

Advance taxation

Finance



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ADVANCE TAXATION Table of Contents Introduction 3 Tax Implications for Set up of Business as Sole Trader 3 Tax Implications for Set up of an Incorporated Company 4 Tax Implications for Investment in Government Bonds 4 Tax Implications for Gifting to Children 5 Conclusion & Recommendation 5 Reference 6 Introduction The client X is 35 years old, and married with four children. It is also given that X falls under higher tax rate bracket. X has ? 125, 000 of funds available for investment. Many alternatives are available to X like, X can set up a business as a sole trader, or an incorporated company with its payroll system and salary drawing option. X can also invest in government securities by evaluating the risk of investment. If X plans to take more risk to earn higher reward, X can invest in shares. X also has the option to give the surplus fund to X's four children. In this case X has to evaluate tax implications on the basis of inheritance tax. In the given situation, X wants to find out the tax implications of each of these alternatives and then choose the best option to invest. Tax Implications for Set up of Business as Sole Trader It is the simplest of all business structures. Setting up a business as a sole trader can be very scary because X' s liability would be unlimited. But at the same time rewards are also unlimited as X will have claims to the extent of profit earned by business. Moreover, X does not have to register with the Companies House and this means that X won't have to pay the corporate tax which X had to pay had he set up an incorporated company. Another advantage for a sole trading business is that if X is not maintaining a payroll, paper works for the employees then red tapes will be reduced greatly. But this business structure exposes X to greater risk for which X may need to cover up with insurance policy. Thus as a sole trader, X can keep all profit after paying taxes on them

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according to tax slab. For every ₹ 2 that X earns above ₹ 100, 000, X will have to pay ₹ 1. Thus, if the income is too high then X's profits may become zero. So, the tax liability of X in case for set up of business as sole trader would be ₹ 12, 500. Tax Implications for Set up of an Incorporated Company

An incorporated company is less risky than sole trading business because here X and the business will be treated as a separate entity. In this case, the business will be responsible for its own finance and not X's own personal finances. But, one of the disadvantages of incorporated company is that any profit that it makes is retained by the company and X's share would be limited to the extent of paid up equity capital of X. In this case it is ₹ 125, 000. Additionally, X will have to put statutory accounts, send annual tax return to Companies House and HMRC. Again if X expects earnings more than ₹ 77, 000, X will have to register for VAT. Thus, in this case, X will have to pay tax @ 20% on ₹ 125, 000, i. e. ₹ 25, 000 and will still have ₹ 100, 000.

Tax Implications for Investment in Government Bonds Generally the investment in government securities is less risky compared to corporate bonds because there is less chance of default. Consequently, the reward for such investment is also low compared to investment shares or other class of asset. Banks are always under supervision of Government agencies like the World Bank and IMF that reduces chance of default in case the banks files bankruptcy. But to a limited extent, the risk of default, market risk and daily fluctuations remains (Wahab & Holland, 2011, pp. 3-10). For instance, X can invest in German Bund yielding 0. 22%, 0. 69%, 1. 67% and 2. 44% for 2 Yr, 5 Yr, 10 Yr, and 30 Yr periods. If the bond is cashed in before maturity to the extent of more than 5% of capital, there is no extra tax for low bracket individual. But, X falls under higher tax bracket (annual income over ₹ 150, <https://assignbuster.com/advance-taxation/>

000), so he'll have to pay 20% extra in addition to difference between the 20% already paid by fund. Investment in bonds is only attractive for senior citizens and pensioners. So, in this case X will have to pay minimum tax of ? 25, 000. Tax Implications for Gifting to Children Inheritance tax is paid on the estate inherited by the beneficiary when someone dies leaving house, gifts, or cash for the beneficiary. It is payable at the rate of 40% over ? 325, 000 for the tax year 2012-13. In X's case it is exempted because ? 125, 000 is below threshold of ? 325, 000. However, if X believes threshold might exceed in future, inheritance tax can be avoided by passing the money or property to four children or by gifting it to X's partner or any qualifying charity established in EU. Such gifts are exempted from inheritance tax and hence it will allow X to avoid inheritance tax. Conclusion & Recommendation After considering all the options available to X and also evaluating the advantages and disadvantages of each of them, it can be said that if X wants to minimize the tax implication of ? 125, 000, the amount should be gifted to X's children for which X will not have to pay any tax. Reference Wahab, N. & Holland, K. 2011. Tax Planning, Corporate Governance and Equity Value. [Pdf]. Available at: http://eprints.soton.ac.uk/150017/1/Tax_Planning_Corporate_Governance_and_Equity_Value.pdf. [Accessed on February 16, 2013].