

An update on the new “Zero-10” tax structure, common questions answered by Sarah Hancock of Brehon Ltd and Richard Stapley

The new “Zero-10” system came into force on 1st January 2008. Some businesses are still unsure how the new rules affect them and what steps they need to take to comply with the new laws and minimize their tax burden. As local accountants we have both been asked many questions about “Zero -10” and its implications. This article presents some of the most frequently asked questions and our advice.

- **I trade as a company, does “Zero-10” mean that I will not have to pay any tax?**

For most Guernsey resident shareholders, “Zero-10” will not reduce their tax burden. Most companies will not pay any tax on profits but any money withdrawn from the company will be taxed.

The exception to this are companies which receive income from rentals or property development. Their profits will still be taxed at 20%.

- **Do I have to pay tax on all distributions from a company after 1 January 2008?**

Tax will be payable on all distributions or deemed distributions made from profits generated after 1 January 2008. This means that you will be able to make distributions without incurring a tax charge until you have used up any undistributed profits or shareholder loans existing at 31 December 2007.

- **What is a deemed distribution and what is the system for returning the tax?**

Several things constitute a deemed distribution, such as payments of dividends, disposal of shares, death of a shareholder, a shareholder leaving the island, the migration or liquidation of a company or the receipt of investment income.

Returns showing distributions and deemed distributions will have to be submitted quarterly on a similar basis to the ETI returns. The company will be responsible for deducting the tax and paying it.

- **Are there any other costs that will increase because of “Zero-10”?**

There are many other increased costs associated with “Zero-10”. Motor fuel costs, “Tax on Real Property”, employer’s social security contributions and company registration fees have all increased. Some allowances are being reduced such as the Statutory Repairs Allowances against property income and claims for tax relief on interest are being restricted.

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- **Should I leave money in the business rather than withdrawing it as this will reduce my tax payments?**

Firstly, if you are reinvesting in the business or intend to do so in the future it is advantageous to leave the money in the business. This is because the money used to increase the working capital or purchase fixed assets is not tax paid as it would have been previously and still is in the case of a sole trader.

Secondly, in the case where you are not reinvesting, keeping the money in the business as long as possible is still beneficial because it will delay the tax payment and interest can be earned on the cash deposits.

- **Am I entitled to tax relief for interest I pay on funds borrowed to start up a business?**

Yes, if the loan is used exclusively to fund the business activities and the claimant is actively engaged in the business when the interest is paid. The claimant also has to own at least 10 % of the company’s shares.

- **Is it possible to save tax using a limited company?**

It is worth a sole trader incorporating if they are reinvesting in their business, i.e. purchasing fixed assets or building up the value of stock. Under new powers the Income Tax Office could set aside any transaction if they deem it to have been undertaken solely with the intention of avoiding tax.

- **Can companies lend money to shareholders tax free?**

No. A loan made to a shareholder is still a distribution. Loans made to Guernsey resident shareholders will be taxed at a rate of 20%. They will also be subject to social insurance. The corresponding loan repayments will be subject to tax relief.

We would advise shareholders to simplify their returns by putting all their remuneration through the ETI system rather than making loans from the company to themselves.

- **Do we need to change our year end to 31 December 2007?**

No. The tax will be calculated using financial statements at your usual year ends. Your 2008 results will be apportioned when being assessed for tax into pre and post December 2007.

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- **How will we keep track of our pre 2008 undistributed profits and shareholders loans?**

We suggest that you keep a quarterly record showing the pre 2008 undistributed profits and shareholders loans and any distributions made from these.

Your financial statements should show the loans and undistributed profits pre and post December 2007.

- **Do we still need to have accounts prepared and tax computations produced?**

Yes. Accounts will need to be prepared but there will be an audit exemption for most small businesses. Tax computations could be more complicated so it will be necessary to have them produced.

- **How will we know where we are without agreed 2007 accounts?**

The best scenario is to prepare your 2007 accounts as soon as possible. You will then be able to identify the moment when you start making distributions that need to be included on the new quarterly returns.

If you are making quarterly returns without preparing 2007 accounts you will have to make your best estimate of which distributions need to be included. The Administrator of Income Tax has granted a concession which allows the tax amount paid on distributions to be revised without a surcharge once the financial statements have been finalised as long as the original returns were made in good faith.

- **Will we pay tax on intercompany rentals?**

No. Group companies are ring fenced so any intercompany transactions are not subject to tax.

- **How will we deal with loans owed from shareholders to the company?**

There is no tax advantage or disadvantage associated with these loans. No action is needed.

- **Will there be any social insurance increases?**

Yes, the upper limits for self employed and employer’s social insurance both rose in 2007 and again in 2008.

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Conclusion

We hope this article has helped you understand some of the implications of “Zero-10”. If you wish to know more or have questions not dealt with here please contact either of us. Our contact details are:

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