M&G wealth

Financial Planning essentials for Small businesses

This is just for UK advisers – it's not for use with clients

Les Cameron

Head of Technical

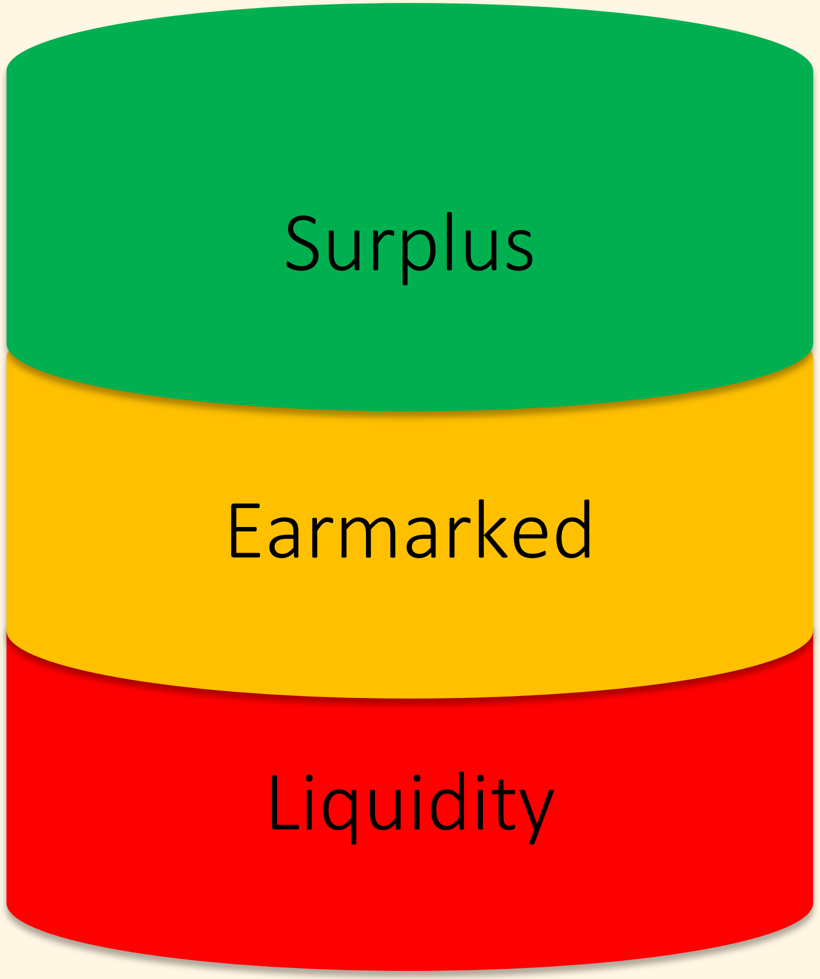
Learning Objectives

By the end of this session you will be able to:

Evaluate	Describe	Describe
The planning & advice considerations when advising business owners	The impact of profit extraction on individuals	The taxation impact of corporate investments

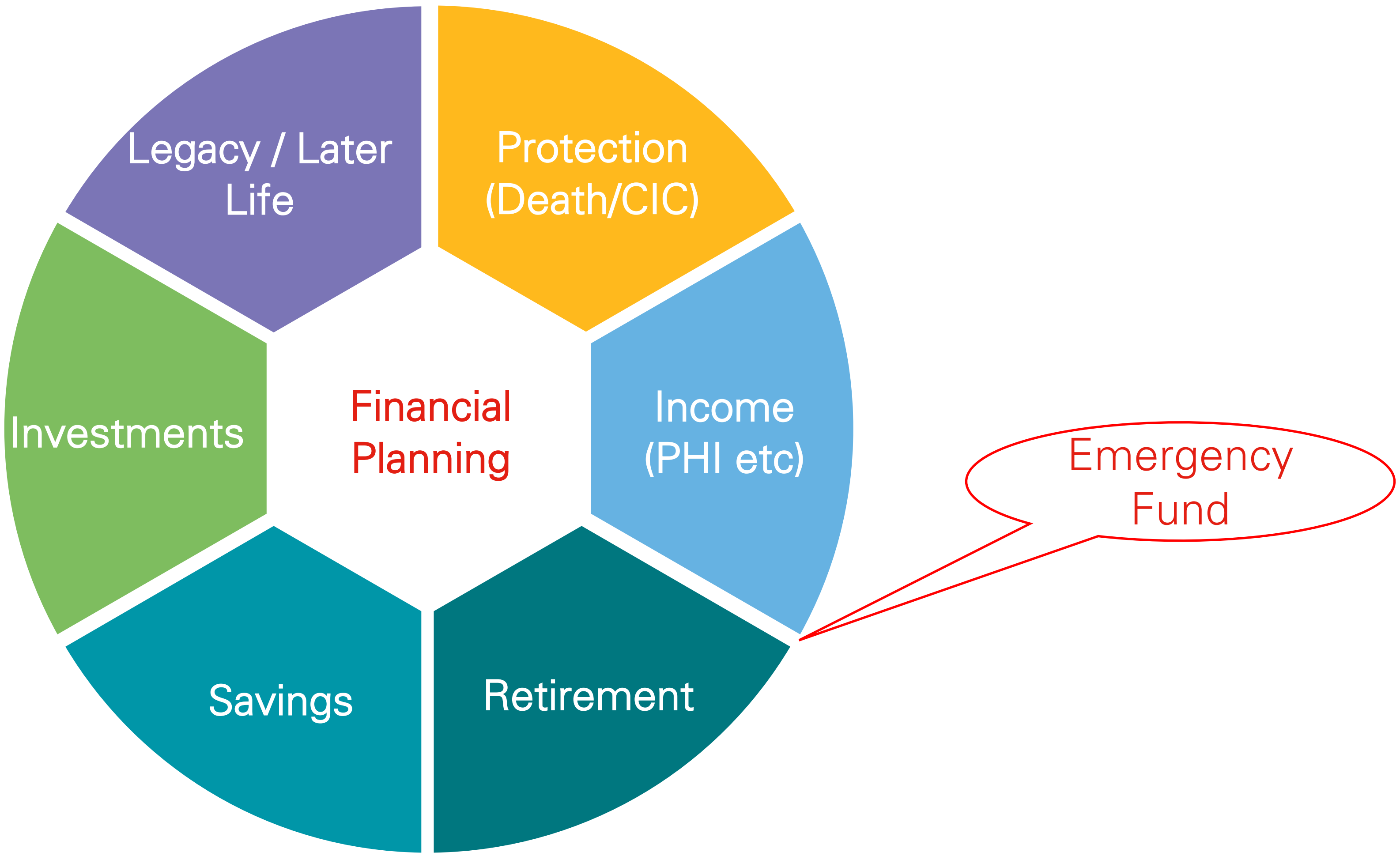
Cash problem?

Eroding value?



Not funding retirement?

Needs, gots and wants



Not funding retirement?

Planning Considerations

Spot the difference

"….my retirement is sorted out, I heard about this unlisted company no-one has heard of and bought up the shares with my SIPP, it'll definitely do well enough to cover my retirement and it's not too risky….."

No-one, ever, probably

"…..my business is my pension…."

Lots of people, definitely

Why is your business going to be your pension?

Value drivers

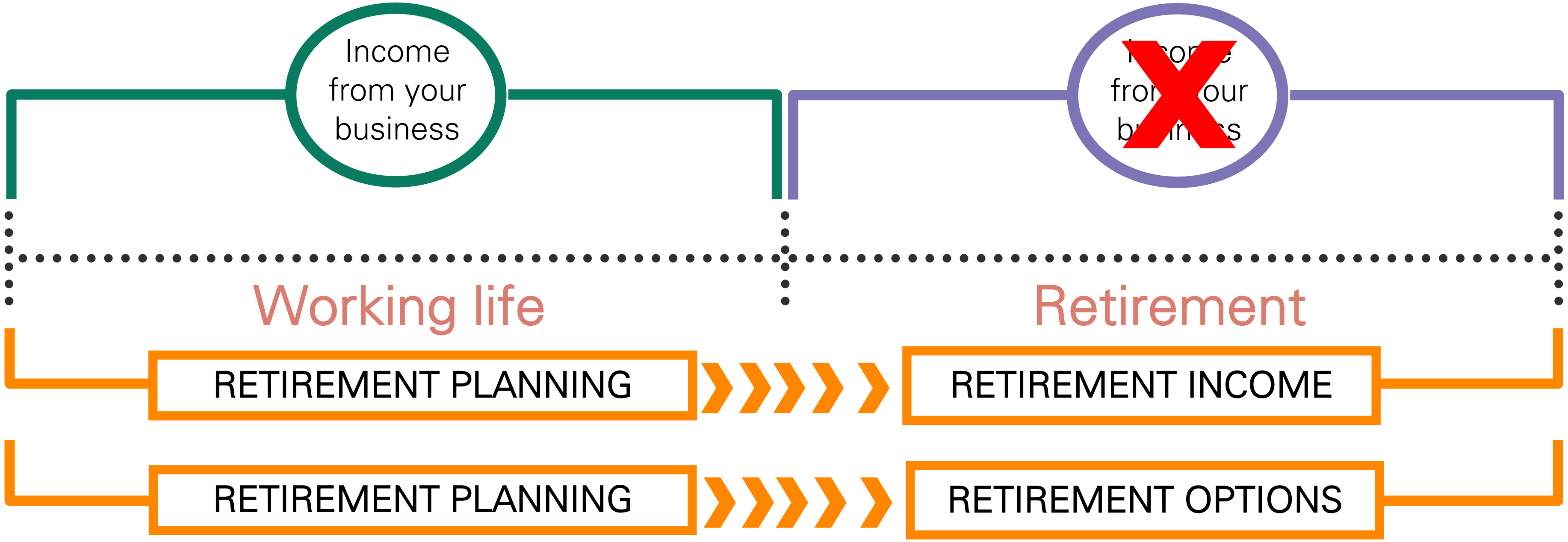
- Strong, growing profits
- Predictable revenues
- Non-reliance on owners
- Scalable products / services
- Little or no competition
- Strong brand
- Innovation
- Strong client base
- High value assets
- Low debt
- Good cash flow

Value blockers

- Timing
- Technology
- Economic cycle
- Availability of capital
- Buyers
- Health
- Tax
- Law / Regulation
- Owner departure!

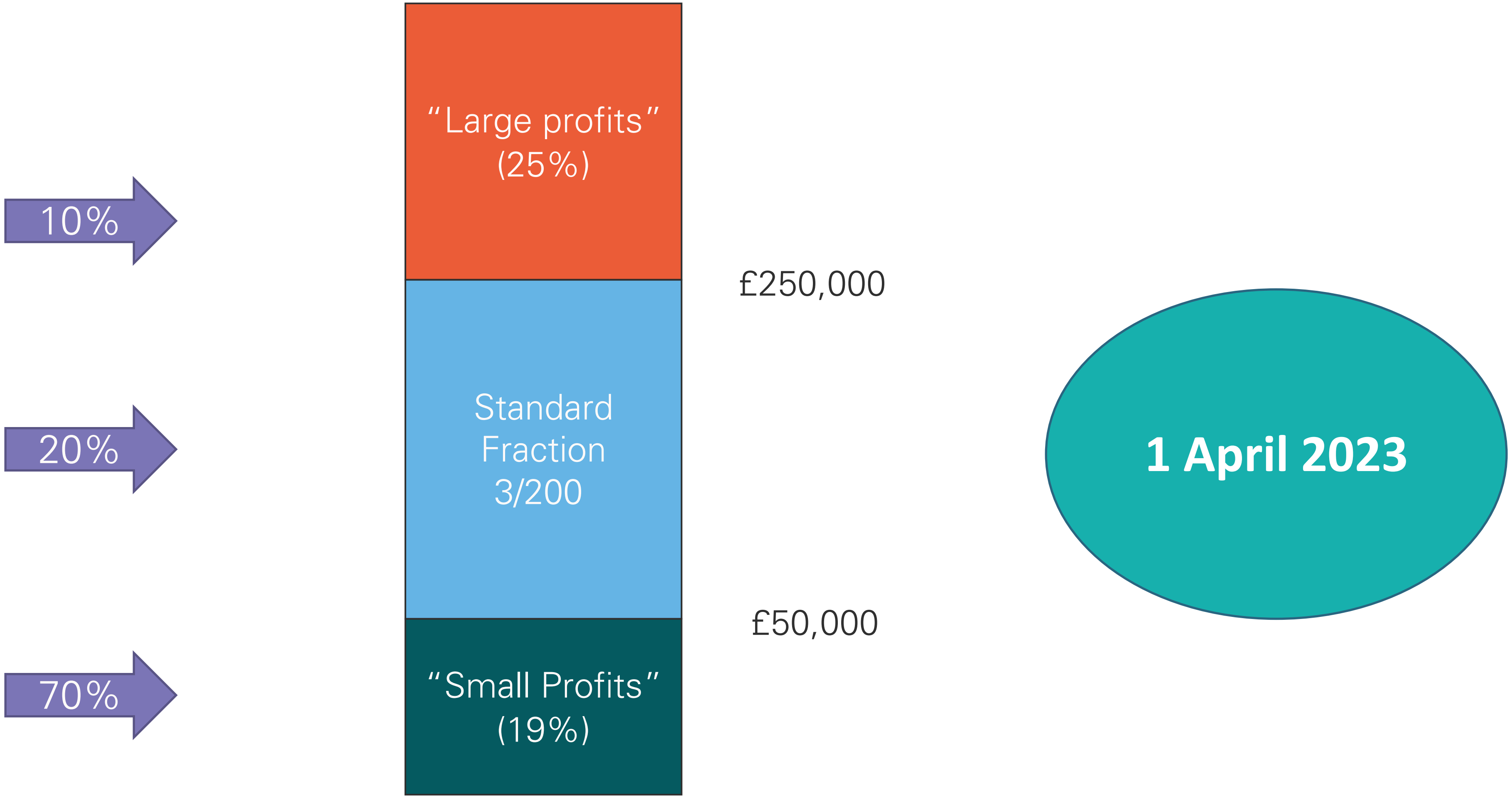
What might prevent you accessing the value of your business?

The challenge



Corporation Tax (wef April 2023)

Corporation Tax changes



Calculating corporation tax

Profit		£130,000
Corp Tax	25%	£32,500
Marginal relief	£250,000	
	<u>£130,000</u>	
3/200	£120,000	£1,800
	Tax due	£30,700
	Effective Rate	23.62%

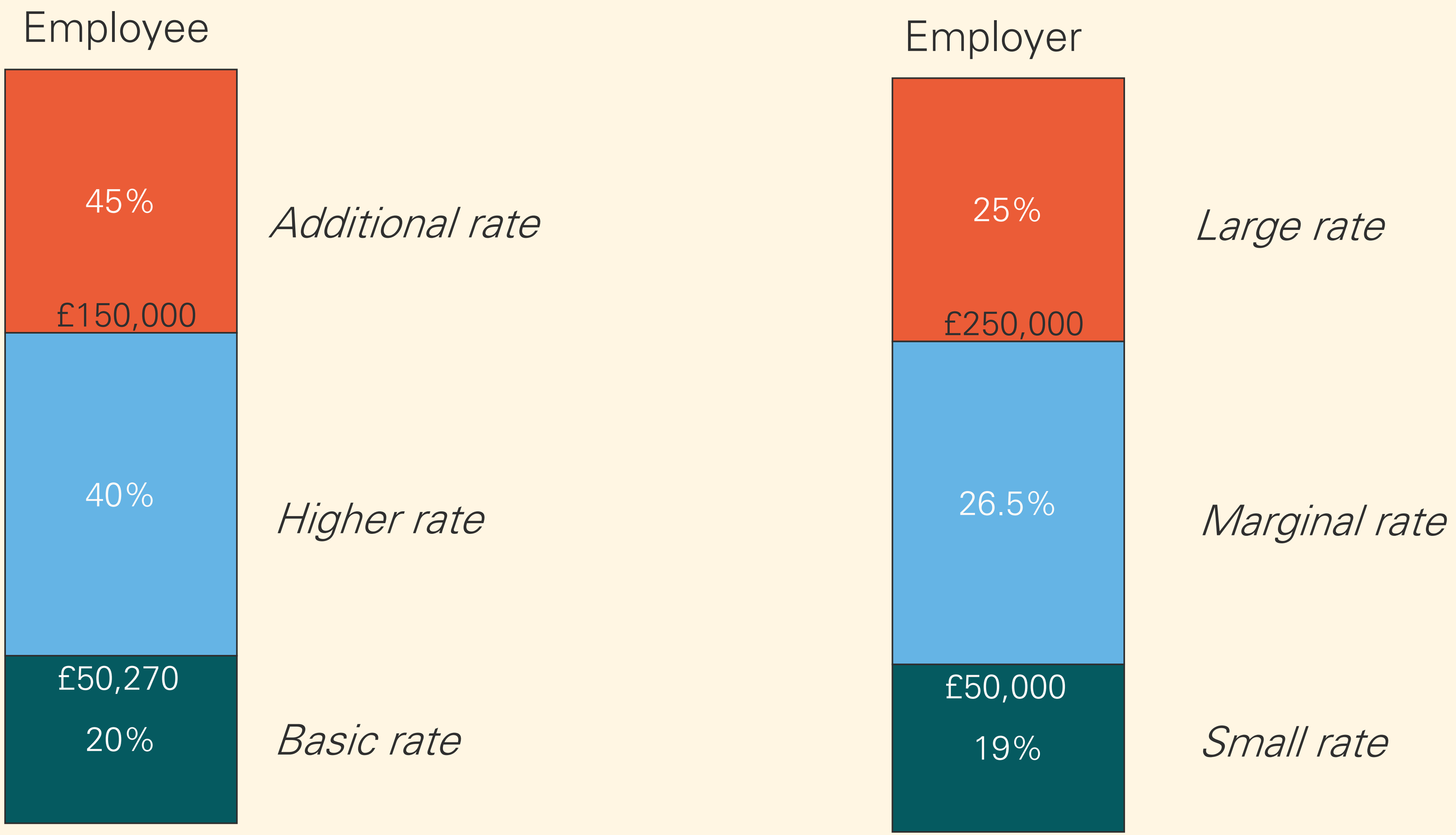
Effective rates

Profit	19%			26.5%			Total Tax	Effective Rate
£10,000	£10,000	19%	£1,900				£1,900	19.00%
£20,000	£20,000	19%	£3,800				£3,800	19.00%
£30,000	£30,000	19%	£5,700				£5,700	19.00%
£40,000	£40,000	19%	£7,600				£7,600	19.00%
£50,000	£50,000	19%	£9,500				£9,500	19.00%
£60,000	£50,000	19%	£9,500	£10,000	26.5%	£2,650	£12,150	20.25%
£70,000	£50,000	19%	£9,500	£20,000	26.5%	£5,300	£14,800	21.14%
£80,000	£50,000	19%	£9,500	£30,000	26.5%	£7,950	£17,450	21.81%
£90,000	£50,000	19%	£9,500	£40,000	26.5%	£10,600	£20,100	22.33%
£100,000	£50,000	19%	£9,500	£50,000	26.5%	£13,250	£22,750	22.75%
£110,000	£50,000	19%	£9,500	£60,000	26.5%	£15,900	£25,400	23.09%
£120,000	£50,000	19%	£9,500	£70,000	26.5%	£18,550	£28,050	23.38%
£130,000	£50,000	19%	£9,500	£80,000	26.5%	£21,200	£30,700	23.62%
£140,000	£50,000	19%	£9,500	£90,000	26.5%	£23,850	£33,350	23.82%
£150,000	£50,000	19%	£9,500	£100,000	26.5%	£26,500	£36,000	24.00%
£160,000	£50,000	19%	£9,500	£110,000	26.5%	£29,150	£38,650	24.16%
£170,000	£50,000	19%	£9,500	£120,000	26.5%	£31,800	£41,300	24.29%
£180,000	£50,000	19%	£9,500	£130,000	26.5%	£34,450	£43,950	24.42%
£190,000	£50,000	19%	£9,500	£140,000	26.5%	£37,100	£46,600	24.53%
£200,000	£50,000	19%	£9,500	£150,000	26.5%	£39,750	£49,250	24.63%
£210,000	£50,000	19%	£9,500	£160,000	26.5%	£42,400	£51,900	24.71%
£220,000	£50,000	19%	£9,500	£170,000	26.5%	£45,050	£54,550	24.80%
£230,000	£50,000	19%	£9,500	£180,000	26.5%	£47,700	£57,200	24.87%
£240,000	£50,000	19%	£9,500	£190,000	26.5%	£50,350	£59,850	24.94%
£250,000	£50,000	19%	£9,500	£200,000	26.5%	£53,000	£62,500	25.00%

Effective rates

Profit	19%			26.5%			Total Tax	Effective Rate
£10,000	£10,000	19%	£1,900				£1,900	19.00%
£20,000	£20,000	19%	£3,800				£3,800	19.00%
£30,000	£30,000	19%	£5,700				£5,700	19.00%
£40,000	£40,000	19%	£7,600				£7,600	19.00%
£50,000	£50,000	19%	£9,500				£9,500	19.00%
£60,000	£50,000	19%	£9,500	£10,000	26.5%	£2,650	£12,150	20.25%
£70,000	£50,000	19%	£9,500	£20,000	26.5%	£5,300	£14,800	21.14%
£80,000	£50,000	19%	£9,500	£30,000	26.5%	£7,950	£17,450	21.81%
£90,000	£50,000	19%	£9,500	£40,000	26.5%	£10,600	£20,100	22.33%
£100,000	£50,000	19%	£9,500	£50,000	26.5%	£13,250	£22,750	22.75%
£110,000	£50,000	19%	£9,500	£60,000	26.5%	£15,900	£25,400	23.09%
£120,000	£50,000	19%	£9,500	£70,000	26.5%	£18,550	£28,050	23.38%
Profit	**19%**			**26.5%**			**Total Tax**	**Effective Rate**
£130,000	**£50,000**	**19%**	**£9,500**	**£80,000**	**26.5%**	**£21,200**	**£30,700**	**23.62%**
£160,000	£50,000	19%	£9,500	£110,000	26.5%	£29,150	£38,650	24.16%
£170,000	£50,000	19%	£9,500	£120,000	26.5%	£31,800	£41,300	24.29%
£180,000	£50,000	19%	£9,500	£130,000	26.5%	£34,450	£43,950	24.42%
£190,000	£50,000	19%	£9,500	£140,000	26.5%	£37,100	£46,600	24.53%
£200,000	£50,000	19%	£9,500	£150,000	26.5%	£39,750	£49,250	24.63%
£210,000	£50,000	19%	£9,500	£160,000	26.5%	£42,400	£51,900	24.71%
£220,000	£50,000	19%	£9,500	£170,000	26.5%	£45,050	£54,550	24.80%
£230,000	£50,000	19%	£9,500	£180,000	26.5%	£47,700	£57,200	24.87%
£240,000	£50,000	19%	£9,500	£190,000	26.5%	£50,350	£59,850	24.94%
£250,000	£50,000	19%	£9,500	£200,000	26.5%	£53,000	£62,500	25.00%

Tax Relief

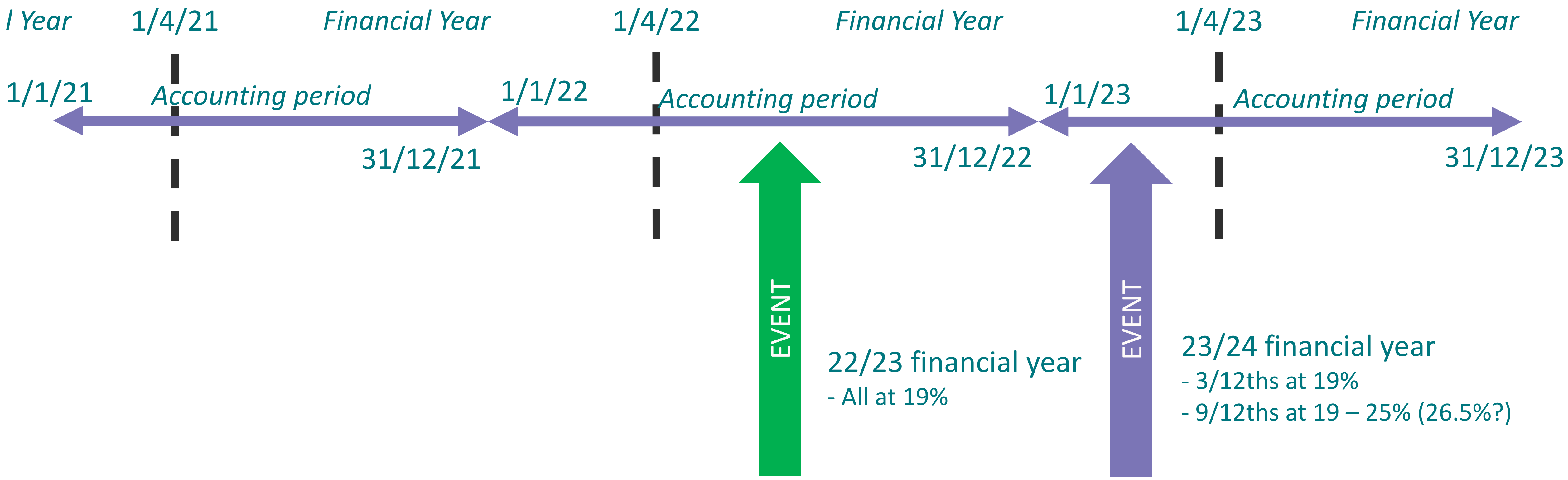

Employee
45%
Additional rate
£150,000
40%
Higher rate
£50,270
20%
Basic rate
Employer
25%
Large rate
£250,000
26.5%
Marginal rate
£50,000
19%
Small rate

Employer tax relief

Profit		£130,000		£120,000
Corp Tax	25%	£32,500	25%	£30,000
Marginal relief	£250,000		£250,000	
	<u>£130,000</u>		<u>£120,000</u>	
3/200	£120,000	£1,800	£130,000	£1,950
	Tax due	£30,700	Tax due	£28,050
	Effective Rate	23.62%	Effective Rate	23.38%

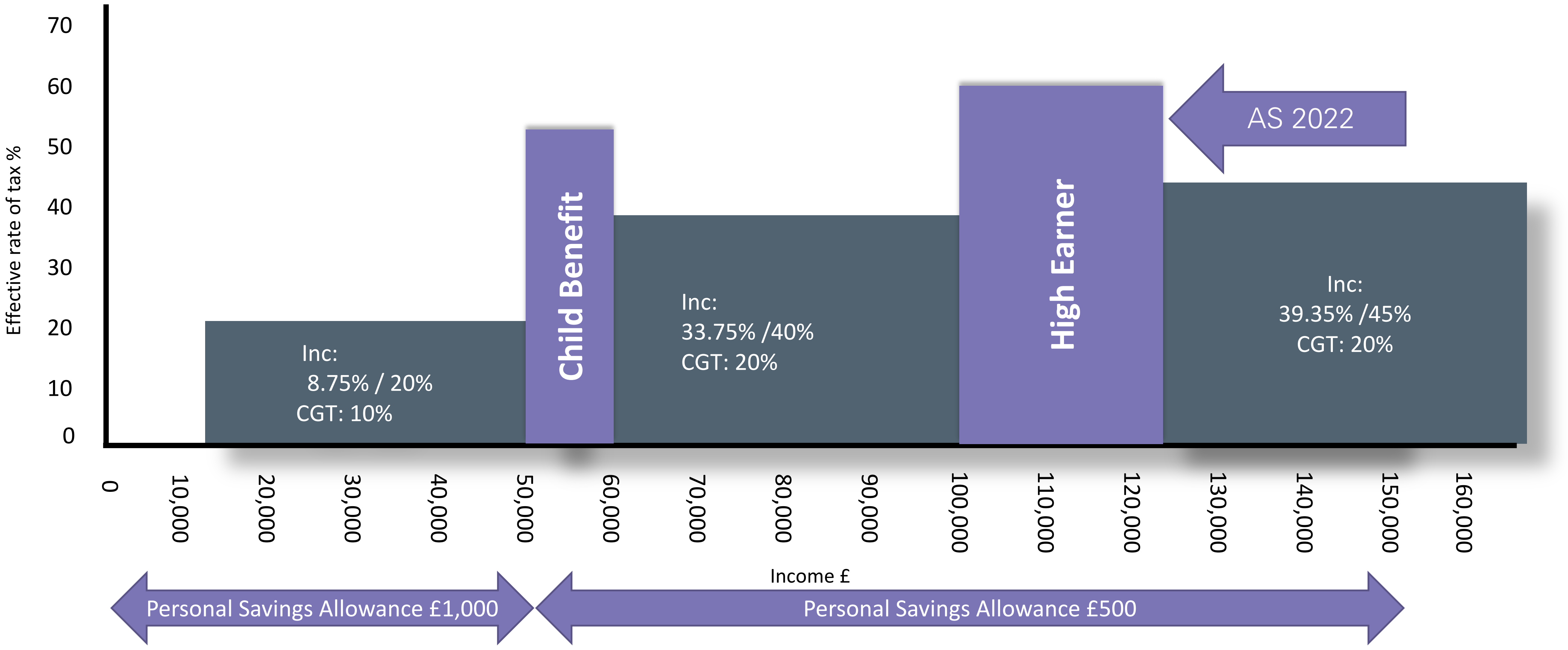
£30,700 – £28,050 = £2,650 / £10,000 = **26.5%**

The "years"


l Year
1/4/21
Financial Year
1/4/22
Financial Year
1/4/23
Financial Year
1/1/21
Accounting period
1/1/22
Accounting period
1/1/23
Accounting period
31/12/21
31/12/22
31/12/23
EVENT
EVENT
22/23 financial year
- All at 19%
23/24 financial year
- 3/12ths at 19%
- 9/12ths at 19 – 25% (26.5%?)

Individual Tax

UK Income Tax Landscape



The full amount of bond gains and interest and dividends are included at Step 1 of the UK income tax computation.

0%s

	2022/23	2023/24	2024/25
ANNUAL EXEMPT AMOUNT Capital gains only	£12,300	£6,000	£3,000
DIVIDEND NIL RATE Dividends only	£2,000	£1,000	£500
SAVINGS STARTING RATE / PERSONAL SAVINGS ALLOWANCE Interest and Bond Gains	£5,000 £1,000 / £500	£5,000 £1,000 / £500	£5,000 £1,000 / £500
PERSONAL ALLOWANCE Interest, Dividends and Bond Gains	£12,570	£12,570	£12,570
	£32,870 + Original Capital	£25,570 + Original Capital	£22,070 + Original Capital

The NI journey

	06/04/22	06/07/22	06/11/22	05/04/23
Above UEL (£50,270)	3.25%	3.25%	2.00%	
Primary Threshold	£9,880 13.25%	£12,570 13.25%	£12,570 12.00%	
Secondary Threshold	£9,100 15.05%	£9,100 15.05%	£9,100 13.80%	

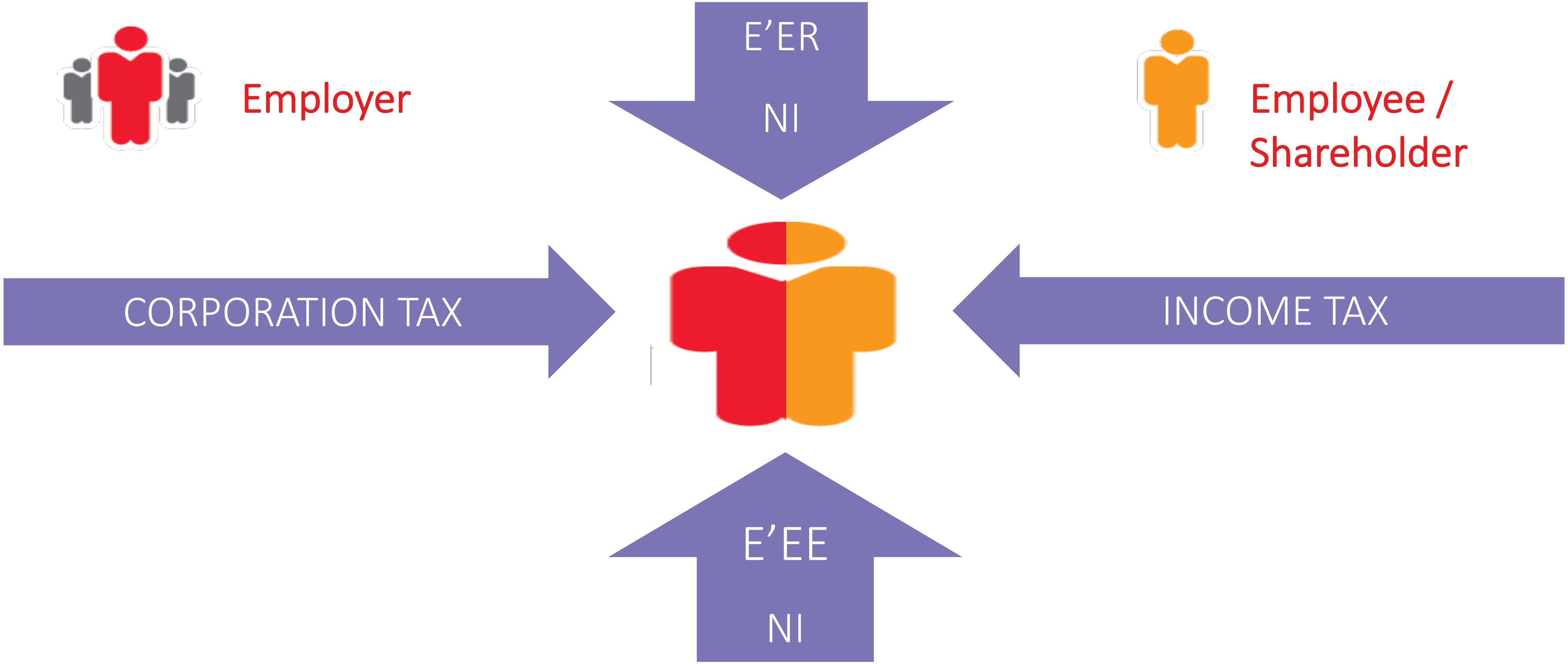
Annual Allowance - Money Purchase Pension Inputs

The calculation

Your Contributions + Your Employer Contributions + Third Party Contributions

Extraction

A foot in both camps



Extraction – 3 (non-Scottish) amigos

3 company owners each have £100,000 profit available for remuneration

Company	All salary	All dividends	All pension
Corporation tax	£0	£19,000	£0
Employers NI	£11,891	£0	£0
Individual			
Salary	£88,109	£0	£0
Income Tax	£22,676	£13,495	£0
Dividend	£0	£81,000	£0
National Insurance	£6,313	£0	£0
Employer pension contribution	£0	£0	£100,000
Profit extracted	£59,121	£67,505	£100,000

20%
£85,000

40%
£70,000

45%
£66,250

So…

a) 81% of £1,000? ✓

or

b) 54% of £1,000? ✓

or

c) 70% of £1,000? ✓

What's best?

Where does £1,000 profits go (above DNR)?

Company Bank Account	Personal Bank Account	Future Bank Account (via pension)
£810	@ 33.75% £536	@ 40% £700

Mary

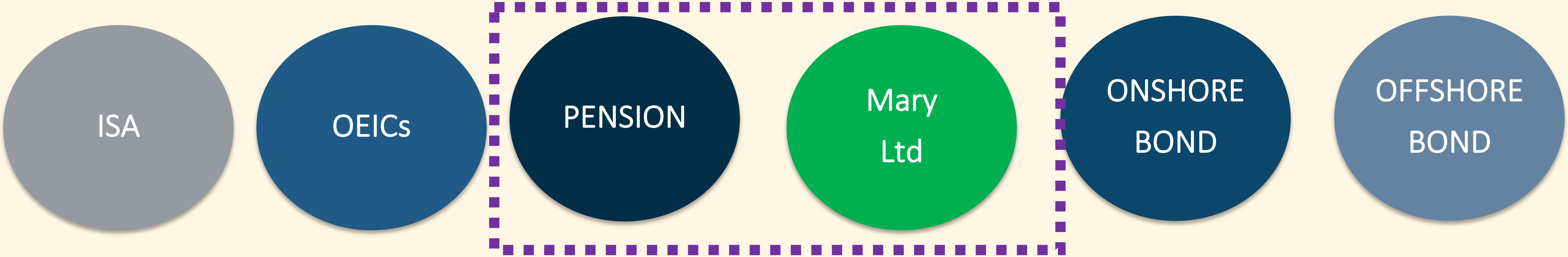
(a case study)

Here’s somethings about …

Mary

- Mid 30s
- IT contractor, through limited company
- Contracts around £200,000 p.a.
- Married to Ted, who is self employed
- She’s the main breadwinner
- 1 young child, 5 years
- Her company has been making £5,000 p.a. pension contributions to her SIPP for the last 5 years. She transferred £30,000 into her SIPP from an old GPP she had with a previous employer.

Wrappers



The problem?

Her business is just something that receives money (when she works) then pays it out to her!

No ones going to buy it!

It’s only Mary Ltd

Annual Allowance – carry forward

	2019/20	2020/21	2021/22	2022/23
Pension Inputs	£5,000	£5,000	£5,000	£0
Unused	£35,000	£35,000	£35,000	£40,000
				£105,000
				£145,000

What if this was £70,000?

Don't look back for just 3 years…

1. Uncover unused allowances from 3 previous years
2. If the prior 2 years to current year have an AA excess, look back further years

MPAA - flexibly accessing benefits

UFPLS

Payment from post
April 15

Income from

Flexi-access Drawdown

Capped

cap

Scheme Pension

< 12 members

Flexible Drawdown

6 April 15

Standalone Lump Sum

Primary Protected TFC

<u>NO</u> issue for Mary – she's nowhere near 55!

Tapered AA – Income Limits

"Adjusted income" > £240,000	"Threshold income"> £200,000

- Add up "total income" – employment income, dividends, interest, FULL bond gains etc etc
- Take off any relief on making a claim pension contributions and any other allowable STEP 2 reliefs

Add in

- Any pension contributions deducted above
- Total Annual Allowance used (Pension Input Amounts)

Deduct

- Value of individual's relievable contributions

Add in

- Salary sacrificed for pension contributions after 8th July 2015

Deduct

- Any relief at source pension contributions.

- Take off any taxable lump sum death benefits

Tapered AA – Income Limits

"Adjusted income" > £240,000

"Threshold income"> £200,000

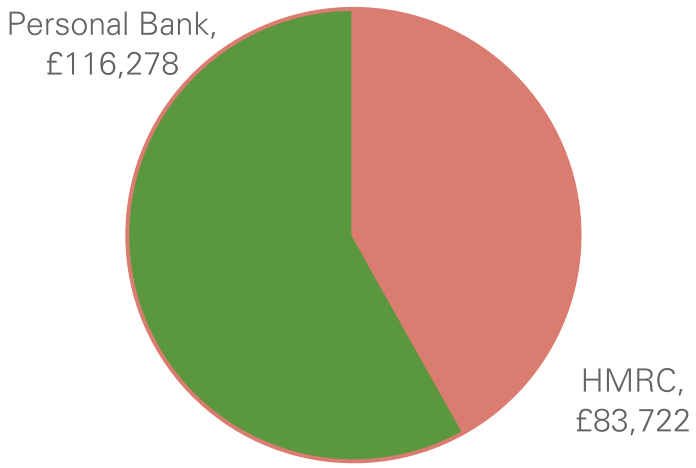
SALARY

DIVIDENDS

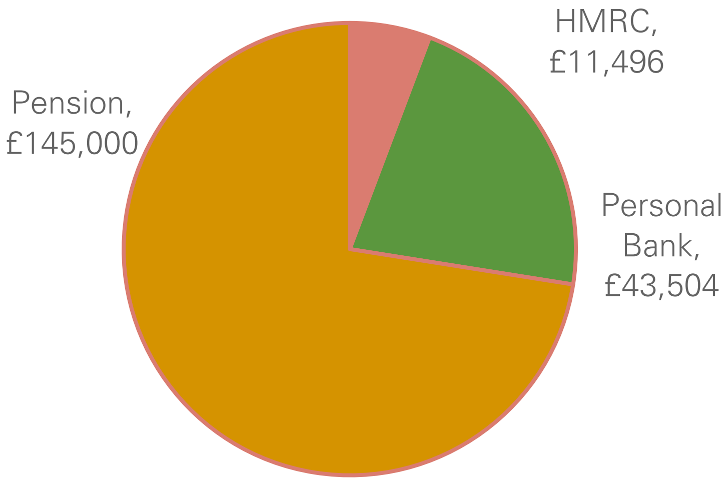
EMPLOYER PENSION CONTRIBUTIONS

£200,000 - Decisions, decisions...

SALARY
£9,100
DIVIDENDS
£154,629
PENSION
£0
CO BANK AC
£0



SALARY
£9,100
DIVIDENDS
£37,179
PENSION
£145,000
CO BANK AC
£0



- Tax inefficient extraction – high tax (>40%)
- Significant cash for living expenses.
- No funds retained – future dividend source
- Additional rate tax liability
- Lost personal allowance
- Child benefit charge to pay (£1,133)
- Annual Allowance lost
- No pension provision

- Reduced taxation (<6%)
- Less money for living expenses
- No funds retained – future dividend source
- No higher rate tax liability
- Personal allowance retained
- No Child benefit charge to pay
- Annual Allowance used
- Maximises pension funding

If only there was an easy way to do this…

Extracting Company Profits Tool

built by M&G

Tax Year 2022/23

RESET

Pre change position

Scottish Tax Payer	No
Available Profits	£200,000
Salary Paid	£9,100
Dividends Paid	£154,629

Gross value of individuals pension contributions

Paid gross e.g.OPS, RACs, AVCs	£0
Relief at Source e.g PP,GPP	£0
Employer Contributions	

Change (use a - for reductions)

Salary Paid	£0
Dividends Paid	-£56,700
Paid gross e.g.OPS, RACs, AVCs	£0
Relief at Source e.g PP,GPP	£0
Employer Contributions	£70,000

After change

Salary	£9,100	Paid gross e.g.OPS, RACs, AVCs	£0
Dividends	£97,929	Relief at Source e.g PP,GPP	£0
		Employer Contributions	£70,000

Assumed rate of tax on pension income 20%

Reduction in individuals bank account	£36,795
Increase in pension provision	£70,000
Amount after PCLS and tax	£59,500
"Return" on bank account reduction	61.71%

Short Summary

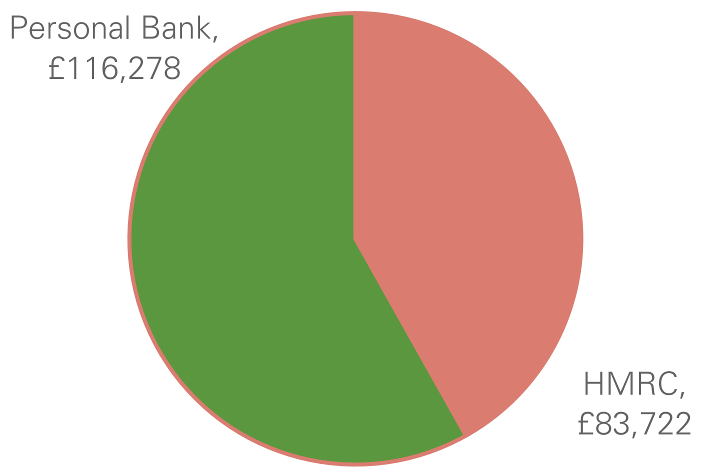
	Pre Change	After change	Difference	
Individual Bank Account	£116,278	£79,483	-£36,795	-32%
Company Bank Account	£0	£0	£0	No change
Pension Contributions	£0	£70,000	£70,000	Infinite Increase
HMRC total take	£83,722	£50,517	-£33,205	-40%

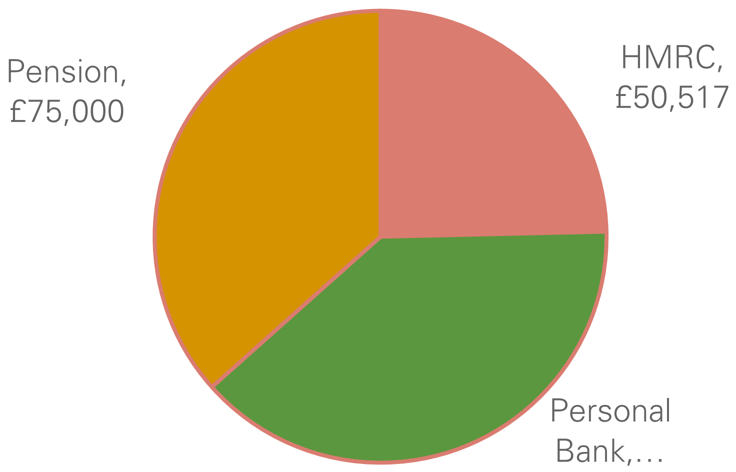
Detailed View

	Pre Change	After change	Difference	
Individual				
Salary	£9,100	£9,100	£0	No change
Plus Dividend received	£154,629	£97,929	-£56,700	-37%
Less Income Tax	£47,451	£27,546	-£19,905	-42%
Less National Insurance	£0	£0	£0	No change
Less Contributions gross	£0	£0	£0	No change
Net Income	£116,278	£79,483	-£36,795	-32%
Less Contributions paid net	£0	£0	£0	No change
Cash remaining	£116,278	£79,483	-£36,795	-32%
Employer				
Available Profits	£200,000	£200,000	£0	No change
Less Dividend Paid	£154,629	£97,929	-£56,700	-37%
Less Employer Pension Contributic	£0	£70,000	£70,000	Infinite Increase
Less Corporation Tax	£36,271	£22,971	-£13,300	-37%
Less Salary Paid	£9,100	£9,100	£0	No change
Less Employers National Insurance	£0	£0	£0	No change
Profit remaining	£0	£0	£0	No change
Pension Contributions	£0	£70,000	£70,000	Infinite Increase

This tool will enable you to sit with a client and discuss the different options that they have for extracting profits from their business. You can input a client's current remuneration structure and highlight the difference adjusting this structure can benefit them and possibly mitigate the tax and national insurance payable to HMRC.

£200,000 - Decisions, decisions...





Personal Bank

- £36,975

Pension Pot

+ £75,000

Pension after TFC + 20% tax

£59,500

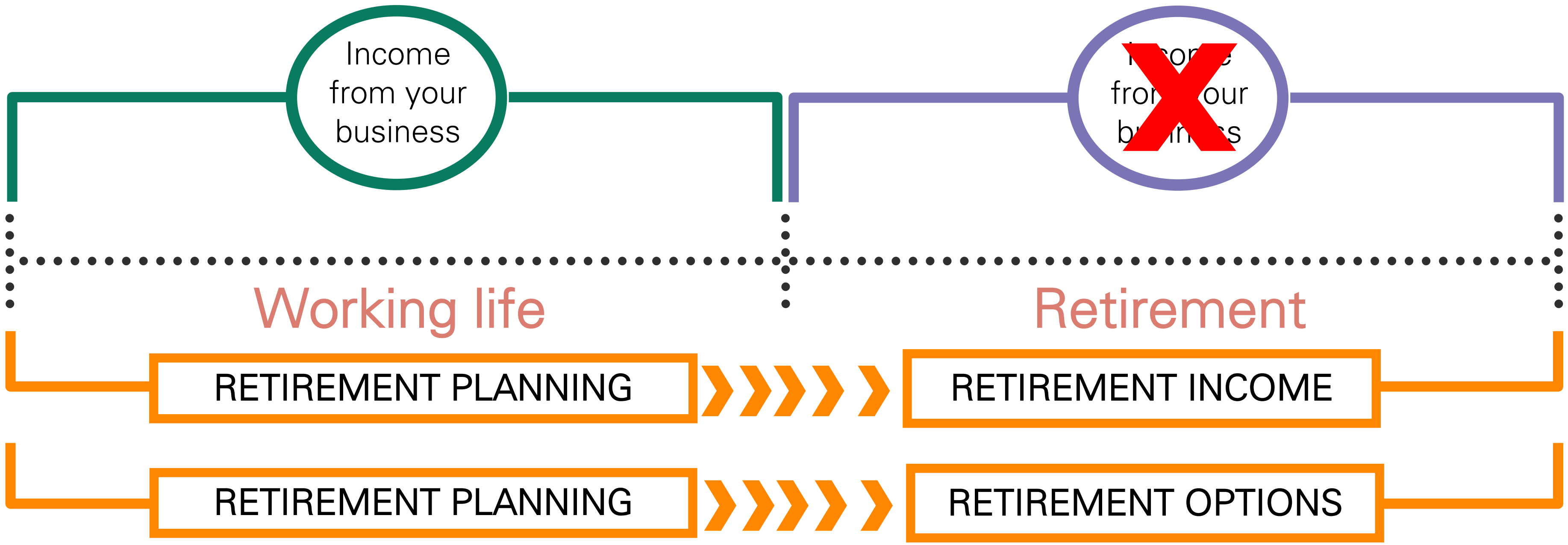
61% return!

Profit Extraction (dividends after DNR)

	£1,000 of profit		
Corporation Tax	19%	26.5%	25%
Realised Profit	£810	£735	£750
Dividends net:			
8.75%	£739	£671	£684
33.75%	£537	£487	£497
39.35%	£491	£446	£455

	£1,000 of pension, 25% PCLS
Net:	
20%	£850
40%	£700
45%	£662.50

The challenge



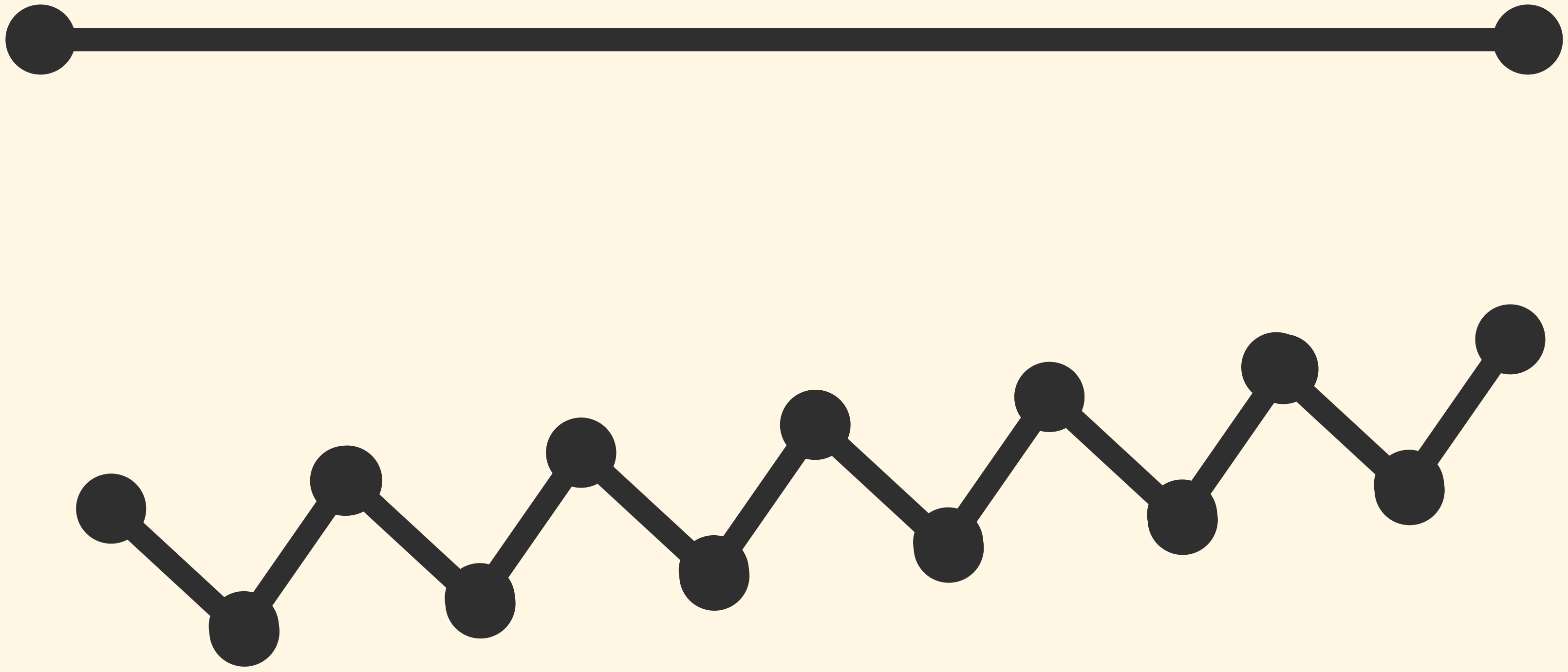
QUESTION TIME

Eroding value?

Planning Considerations

Different shapes and sizes

Overarching concern



Inflation Modeller Tool

built by M&G

RESET

Assumptions

Cash held	£1,000,000
Net Return (Inc charges and any OAC on invested)	
Cash	3.00%
Invested	5.00%
Inflation assumption	7.00%
Investment period (yrs)	5
Cash to be invested (%)	100.00%
Initial Adviser Charge (%)	1.00%

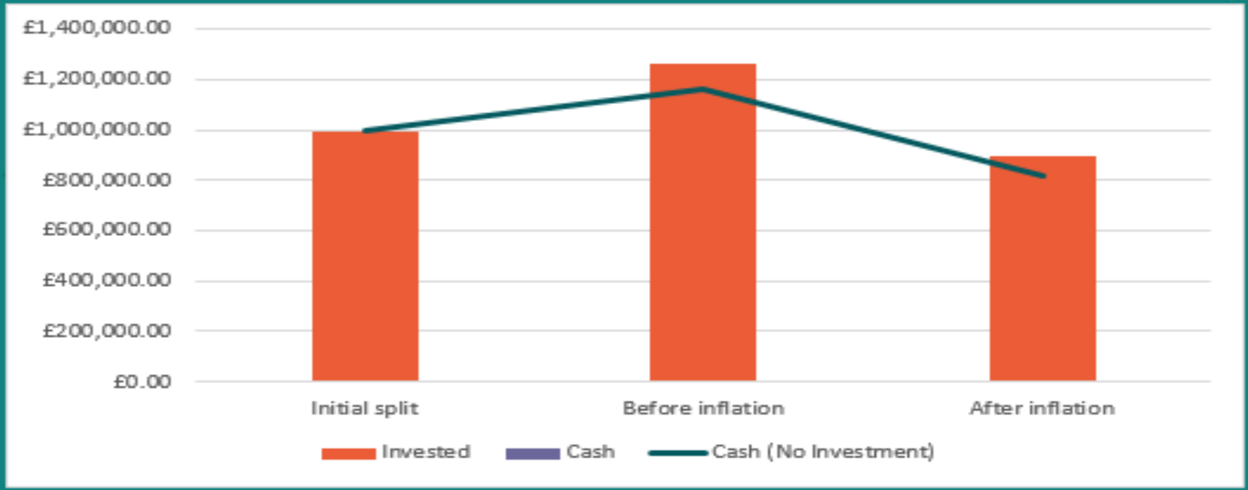
Current position

	Current value	Projected values Before inflation	After inflation	Real return
Cash (No Investment)	£1,000,000	£1,159,274	£815,373	-£184,627

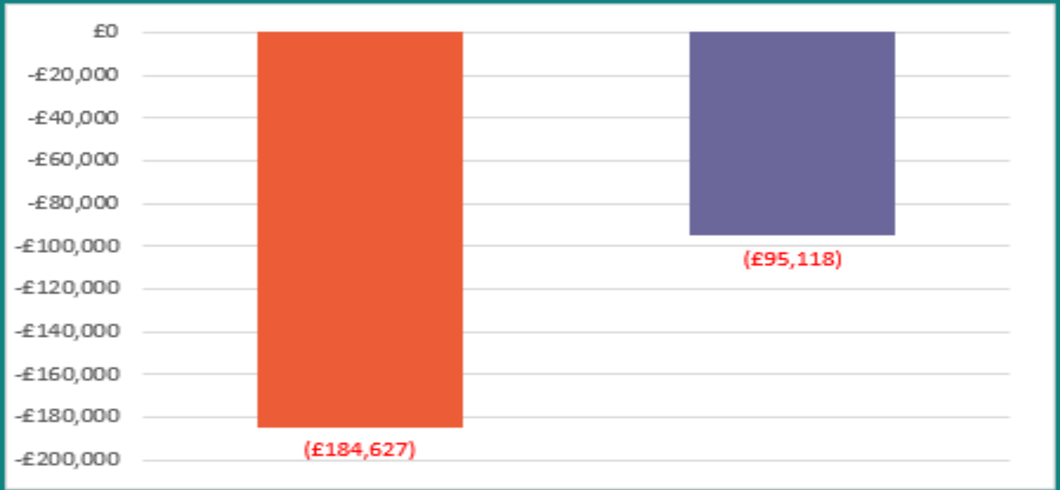
Potential position after cash invested

	Current value	Projected values Before inflation	After inflation	Real return
Invested	£990,000	£1,263,519	£894,882	-£95,118
Cash	£0	£0	£0	£0
	£990,000	£1,263,519	£894,882	-£95,118

Projected values



Real Return



Important information about this tool

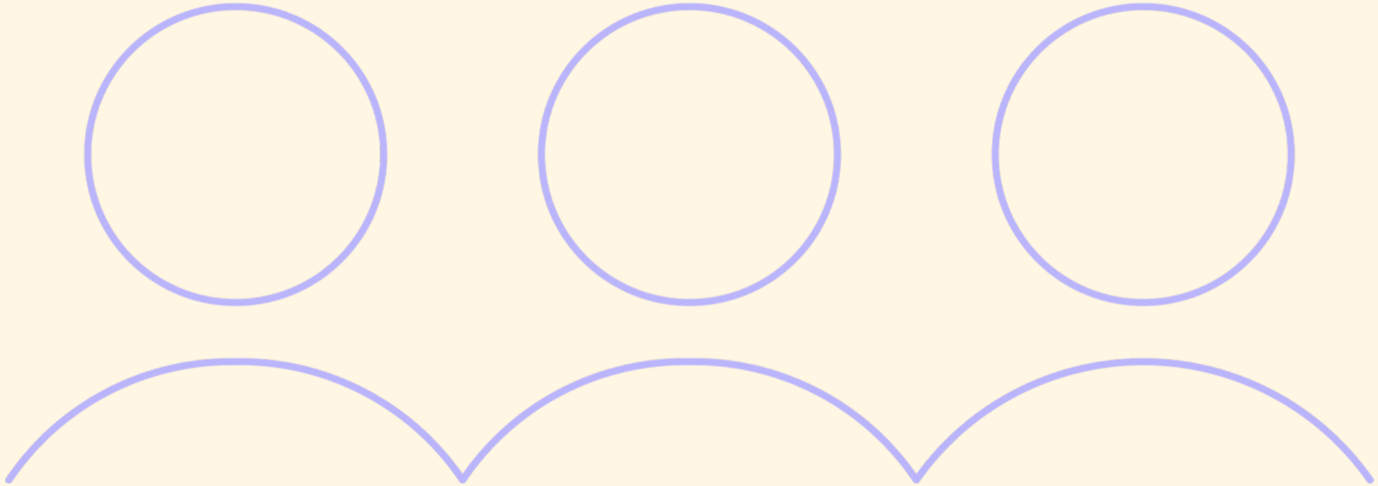
This calculator allows you to demonstrate the impact of inflation on your client's investment and cash holdings over a set time period. It also demonstrates the overall returns achievable before and after inflation is taken into account.

The inflation modeller is not a personal illustration and the values presented do not suggest any recommendation and should not be taken as offering advice from M&G.

The figures represent only potential growth over the term shown and is not an indicator of future performance.

Three’s a crowd?

- Company Director
- Accountant
- Financial Adviser



Potential Investments

OEIC which must distribute net income

Insurance Bond which is non income producing

Insurance!

Insurance policy designed as an investment – the directors can top it up or cash it in, fully or partially at any time.

Bond set up

- Company as owner
- Life assured – director(s)
- Directors can leave!
- Offshore Capital Redemption
- Contract of long-term insurance
- ~~Regular Withdrawals~~

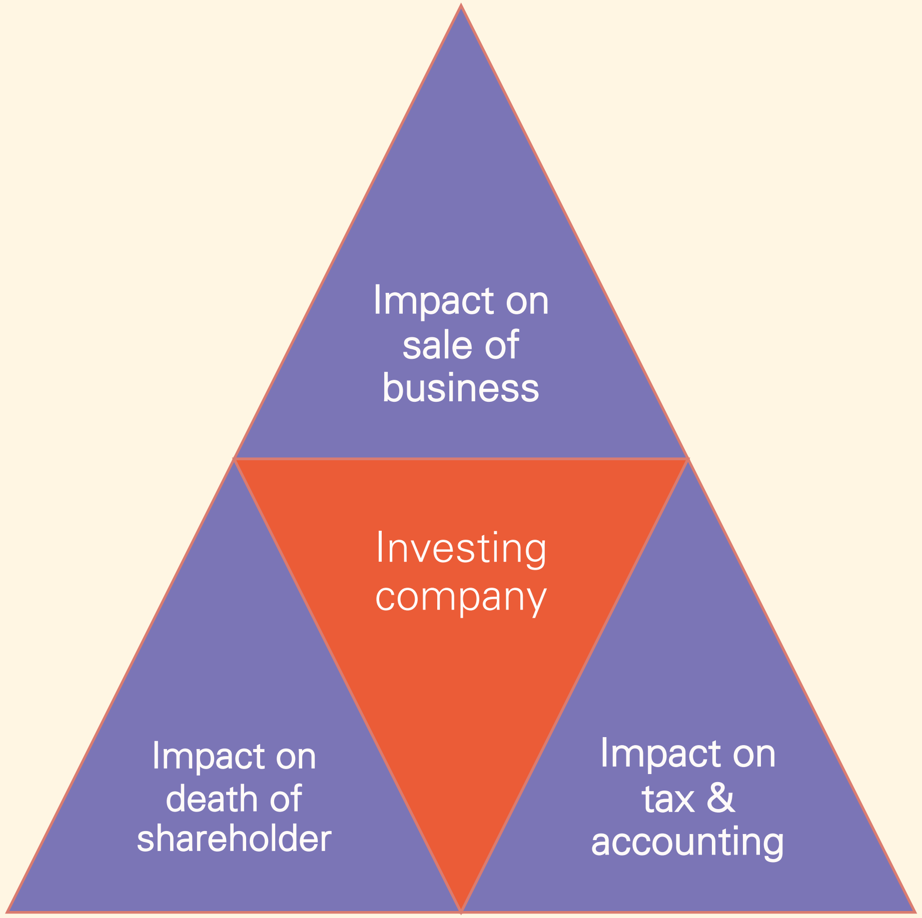
Advice issues

~~Attitude to Risk~~

~~Capacity for Loss~~

Suitable investment!

Tax concerns



Capital Gains Tax

£1,000,000 @ 10%


"Personal" company test
Officer or employee test
Trading company test
Relief available

…Most companies and groups will have some activities that are not trading activities. The legislation provides that such companies and groups still count as trading if their activities "… do not include to a substantial extent activities other than trading activities"…

….. The question to ask is how should a company's non-trading activities be measured to assess whether they are substantial? ……

HMRC Capital Gains Manual: CG64090

The 20% rule

Investment Income

Time and expenses on investment activities

Value of investments

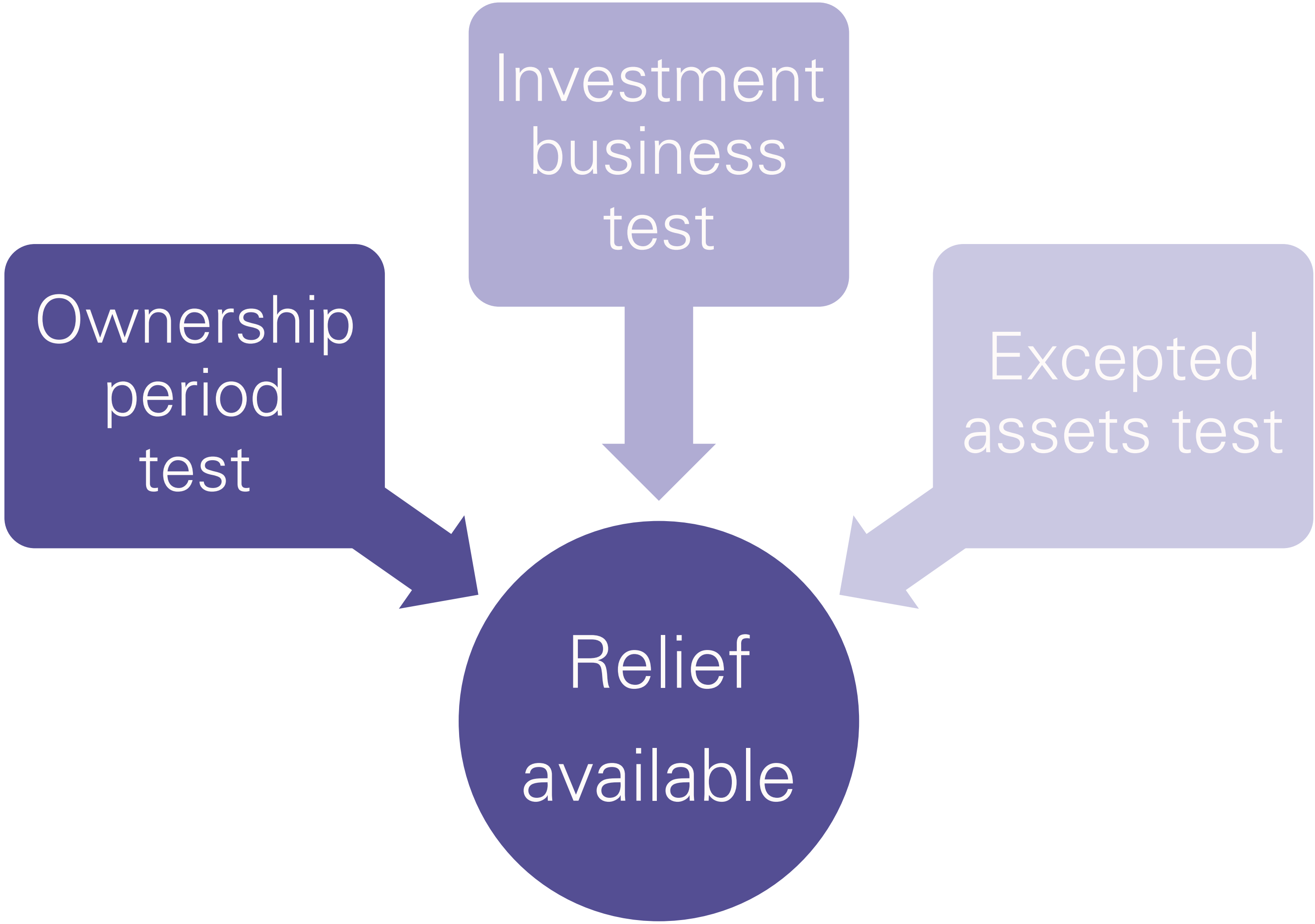
Company history

Shares disposed after **5 April 2020**, must satisfy the conditions for **2 years** prior to disposal

"in the round"

Inheritance Tax

Business Relief



The “wholly or mainly rule”

The company will be trading unless its business consists wholly or mainly of holding investments.

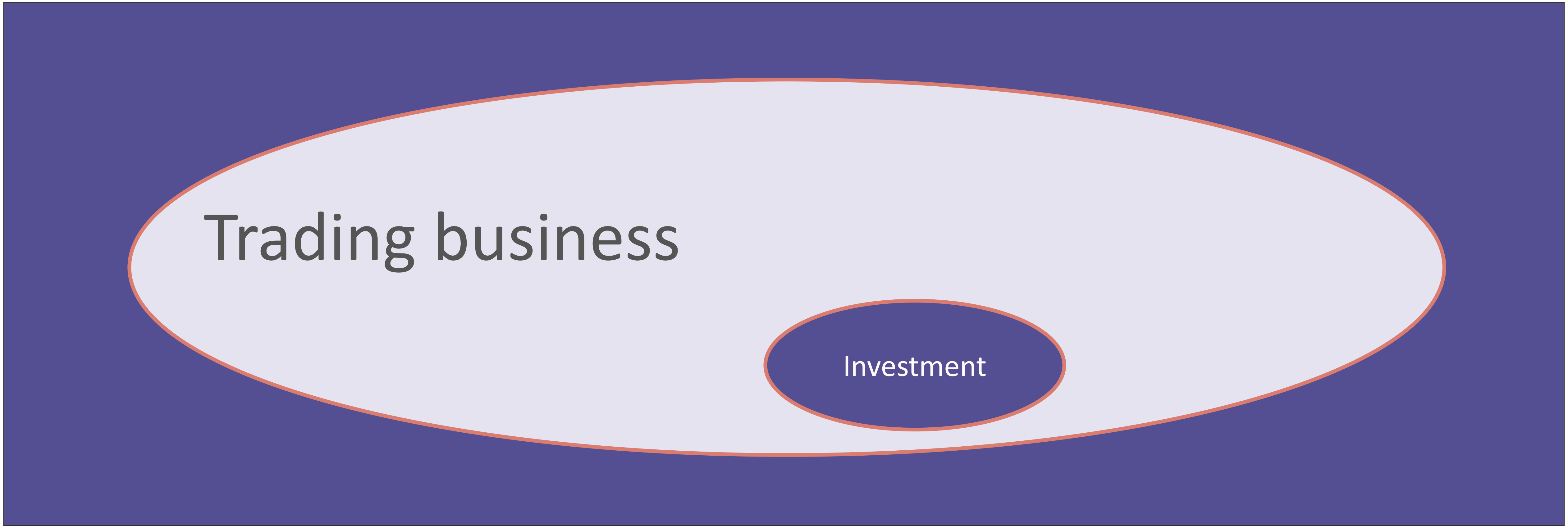
A generous test as “mainly” simply means more than 50%. HMRC will look at the main activities, assets, income and gains.

50% test

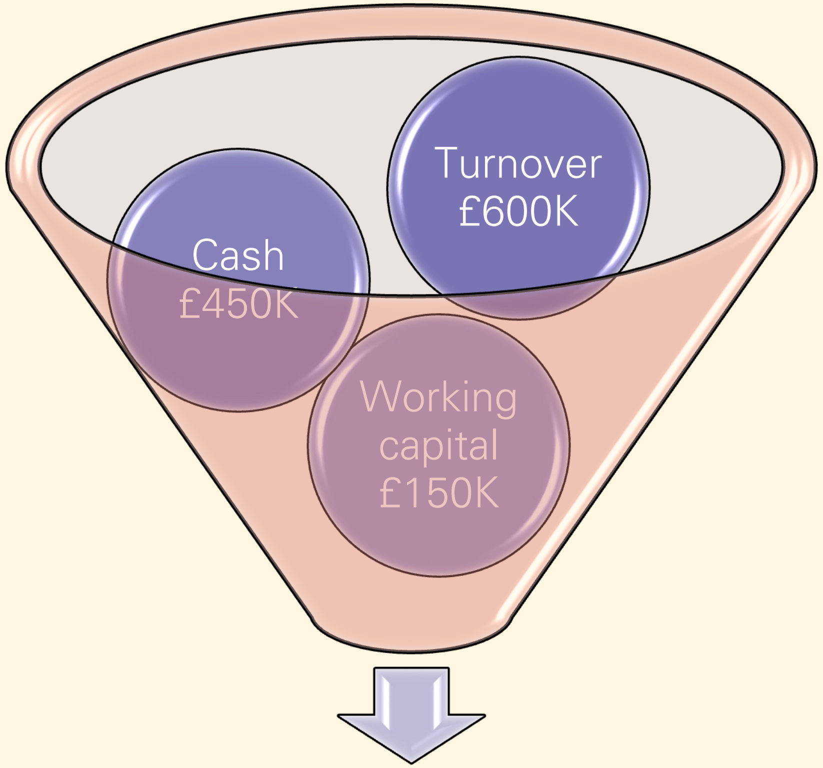
Good

Story continues…

Excepted Assets



Mrs Wilkins



Surplus £300K

Barclays Trust Company

versus

HMRC

Special Commissioner

"Was the £300,000 cash held by the company required for future use for the purposes of the business?"

"This is a question of fact and on the evidence before me I cannot find that it was so required.

In my opinion 'required' implies some imperative that the money will fall to be used upon a given project or for some palpable business purpose."

Corporation Tax (bonds)

Company held bonds

… where a company… is a party to an ‘invest[illegible]nsurance contract’, this is treated as a loan relationship of the[illegible] it is taxed as a creditor relationship under the loan [illegible] rules … rather than under the chargeable event [illegible]ith any profits or losses arising treated as non-trading credits or [illegible]its of the company.

!!!Forget chargeable events!!!

HMRC Insurance Policyholder Taxation Manual: IPTM3900

Accounting Standards

New UK GAAP

FRS 105

FRS102

Micro entities

Historic Cost

Other private companies

Fair Value

Micro Entities

Turnover	Employees	Balance Sheet
£632,000	10	£316,000

Two out of three must apply

Micro Entities

Historic cost = No annual adjustment = Tax deferred

Fair Value

Fair Value = Annual adjustment = Annual growth taxed

Onshore bond

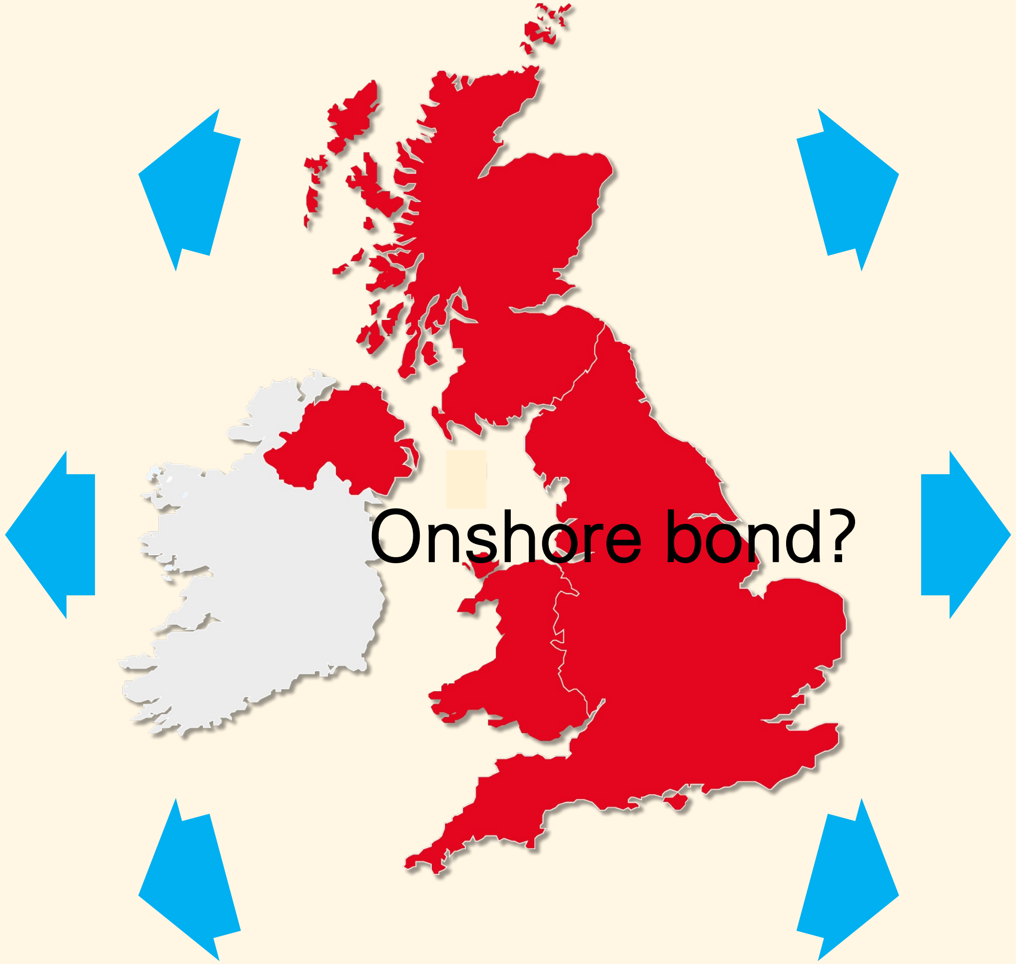
20%
TAX
CREDIT

Disposals
(i.e. a ‘related transaction’)

Annual increases

The $64,000 question!

Offshore bond?

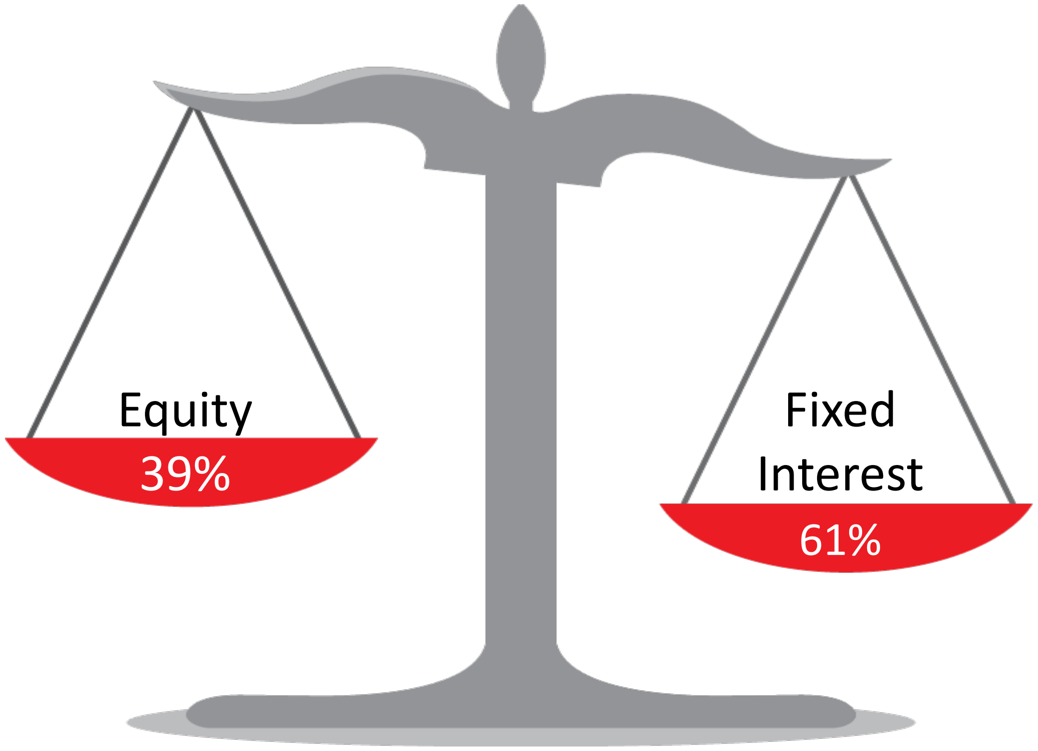


Offshore bond?

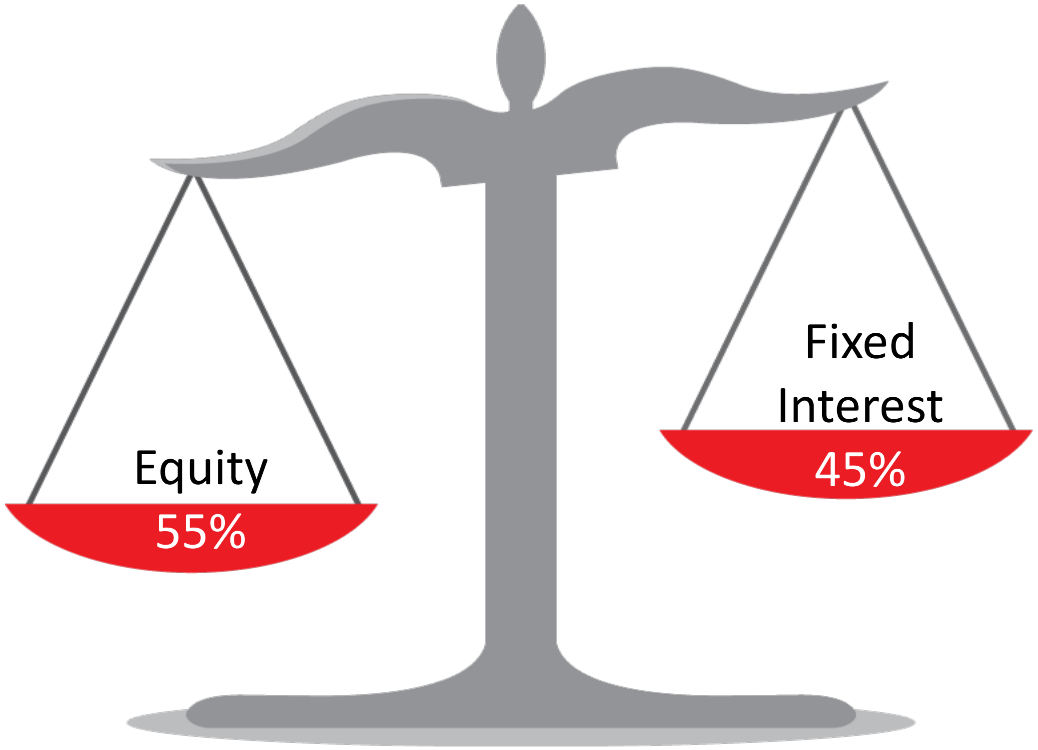
Can a bond be assigned out the company?

Corporation Tax (OEICs)

OEICs – dividends or interest



“Debt”



“Equity”

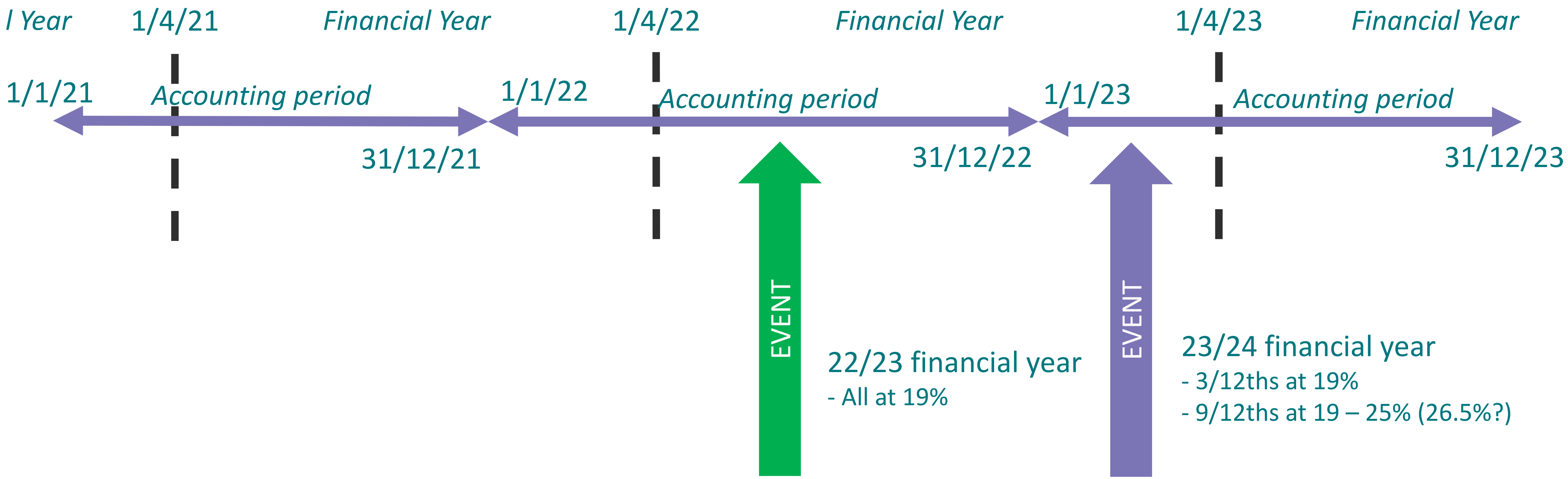
The 60% rule - but it doesn’t matter for Equity Funds!

OEICs – tax treatment

	Interest	Dividends	Gains
Historic Cost			
Debt Fund	Taxed	N/A	Held at cost, taxed on disposal
Equity Fund	Taxed	Exempt	Held at cost, taxed on disposal
Fair Value			
Debt Fund	Taxed	N/A	Revalued, taxed annually
Equity Fund	Taxed	Exempt	Revalued, but taxed on disposal

Corporate Investors (Existing)

The “years”


l Year
1/4/21
Financial Year
1/4/22
Financial Year
1/4/23
Financial Year
1/1/21
Accounting period
1/1/22
Accounting period
1/1/23
Accounting period
31/12/21
31/12/22
31/12/23
EVENT
22/23 financial year
- All at 19%
EVENT
23/24 financial year
- 3/12ths at 19%
- 9/12ths at 19 – 25% (26.5%?)

Case study – historic cost

XYZ ltd prepares accounts on a historic cost basis, the company year matches the financial year. It usually has profits around £100,000. It holds an onshore investment bond that currently has an £100,000 gain.

	2022/23	2023/24
Bond gain	£100,000	£100,000
Grossed up	£125,000	£125,000
Corporation tax	19%	26.5%*
CY due	£23,750	£33,125
Tax credit	£25,000	£25,000
CY	(£1,250)	£8,125

*wholly in marginal rate

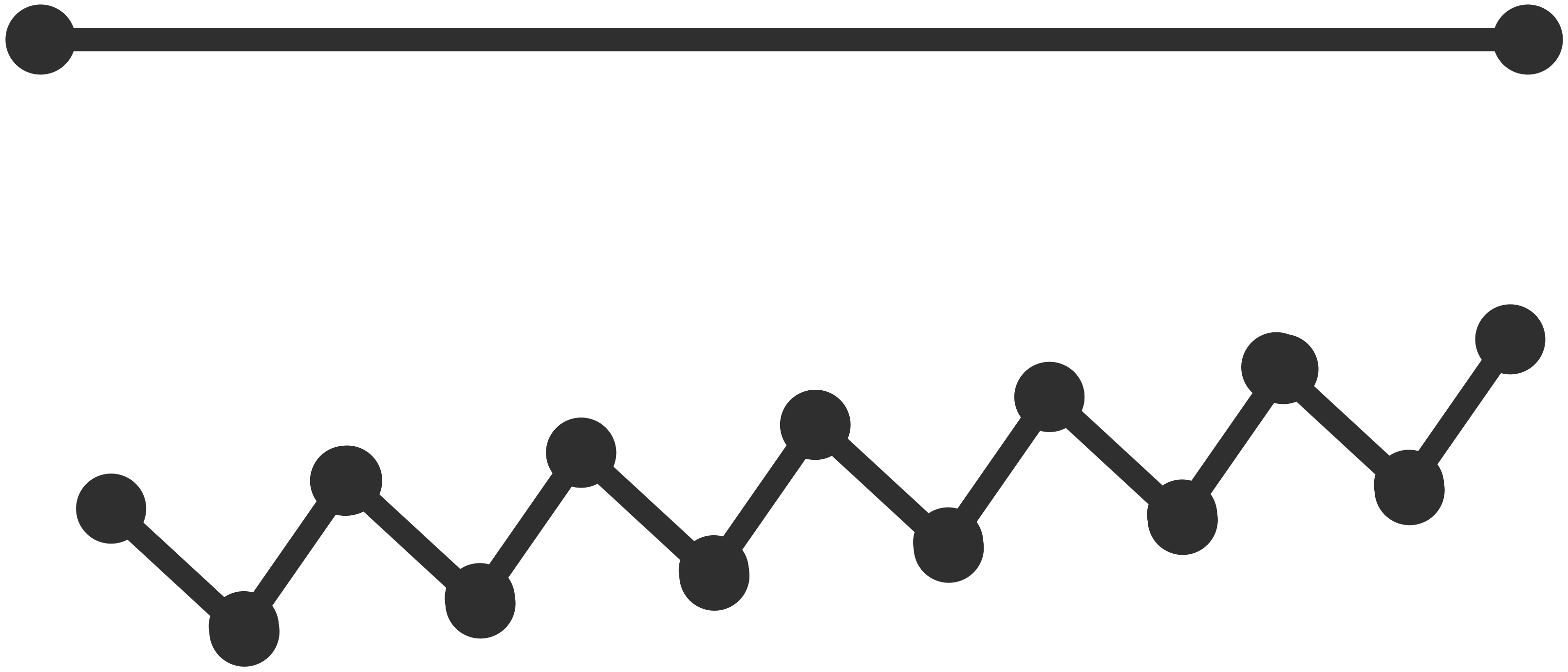
By realising the profit already made on the bond, reinvesting, and carrying a rebased cost into the new corporation tax regime the company saves corporation tax of £9,375, or 7.5% of the grossed up gain. The same **percentage** saving would apply to an offshore investment.

Tax Changes

	Tax Relievable Action	Tax Payable Action
Tax Rise	DEFER	BRING FORWARD
Tax Cut	BRING FORWARD	DEFER

QUESTION TIME

Overarching concern



Learning Objectives

By the end of this session you will be able to:

Evaluate	Describe	Describe
The planning & advice considerations when advising business owners	The impact of profit extraction on individuals	The taxation impact of corporate investments

Support




M&G wealth