will help to ensure that the quality of Nomads is at an appropriate level without (hopefully) over burdening Nomads or their AIM quoted clients.

Richard Kleiner



Retention of title – are you covered?

By Bernard Hoffman

The laws surrounding retention of title are complex, and thus often result in unsuccessful claims.

Retention of title (or reservation of title) has been a contentious issue for many years when customers go into insolvent liquidation.

Proving your retention of title claim

The majority of suppliers' terms and conditions of trade contain clauses that attempt to retain ownership of the goods supplied until payment was made in full. Suppliers are required to provide copies of their retention of title terms and conditions, as well as evidence proving that these were communicated to, and accepted by, the customer at the time the agreement was drawn up.

While most retention of title clauses are well worded, they will be invalid if only communicated to a company at the time, or after, the goods are delivered (i.e. post – contract).

The Suppliers will lose their entitlement if they fail to ensure that their retention of title clauses were accepted when they entered into the business relationship with the customer.

Perfecting your retention of title clause

With a little care, retention of title claims can be perfected and suppliers may be happily reunited with their stock. The following points should be considered.

- The best – worded clause is worth nothing unless you can prove that it was accepted by your customer prior to contracting.
- The most successful retention of title claims, and those that can be processed the quickest, are where the supplier is able to provide a copy of its terms and conditions, signed by the insolvent company, when the agreement was made or subsequently modified.

Retention of title remains a complex area of business law and companies could save themselves time and money by ensuring that theirs is watertight. Our recovery team can assist by reviewing your retention of title procedures and advising on the likely success of a claim in an insolvency situation.

If you require any further assistance please contact our Business Recovery team and speak to either Bernard Hoffman or Ian Yerrill.

A PRACTICAL GUIDE TO BEING “DEAL-READY”

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Imagine the following:-

Your business is running smoothly, targets and forecast are being met and you are confident of your market position. Your team are empowered and fully aware of the aspirations and visions for the business. It therefore seems the right time to move up a gear and take the next strategic step in the corporate development of the business. This is likely to involve some sort of transaction be it acquisition, merger or even the sale of the business. It may also involve the introduction of some fresh capital, possibly through private equity investors or venture capitalists or indeed a flotation.

Any of the above transactions will mean a substantial amount of extra and unfamiliar activity rather than business as usual. This article aims to provide a practical guide for managers and business owners who may need now or in the future to get their organisation “deal-ready”.

The top ten issues

1. Planning, plan well

- Start planning now – the whole process is a race against time and even if a deal is envisaged well into the future the best rule is to start planning now;
- Keep people informed but day-job focussed – planning early brings its own risks particularly as the lure of a potential “deal” will inevitably distract attention from the day to day operations. However, the worst thing is to say nothing not least because people will always notice changes in any event and individual imaginations can run wild;
- Planning on a macro and a micro scale:

Macro-planning concerns matters such as what the likely obstacles to obtaining the vision and effecting the transaction will be. A review needs to be made as to how the business needs to be changed in the interim period. For example, if the aim is a trade sale, is three or five years time a realistic target given the growth prospects? Or is it that the business is too small or too low profile to attract sufficient trade buyers, in which case growth will be more important and networking and undertaking joint ventures will also be an important consideration.

Micro-planning addresses such matters as when in the year would be a good time to do the deal. For example, if profits are mostly made in a particular quarter then you may want investors or potential buyers to be engaged in the period immediately following the profit surge.

2. Ruthless prioritisation

Management time is finite so the secret to getting important things done is ruthless prioritisation. There are schools of thought that say it is important to put a specific financial value on the realisation of each item on a list, plus a probability rating. In this way effort and resources are focussed on the highest value aspects and most achievable tasks.

3. Communication

- This is a tricky issue. The dangers of alienating staff through over-secrecy or distracting them through too much information are important considerations of communication.
- The issue of the timing of any announcement within the company is something that should be carefully considered and clearly key personnel and management who will be staying with the business following the transaction will need to be briefed (even if on a confidential basis).
- In the case of quoted companies both the Stock Exchange and the AIM market have confidentiality requirements and rules about share dealing in the period ahead of any announcement of a deal. It is important that all directors (and their associates) are familiar with such rules and requirements.
- When planning the deal the following questions will need to be asked:-
 - Who will be effected (e.g. customers, suppliers, shareholders, personnel) and
 - What do they need to be told

4. Select a good team and work together

This is an area where lessons can be learned from the private equity sector who acknowledge the importance of a good team when deciding where to invest. Such a team does not depend purely on technical skills and managerial due diligence but should pay attention to the following:-

- Bedding down the team - whatever the makeup of the team it needs to be at top strength when a deal is planned. Any new team (even an established one where a single new member has been added) must go through the stages of being formed, members jostled for position, rules and pecking order are established and finally performance is coherent and well managed.
- Chemistry – chemistry between team members should not be ignored and it is important that the team should contain the right mix of “big picture”, focussed strategic thinkers and “day-to-day detail” and operational people.
- Technical abilities – clearly these cannot be ignored.
- Getting rid of dead wood – whether in terms of technical ability or personality any weak team member who is not contributing at the right level will need to have their position considered carefully.
- Restructuring the board – board composition is another consideration particularly in the case of a flotation or

where outside investors are being brought in.

5. Have a data room, not a black hole

One of the commonest shortcomings of companies preparing to do a deal is a poor control of the relevant data. It is absolutely crucial to have a single, reliable version of the key data and financials in one place.

The tradition is for a growing company to consider sales and marketing before financing and human resources but this attitude does not impress potential investors or trade buyers whose sights are set on the next three to five years. These outsiders will want to see that the requisite infrastructure to support the business is in place and having key data at the fingertips of the company will be a reflection on the quality of the business and of its internal processes.

6. Getting information out of heads, into systems and procedures

It is important to ensure that the business has integrated its “knowledge into systems and procedures rather than leaving it in the heads of employees and senior management. It is inevitable that the headcount of employees will change post the transaction and clearly skills and know-how can be important considerations for a trade buyer or an investor. If there are areas where any one employee has expertise then it is vital that that knowledge is documented and systemised.

7. Remember the premium on performance management

It is important never to forget that potential partners, buyers or investors put a premium on businesses that show a strategy linked to the day-to-day activities. A company that makes regular forecasts and then hits or exceeds those targets and aligns its strategy with monthly measures such as key performance indicators (KPI's) can often attract a better price. At the very least, such a company is likely to find the deal process a much smoother affair.

8. Make the strategy live

Having the strategy focused should not be a one off exercise for the purposes of preparing information for a deal but should live in daily operations. While the deal provides a good focus for setting objectives and making changes, the strategy-setting needs to be embedded in the business with the goals aligned via critical success factors, to performance measures.

9. Expect management “stretch”

As referred to earlier in this article, there will be a tendency to focus on the deal at the expense of day-to-day operations: certainly there will be very real demands on senior management's time. It is however vital to maintain everyday performance and consideration will need to be made of additional, temporary or secondment help to keep all bases covered.

10. Aiming beyond completion

Finally, depending upon the transaction it is important that you look beyond the deal itself. Any corporate finance adviser should stress the importance of having a post-deal “100 day action plan” in place from the very start. You should absolutely avoid trying to

Will the Revenue abide by The Queensberry Rules?

Four years on – who had the final say on the Arctic case? A very brief summary of the position so far...

In April 2003, H M Revenue & Customs – HMRC (or the Inland Revenue as it was then) issued a Tax Bulletin setting out their view on how the settlement legislation could apply where someone enters into an 'arrangement' to divert income to someone else to save tax where those arrangements are:

- bounteous; or
- non commercial; or
- not at arms length; or
- in the case of a gift between spouses (now including individuals in civil partnership) wholly or substantially a right to income.

Meanwhile, Mr and Mrs Jones (a husband and wife trading as Arctic Systems Ltd) had started fighting their case against HMRC. They were obliged to work through a limited company because of the business in which they were involved. A company was subsequently formed with each spouse acquiring one share for £1. Mr Jones was the only Director and a higher rate taxpayer by virtue of his dividend income.

Both Mr and Mrs Jones drew a small salary but for the years involved distributed income in the form of a dividend shared equally in accordance with the share capital. The majority of the fee earning work was undertaken by the husband but the wife did the book keeping and was also company secretary. HMRC were seeking to attribute all the dividend income to Mr Jones to enable them to claim further tax at the higher rate.

Round one

In an extraordinary hearing two Special Commissioners considered the facts of the case. There was an opposite opinion voiced by each but this was finally determined by the presiding Commissioner who had the casting vote and found in favour of HMRC..

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A practical guide to being 'deal-ready'

figure things out after the transaction has occurred particularly as in the first three months post-deal, people will have certain expectations and be more receptive of change so it is important to look early at where the business is going, how the vision and objectives can be obtained and work back from there to formulate your plan.

One last general point and a very important one is that many people tend to view completion of the deal as the "finish line". In fact, completion is actually the start of a whole new race.

Richard Kleiner

Round two

Undeterred, Mr and Mrs Jones took the matter to the High Court. The court was to decide whether there was an 'arrangement' and if legislation which specifically allowed gifts between spouses would stop HMRC applying the settlement legislation. Mr Justice Park found in favour of HMRC. He believed that Mrs Jones had acquired her share only to obtain a future dividend stream determined by her husband. The court also stated that the spouses exemption for outright gifts could not work where the 'property given is wholly or substantially a right to income'.

Round three

Mr and Mrs Jones would not let the matter rest and took their case to the Court of Appeal who concluded that no bounty existed where there was a normal commercial transaction between two adults to which each was making a normal commercial contribution. There was not deemed to be an 'arrangement' to divert income because there was no service agreement between the company and Mr Jones. The salaries drawn appeared to be dependent on how well the company did year-on-year. Similarly it was determined that a share could not be regarded as a gift wholly or substantially of a right to income because a share carries other rights. Round three to Mr and Mrs Jones - were HMRC ready to throw in the towel?.

Round four

No! – off to The House of Lords. The Lords decided that there was an 'arrangement' – the parties had intended an element of bounty and it was agreed that there was a gift. However, it had to be determined whether the transfer was wholly or substantially of a right to income. The judges concluded that a share had

other rights - 'property' given which consists of ordinary shares in a company between spouses (or between civil partners) will always attract an exemption. Final round to Mr and Mrs Jones - was this the knock out punch?

The future

No - the very next day- a Ministerial statement was released stating that legislation was being considered to reverse aspects of the final judgment.

The printing of this article has been delayed so that the comments in the press notice issued last month by H M Treasury and reactions to it could be considered. The Government will be consulting on draft legislation to take effect from 2008-09 to address the issue of "income shifting". It is stated that this "will seek to remove the tax advantage obtained from income shifting. It would apply when income is in the form of distributions from a company (dividends) or partnership profits. Income from employment, interest on savings and any other source will not be affected"

The usual questions are quite rightly being asked. Why should two people who are exposed to the risk of running a business not be entitled to a share of the reward? Why, if red tape is to be cut, is it necessary for further records to be kept of the contribution by each person? Is it really necessary to create a further level of legislation when we are being told that tax law is to be simplified? Is this government discouraging family run businesses? Why if a spouse or partner in civil partnership may be entitled to half the value of a business after separation is there going to be restriction in the share of profits whilst in marriage?

Will there be satisfactory answers to these and the numerous other questions now being asked - watch this space!

David Allis - Tax department



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Ajay Shah

Associate

Deval Patel

Consultants

Graham Thomas
Julian Fellerman
Michael Fialko

GERALD EDELMAN
Business Recovery Professionals

Partners

Ian Yerrill
Dave Murphy
(Other partners as above)

Consultant

Leslie Crowther

GERALD EDELMAN
WEALTH
MANAGEMENT LTD
Independent Financial Advisers

Directors

Michael Harris
Colin Burns
Richard Kleiner
Graham Thomas

Office Locations

25 Harley Street,
London W1G 9BR
+44 (0)20 7299 1400

Edelman House
1238 High Road,
London N20 0LH
+44 (0)20 8492 5600

Gateway House
High Point Business Village
Henwood, Ashford
Kent TN24 8DH
+44 (0)1233 666280

Unit 1, Warners Mill
Silks Way
Braintree, Essex
CM7 3GB
+44 (0)1376 569333

gmail@geraldedelman.com
www.geraldedelman.com