Tax Planning Solutions

How Business Owners Can Use Excess Capital More Efficiently

While there may be periods when all of a business's assets are needed for trading activities, there may also be times, often later in the life cycle of a business, when it holds surplus cash. The owners of companies that are holding high levels of surplus cash may not always be aware of the potential tax implications.

The Dangers of Excess Cash

Holding significant surplus cash can mean shareholders don't get the full range of tax reliefs that the owners of trading businesses would normally benefit from. These include Business Relief (BR) for inheritance tax purposes and Business Asset Disposal Relief (BADR - formerly known as Entrepreneurs' Relief) for capital gains tax purposes. BR can have a big impact when trying to sell or pass on a business:

- HMRC may deem the surplus cash to be an 'excepted asset' meaning that BR would no longer be applicable to that cash.
- If most of the company's assets are held in cash (or other investments) there's a risk that the whole company will no longer qualify for BR.
- If the firm is deemed to be an 'investment company' by HMRC, then when it's sold/liquidated the directors may not be entitled to BADR

A Potential Tax-Efficient Solution

One option would be for directors to withdraw the surplus profits in the form of extra dividends. However, in some cases there may be a complicated share structure in place, or the directors may not wish to extract the profits. There may also be a potential future need for that capital within the business.

By deploying a company's excess cash into a trading activity, shareholders can restore the full availability of BR to mitigate inheritance tax and also, BADR to mitigate capital gains tax.

The simplest way for firms to obtain or re-instate these tax reliefs is to put the excess cash to work in a BR-qualifying trading activity such as secure asset-backed lending, via a Corporate Cash Management Service.

An Effective Way for Business Owners to Use Excess Capital More Tax Efficiently

Your Business

- If the trading business is holding more than 20% in cash, then the cash element may be liable to inheritance tax
- If the cash element represents more than 50% of the business' value, the entire business may be subject to inheritance tax
- On the sale/disposal of the business, BADR may be lost, leading to an increase in capital gains tax
- Cash held on deposit can receive poor returns

Corporate Cash Management

- The excess cash is deployed into BR qualifying trading activities, such as secure asset-backed lending (remains on the company's balance sheet as a lending activity)
- Obtains / reinstates BR, often immediately, for inheritance tax
- Obtains / reinstates BADR for capital gains tax
- Targets a return of 4% to 6% per annum
- Liquidity provides access and control if the needs of the business change

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CASE STUDY

Using BR to Pass on a Business Tax-Efficiently

Company:	Norfolk Cruises
Established:	1981
Value:	£5 million
Unused cash within the business:	£1.2 million
Owner:	David Michaels
Age:	71
Goals:	To retire and pass on the business to his daughter and son-in-law

Background

40 years ago, David Michaels set up his leisure business, Norfolk Cruises, offering high-quality boating holidays on the Norfolk Broads. Times have not always been good, but in 2010, Michael's daughter joined the company and suggested they introduce Glamping as an additional service. The business is currently thriving and they recently signed a deal with a major travel company.

Two years ago, Michael decided to sell an engineering plant that he purchased several years back when he was looking to expand into servicing and maintaining cruise boats. The company is now sitting on the proceeds from this sale with a cash surplus of over £1 million.

Michael is now semi-retired, wanting to spend more time enjoying fishing and playing golf, but he still likes to stay involved in the business. He's adamant that, having spent so long building up the business, his daughter Alison inherits it and continues to run it with her husband Steve, when he's gone.

The problem

Now that Michael is semi-retired, he's less inclined to reinvest company profits into new ventures, and he feels this is something Alison can do as she pleases once he has passed away. He wants to leave the business in good shape with plenty of cash reserves to allow her to grow and expand into new areas.

However, because the excess cash in the business is not actively trading, it's likely that when Michael dies, HMRC will not grant BR on the full value of his company shares. This would leave Alison with a large inheritance tax bill.

The solution

After talking the situation through with their accountant and financial adviser, Michael and Alison decide to deploy £1 million into a Corporate Cash Management Service. This is comprised of BR qualifying, asset-backed lending activities and is expected to generate an annual return of 4% - 6%. With 100% of the business' assets now trading, full BR should be available and when Michael dies the business will pass to Alison free of inheritance tax.

Further Information & Support

If you have any questions or would like further information, please contact John Castle of Tax Planning Solutions:

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