CAPS TECHNICAL BULLETIN

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"ACT NOW, DON'T PAY LATER"

The Chancellor said this a number of times during the delivery of his budget speech, and it was certainly true in respect of Capital Gains Tax (CGT). There were a number of surprises, one of them being the reduction in the rates of Capital Gains Tax from the present 18% and 28% to 10% and 20% respectively, with effect from 6 April 2016. Those who were about to complete a transaction, giving rise to a capital gain, may have been able to act in time to defer the date of disposal until 5 April 2016 allowing them not only to pay their CGT bills a year later but, more importantly, to pay at a lower rate. However, continuing with his theme of battering residential landlords and those with more than one home, the reduction in rates will not apply to residential property.

Staying with personal tax, the personal allowance is to rise to £11,500 with effect from 6 April 2017 and the basic rate band will rise to £33,500 from the same date, although perhaps not in Scotland?

Some changes are proposed to entrepreneurs' relief. External investors, who are neither employees nor directors, who subscribe for ordinary shares in unlisted trading companies on or after 17 March 2016 and hold them for a 3-year period, will qualify for relief.

Retrospective changes, effective from 3 December 2014, are to be made to the entrepreneurs' relief legislation as provisions in the Finance Act 2015 preventing entrepreneurs' relief on the disposal of unincorporated businesses to companies owned by the individuals affected more taxpayers than had been intended. Under the new rules, where the Vendor will own less than 5% of the acquiring company, entrepreneurs' relief will be available on the sale of the unincorporated business to the new company.

The members of the Office of Tax Simplification must be weeping. As they bravely try to simplify the largest volume of tax legislation in the world, the Chancellor makes more and more additions. One of these is yet another type of ISA, this time for those under 40, who can save up to £4,000 per annum and, provided they apply this investment to buy their first home or to save until they reach age 60, the Government will add a 25% bonus. This is all fine and well for high earning individuals or those with wealthy relations able to invest such sums, but many young people are simply unable to save anything at all and you do wonder if this is yet another case of the Government helping the rich to get richer.

Many of you will remember the introduction of stake holder pensions, designed so that the masses could contribute to a pension scheme. What happened in many cases was that husbands contributed to a stake holder pension for a non working wife, or indeed grandparents started stake

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holder pensions for babes in arms. A similar relief which has probably been utilised in a way that the Government had not considered when it was introduced is Employee Shareholder Status (ESS) shares. The idea was that employees would be able to give up certain employment rights in exchange for shares issued to them by their employer. The Capital Gains on disposal of such shares are tax free. Guess what happened? Highly paid executives gave up their rights in exchange for usually some type of flowering or growth share and, if their company did well, they were able to realise substantial Capital Gains Tax free profits. The Government have wakened up to this and are now capping the gains on ESS shares at £100,000. This will be a lifetime limit.

Another anti-avoidance provision is being introduced in relation to loans provided by Employee Benefit Trusts (EBTs). Where PAYE cannot be collected from the employer, then HM Revenue & Customs will be able to go after the individual employee. Also, where an EBT has made a loan to an employee, and this remains outstanding at 5 April 2019 then a charge will arise. If the Rangers case (**Advocate General for Scotland v Murray Group Holdings Ltd [2015] CSIH 77)** is lost at the Supreme Court then this "plan B" should sweep things up nicely for the Government.

Louder sobs from the Office of Tax Simplification as the Chancellor announces that, from 6 April 2018, employers National Insurance Contributions (NIC) will be due on termination payments over £30,000. Income tax and National Insurance continue their flirtation without the Government finally doing the obvious thing and marrying the two. Now that would be simplification.

Corporate taxes did not escape the Chancellor's fiddling about. Apart from the reduction in the corporation tax rate to 17% from 1 April 2020, tax losses arising after 1 April 2017 will be available to carry forward against profits from all of a company's other income, not just profits from trading. So far so good. There has to be a catch which is that, from the same date, losses brought forward will only be able offset against 50% of profits. This is subject to a £5 million profit de minimis and so will not affect most companies.

From 6 April 2016, the income tax rate on dividends received by individuals increased by 7.5%. This caused the Government to worry that people might start to try to convert income into capital and hence the consultative document on Company Distributions issued in December 2015. Another budget announcement, to be effective from 6 April 2016 is that loans to participators will be subject to Section 455 tax at 32.5% rather than the current 25%. Existing loans will be unaffected. This is a sensible change which should probably have been announced at the same time as the increase in the rate of income tax on dividends.

With the Chancellor making so many interesting changes to the taxation system, no wonder the Accounting Standards Board feel that they too have to get in on the act by complicating things with FRS 102 and turning everything we learned for our exams upside down!

GOING DIGITAL – GREAT EXPECTATIONS?

"*By 2020, businesses and individual taxpayers will be able to register, file, pay and update their information at any time of the day or night, and at any point in the year, to suit them.*

For the vast majority, ***there will be no need to fill in an annual tax return***."

(From Transforming tax by 2020, page 4 of Making tax digital **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/484668/making-tax-digital.pdf**).

From tax return to digital tax account

Tax administration is changing, and while "death of the tax" return may sound alarmist, it is certainly true that the way practitioners carry out tax work on behalf of clients is going to change.

A large part of this is the digital tax account. There will be two sorts of digital tax account, one for taxpayers whose main source of income is taxed at source (and any secondary source is under £10,000), and another for those whose main income is self-employment or rental income. Advisers will need to adapt to a different role; that of assisting clients to update their digital tax accounts.

A number of potential problem areas are already evident: What if HM Revenue & Customs (HMRC) Agent digital service doesn't keep pace with individual digital accounts? Already, software or access issues limit an agent's ability to help clients update. Some clients may think they can "go it alone", which may not be in their best interests.

Pre-populated digital tax accounts for PAYE taxpayers

Here we are talking about clients with a main source of PAYE income and a secondary source of under £10,000 from rental and/or self-employment.

Where there is a main source of PAYE income, HMRC will aim to pre-populate the digital tax account, requiring only checking and updating of specific figures from the taxpayer. It will use information feeds from DWP, RTI and from banks and building societies to supply the figures.

HMRC will then use its new simpler assessment powers (in Finance Bill 2016 - **https://www.gov.uk/government/publications/income-tax-simple-assessment**) to issue a legally enforceable assessment, based on the information in the digital tax account. This will all be done without the need for the taxpayer to complete a self-assessment tax return. There will be just 60 days in which to check the HMRC assessment and make any adjustments.

Individuals can already access their digital tax account from the Gov.uk website at: **https://www.gov.uk/personal-tax-account**.

Digital Tax Accounts for business

The approach with businesses will be different. Here information will be inputted to calculate any tax due.

Exactly what will be required is to be discussed in a number of consultations, following on from the recent Budget. The starting point is Government's intention that businesses will update their digital tax accounts 'at least quarterly' and that this will, unless timescales are revised, be up and running by April 2018.

A new platform

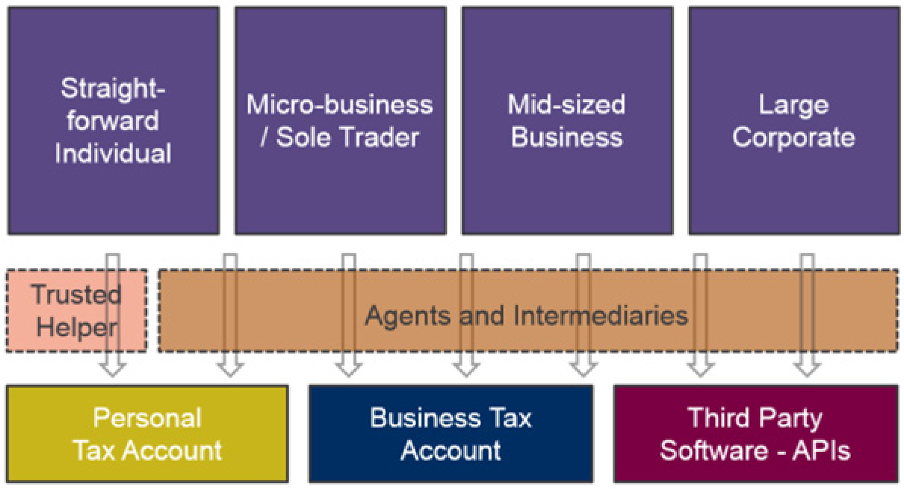
To set all this in context, HMRC's entire digital platform is being re-written and is moving onto "the cloud". This is a massive technological change and is set out in more detail in HMRC's recently published Information Technology Strategy document (**https://hmrcdigital.blog.gov.uk/wp-content/uploads/sites/20/2016/02/HMRC-IT-Strategy-2016.pdf**).

What matters from a tax agent's point of view, is that the traditional relationships between HMRC, client and agents will be changed by the new digital platform.

This is most clearly illustrated by a diagram, see Diagram 1 above, of HMRC's Multi-Channel Digital Tax Platform (from page 9 of the Information Technology Strategy document).

Here it can be seen that 'Agents and Intermediaries' no longer stand between HMRC and the client, but form a separate layer, accessing Personal and Business Tax Accounts on behalf of clients.

Diagram 1



Equal access

"By April 2016, every individual and small business will have access to a digital tax account. The digital accounts will present individual taxpayers with a personalised picture of their tax affairs, along with prompts, advice and support through webchat and secure messaging." (page 4, Making tax digital, Transforming tax by 2020).

While it is HMRC's aim that agents will, at all times, be able to 'see and do' all that their clients can see and do, Agent Services (previously known as Agent On-line Self-Serve – AOSS) has yet to achieve this. While taxpayers can access their digital tax account, it may be the summer, or later, before agents will have the same access.

The four foundations

In its Making Tax Digital Roadmap, the Government sets out the timetable and general framework, with the ambitious aim of a fully digital tax system by 2020.

The four 'foundations' are:

- **Tax simplified** - HMRC should use the information it already has and let taxpayers see this information via their own digital tax account
- **Tax in one place** - the target is for every taxpayer to be able to see a complete picture of their dealings with HMRC in one place.
- **Making tax digital for businesses** – moving toward more real-time information and interaction with HMRC
- **Making tax digital for individual taxpayers** – with digital accounts giving individual taxpayers a personalised picture of their tax affairs, along with prompts, advice and support through webchat and secure messaging

Capability and competence gap

These principles seem unobjectionable, even laudable, but there would appear to be a very significant gap between the current digital capability of small and medium sized businesses and the level of digital and accounting competence required to make the plan work.

The theoretical possibilities of digitalisation are immense, but actual take-up by business lags far behind. Some commentators consider that perhaps only one in twenty businesses are in a place to take advantage of any improvements in HMRC's digital performance.

From the point of view of the average business and its advisers, it is likely to take considerable time and resources to positively impact this position.

Some case studies

HMRC has created some case studies to illustrate Making Tax Digital (**https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/485372/Making_tax_digital_-_case_studies.pdf**).

Though these are fictional examples, these do show how HMRC anticipates digital tax administration working for businesses and their advisers. There are four case studies.

Study one: This is the digitally competent teacher with part-time freelance earnings, and rental income. The 'secondary' sources are over £10,000.

Here is a PAYE taxpayer with three sources of income, who would normally be in self-assessment. The digital future? This taxpayer is expected to manage without an agent, given on-line support from HMRC. The taxpayer will:

- Use a smartphone App to do the bookkeeping
- Send HMRC quarterly updates via their digital tax account
- Settle the tax bill monthly payment by direct debit
- Benefit from personalised guidance from HMRC through a 24/7 virtual assistant and webchat

Study two: This is a stand-alone business - a self-employed landscape gardener who is VAT registered with two employees. HMRC has given this taxpayer an agent. In HMRC's view, the taxpayer goes from manual bookkeeping, where they were significantly in arrears and error prone, to being fully up to date and accurate, with digital record keeping and quarterly submissions to HMRC.

In practice, is digitalisation alone going to improve book keeping, or are we facing a steep learning curve for clients?

Study three: Here a digitally confident pensioner with an occupational pension is able to manage their affairs just with HMRC on-line assistance.

Study four: This is a family company plumbing business. The transformation is from using excel spreadsheets, to Apps.

Downloading information from the company bank account into accounting software, for quarterly submissions *"All [the company director] needs to do is review it and update the company's digital tax account with HMRC."*

Again, experience suggests that many clients (and their advisers) would be unhappy submitting accounting summaries to HMRC without a review from their accountant or tax adviser. This obviously has cost implications.

The next step: ICAS and practitioner input

Now is the time for practitioners to consider how they see their future role. The transformation to digitalisation is unlikely to be halted. We may however influence the details. ICAS has been in discussion with HMRC from the beginning of the Making Tax Digital programme.

It has facilitated visits to a number of practices in Scotland.

This has enabled a direct dialogue where HMRC can begin to see some of the challenges and better understand the role of practitioners in converting the raw information of business records into a reliable basis for taxation. Aspects of accounts preparation, such as journal entries to split out loan interest, or re-allocated capital expenditure; a practice's knowledge of client so it can spot potentially disallowable costs or duplicated entries; these basics are not common knowledge at HMRC.

Following the Budget, there will be a number of consultations on aspects of Making Tax Digital. The details, exemptions, and procedures will be very significant. To be involved in the process, get in touch (**tax@icas.com**) and put forward your views, and those of your clients.

Don't rely on someone else making representations. If you don't highlight the areas that will impact your practice, you may face a system which doesn't meet your needs. We are very happy to get your input.

A BRIEF OVERVIEW OF SCOTTISH TAXES

The terminology can cause confusion. 'Scottish taxes' or 'devolved taxes' encompass different types of devolution and varying responsibilities and these terms lack precision. For example, the devolved powers over income tax are fundamentally different from the devolved powers over Land and Buildings Transaction Tax.

The following is a brief guide to where we are now following Royal Assent being given to the Scotland Act 2016 on 23 March 2016. It covers the different types of devolved taxes, the dates of implementation, and where to go for the relevant legislation and guidance.

The three types of tax devolution

Fully devolved taxes – Land and Buildings Transaction Tax (LBTT), Scottish Landfill Tax, Aggregates Levy and Air Passenger Duty.

These taxes are, or will be, the outright political responsibility of the Scottish Parliament and the administrative duties rest with the new tax authority, Revenue Scotland. The nature of the taxes, the legislation, and the associated collection and management duties are or will be fully devolved and solely the responsibility of those in Scotland.

Partially devolved taxes – Scottish Rate of Income Tax 2016/17, and income tax rates and bands from April 2017 onwards

Partially devolved taxes involve joint responsibilities, with political responsibility split between the UK and

Scottish Parliaments. The UK Parliament is responsible for the tax base, ie what is considered to be income, and how it is measured. The Scottish Parliament is currently responsible for the Scottish Rate of Income Tax (SRIT) as provided for in the Scotland Act 2012. In future, when the Scotland Act 2016 is implemented, the Scottish Parliament will also be responsible for the rates and the bands, allowing it to exert much greater control over how much is assessed for collection and from which taxpayers.

Administrative responsibility remains with HMRC but the Scottish Government will pay any additional costs of collection.

The Scottish income tax rate(s) – initially SRIT and then in future the full rates and bands - will be applied to earned income, pensions and rental income, but not to savings income and dividend income.

Assignment taxes - VAT receipts

VAT remains the responsibility of the EU (in terms of defining the tax base), and the UK Parliament (in setting the tax rates), with administration and collection by HMRC. Receipts in Scotland from the first 10p of the standard rate of VAT and the first 2.5p of the reduced rate of VAT will be assigned to the Scottish Government.

Implementation dates

- **1 April 2015** for Land and Buildings Transaction Tax and Scottish Landfill Tax
- **6 April 2016** for Scottish Rate of Income Tax
- **6 April 2017** is the expected implementation date for the new Scotland Act 2016 powers over the income tax rates and bands
- **1 April 2018** for Air Passenger Duty
- At a date yet to be agreed for Aggregates Levy
- **From 2019/20** for the assignment of VAT.

Relevant legislation

Enabling legislation enacted by Westminster:

- The Scotland Act 1998, which has subsequently been amended by the Scotland Act 2012 (which provided for SRIT and defined who is a Scottish taxpayer, and devolved tax powers over SDLT/LBTT and LfT/SLfT), and the Scotland Act 2016 (which provides for the full rates and bands of income tax, assignment of VAT, and the devolving of tax powers over APD/SAPD and Aggregates Levy)

There is a health warning if using the legislation – make sure it is fully consolidated, which is not always the case on **legislation.gov.uk**

Devolved legislation enacted by the Scottish Parliament

- Land and Buildings Transaction Tax (Scotland) Act 2013 - and the LBTT (Amendment) (Scotland) Act 2016 (the latter provides for the 3% additional supplement on residential property)
- Landfill Tax (Scotland) Act 2014
- Revenue Scotland & Tax Powers Act 2014

Each of the above three Scottish Acts are supported by a considerable quantity of Scottish Statutory Instruments.

Revenue Scotland Guidance is available at: **https://www.revenue.scot/** in relation to each of the three Acts, which is helpful in marrying up both primary and secondary legislation and pointing towards practical aspects such as the necessary forms.

Amended UK legislation

There is legislation regarding the SRIT and, in future, this will also be the case for the Scotland Act 2016 income tax measures. In general, the relevant legislation is in ITA 2007, providing for the Scottish rate(s) and also the legislation around the treatment of savings and dividend income.

Basic information can be found about SRIT on Gov.uk at: **https://www.gov.uk/scottish-rate-income-tax/how-it-works** and guidance on who is a Scottish taxpayer can be found at: **https://www.gov.uk/hmrc-internal-manuals/scottish-taxpayer-technical-guidance**. Employers guidance is in the Employer Bulletin of June 2015 (page 10) at: **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/439968/Employer_Bulletin_June_2015.pdf**.

You can find more detail in the following sources:

- Article by Donald Drysdale on the Scottish Rate of Income Tax – Tolley's Practical Tax, December 2014
- Tolley's Tax Digest 'Scottish Taxes' September 2015
- Bloomsbury Professional series
  - 'The Management of Taxes in Scotland' by Charlotte Barbour
  - 'LBTT' by Ken Wright
  - 'Income Tax' – this includes a chapter in it by Donald Drysdale
- Green's 'The Scottish Tax Yearbook 2015' by John St Clair

There is also more information on the SRIT at icas.com at: **https://www.icas.com/technical-resources/scottish-rate-of-income-tax-key-information**.

TAX DEBT RECOVERY – WHERE'S THE BORDER?

Scottish taxpayers, rest of UK taxpayers, devolved, assigned and HM Revenue & Customs (HMRC) - administered taxes, Revenue Scotland and HMRC: as if this wasn't confusion enough, what happens when it comes to debt recovery?

Direct Recovery of Debts

Most people will have heard of HMRC's new power called Direct Recovery of Debts; a power called 'regressive and draconian' by the Law Society of England and Wales because of concerns centred on the lack of judicial supervision and the effective reintroduction of Crown preference, which it called '*a measure swept away with good reason in 2002*'.

Geographical scope

What is less apparent at first glance is the measure's geographical scope. Issue Briefing: Direct Recovery of Debts published 5 August 2015 (**https://www.gov.uk/government/publications/issue-briefing-direct-recovery-of-debts--2/issue-briefing-direct-recovery-of-debts**), does not mention any geographical restriction. But if you wade through Finance (No 2) Act 2015, schedule 8, under the heading 'extent' at paragraph 24 it says '*This Part of this Schedule extends to England, Wales and Northern Ireland.*' So, when it comes to debt, where is the border, and what in practice does this mean?

Devolved taxes

Land and Buildings Transactions Tax (LBTT), Scottish Landfill Tax (SLfT), are devolved taxes. Air Passenger Duty (APD) and Aggregates Levy (AL) are due to follow suit, following the Scotland Act 2016, with APD from April 2018 and AL at a date yet to be agreed (see **https://www.gov.uk/government/publications/the-agreement-between-the-scottish-government-and-the-united-kingdom-government-on-the-scottish-governments-fiscal-framework**).

Administration

Currently Revenue Scotland is only responsible for administration of LBTT and SLfT, while HMRC administers the others.

HMRC is also responsible for administration, including collection, of the Scottish Rate of Income Tax, which is not a devolved tax – it is only a Scottish rate of tax, which is part of the overall income tax bill.

The debt recovery risk on these taxes seems relatively low. For example the LBTT system is administered in conjunction with Registers of Scotland, and will not allow the registration of title until the tax is settled. For SLfT, there are only about 40 registered taxpayers, and such businesses risk losing their operator's licence if there are compliance issues and returns are not submitted.

Calculating the debt and enforcing it

For partially devolved taxes, like SRIT, the Scottish Parliament sets one of the parameters – the rate; and following implementation of the Scotland Act 2016, all rates and bands for Income Tax with effect from 6 April 2017, although all other aspects of Income Tax remain UK based. This includes what is included as income, how it is measured, the reliefs, and all aspects of compliance.

For UK-wide taxes, such as Capital Gains Tax and Inheritance Tax, the UK Government decides on the rules for working out the tax due.

As regards enforcement, this depends on who administers the tax. Currently Revenue Scotland administers only LBTT and SLfT, while HMRC administers income tax, which includes SRIT and, in future, all Scottish income tax.

Residence of taxpayer

One further twist is that the law used for enforcement will depend on the current country of residence of the taxpayer. For example, a Scottish taxpayer with an unpaid SRIT liability (or Scottish Income Tax liability from April 2017), who moves to England, would be pursued under English law and HMRC powers relating to England.

On the other hand, someone moving from Wales to Scotland with unpaid CGT, would find recovery under Scots law and HMRC powers applying in Scotland.

New areas of complexity

Watch out for some new interactions. Capital Gains Tax is UK-wide, and the rate payable depends on whether the individual pays basic or higher rate income tax , but this is UK basic and higher rate. So from 2017, we may see individuals who are Scottish higher rate taxpayers for income tax, but, for Capital Gain Tax would need to be 'reassessed' on rest of UK (rUK) income tax to determine the rates of CGT (see explanatory note 137 on clause 15 Scotland Bill (now Scotland Act 2016) **http://www.publications.parliament.uk/pa/bills/lbill/2015-2016/0073/en/15073en.pdf**).

Tax debt recovery: who enforces?

When it comes to tax debt recovery, the first thing to establish is whether it is HMRC or Revenue Scotland who is carrying out enforcement. This should be fairly straightforward to establish, the only smokescreen being that HMRC now uses outsourced debt collectors.

There is a list of the agencies which HMRC uses at: **https://www.gov.uk/if-you-dont-pay-your-tax-bill/debt-collection-agencies**. Agencies generally exercise the same powers as HMRC, though if there is uncertainty about the amount of the debt, this will need to be resolved with HMRC directly.

HMRC powers: Scotland and rUK

HMRC's legal powers differ between Scotland and the rest of the UK. Revenue

Scotland has no unique powers: it will use the court processes available to debtors generally in the country in which the debt is pursued.

The essential difference is that HMRC works through the courts in Scotland, albeit with special procedures (see FA 2008 s128 Summary Warrant Scotland); whereas in the rest of the UK, HMRC has certain recovery powers which it can exercise without court intervention. These are:

- Direct recovery of debt – as mentioned above, and
- Legally taking possession of goods (sometimes referred to as distraint)

The Tribunals, Courts and Enforcement Act 2007 updated HMRC powers of taking possession of goods, and included HMRC as 'Enforcement agents' under s63(3)(b). But per s147(2) these powers do not apply in Scotland.

HMRC tax debt recovery in Scotland

The result of these rules is that HMRC's approach to tax debt recovery differs in Scotland. The initial approach, if time to pay cannot be agreed, is likely to be to the Sheriff Court for a Summary Warrant, which gives the power to take the money directly from pay or bank account, take and sell goods that are within business premises or kept on an individual's property but outside their house, for example, in a garage.

Insolvency

Where insolvency is envisaged, then HMRC's Enforcement and Insolvency Service (EIS) will be involved. The Edinburgh office covers Scotland and Northern Ireland. In terms of policy, the Edinburgh office may approach debtors differently from the Worthing office, which covers England and Wales.

For example, it has been known for the Worthing office to set limits on its involvement, for example, not voting on IVA proposals where the HMRC debt is small; essentially leaving the decision to other creditors. The Edinburgh office, by contrast, is likely to consider proposals on a case by case basis.

One significant difference on insolvency is that the courts in the rest of the UK will usually agree to a number of adjournments in bankruptcy proceedings, to enable the taxpayer both to clarify the amount of the tax debt and to arrange for payment.

In Scotland, after an initial lodgement of a petition for sequestration, the debtor (or their legal agent) may set out why the sequestration should not be granted, and the sheriff may defer the award of sequestration for 42 days, where the debtor can pay in that period. Strictly speaking this is a one-off period of grace, in which to arrange payment, not an open ended process to dispute the amount of tax due.

It is therefore imperative to negotiate directly with HMRC where the amount of the tax debt is disputed, and not to rely on any window of opportunity once the case comes to court. One possible exit route here to avoid sequestration is to apply for the Debt Arrangement Scheme.

HMRC tax debt recovery in rUK

HMRC debt recovery in the rest of the UK follows a less predictable pattern. The power to legally take possession of goods without a court order can be very successfully used, if only to persuade the debtor to agree to immediate payment.

Direct Recovery of Debt – UK (except Scotland)

Direct Recovery of Debt may seem to be a significant expansion of power, but in practice it is subject to a significant number of restrictions (see **https://www.gov.uk/government/publications/issue-briefing-direct-recovery-of-debts--2/issue-briefing-direct-recovery-of-debts#safeguards**).

Safeguards

Key safeguards include that a minimum of £5,000 should be left across the debtor's bank accounts, after the payment is made; there should be a 30-day period, once recovery action has been started, to lodge an objection; and an HMRC officer should meet the debtor face to face before DRD action is taken.

There is also specific guidance for 'vulnerable taxpayers', though one must question whether HMRC is in the best position to make decisions on vulnerability, where it is both judge and jury in debt cases (**https://www.gov.uk/government/publications/direct-recovery-of-debts-and-vulnerable-customers/direct-recovery-of-debts-vulnerable-customers**).

Estimated debts

A potential problem area here is estimated debts. These will be treated as 'not appealable' – (compare to HMRC safeguards as above), as the only remedy is Special Relief, and this is not, formally, an appeal (see **http://www.hmrc.gov.uk/manuals/sacmanual/SACM12215.htm**).

In addition, where an HMRC debt has been challenged in court, Special Relief will be denied (see **http://www.hmrc.gov.uk/manuals/sacmanual/SACM12220.htm**, penultimate bullet point).

Time to pay

In terms of time to pay, HMRC's normal timeframe will be payment within 12 months, though in exceptional circumstances, such as serious unexpected ill-health or insolvency of a major customer or supplier, a longer period may be negotiated.   Where time to pay is agreed, HMRC will require payment by direct debit and any failure to meet agreed instalments is likely to lead to court action.

Debt Arrangement Scheme in Scotland

One point to notice is that in Scotland the Debt Arrangement Scheme can be used for tax debt, so long as all other debts are included. It may be useful in obtaining longer time to pay periods. There is currently no equivalent in the rest of the UK (though the position may change). HMRC does not normally recognise informal debt management plans.

Conclusion

Devolution is bringing increasing complexity to both tax and tax debt recovery across the UK. It is important to be aware of the boundaries so that challenges to the amount of a tax debt and negotiations regarding its recovery can be effective.

THE UNION CUSTOMS CODE

The world of Customs Duties and import and export documentation is a very niche area of the tax code with more than its fair share of acronyms and specialist language. Businesses who are involved in significant importing and exporting will have staff who are well-versed in the intricacies of moving goods across borders. It's a branch of tax where a review of procedures by advisers and auditors with appropriate knowledge and expertise can often highlight opportunities for relief or areas of risk where specialist advice is required, and which other practitioners will choose to leave well alone! This article is therefore simply intended to raise general awareness of some significant changes.

The Union Customs Code (UCC) is being introduced across the European Union on 1 May 2016. There will be a number of changes to how goods cross EU borders and there will be a direct impact on businesses who are involved in the import and export of goods. The UCC aims to streamline procedures, provide greater clarity and move towards a paperless and fully electronic system.

The issues for businesses and their advisers are likely to be:

- the cost of additional guarantees required under the UCC
- preparing for the changes to procedures for the transfer of goods
- the impact of the changes on key business relationships with customers and suppliers
- understanding the benefit of the customs authorisations to the business
- reviewing documentation for export and import processes to confirm that this is proportionate and will meet the HM Revenue & Customs (HMRC) requirements
- keeping up to date on further changes to the system

The main changes from 1 May 2016 are:

- for new authorisations, mandatory guarantees for most special procedures and temporary storage will apply
- the ability to make some movements under temporary storage rather than national transit or Electronic Transit System
- the removal of the earlier sales provisions relating to valuation – but there are some transitional arrangements
- all communications between customs authorities and economic operators must be electronic

Some procedures and reliefs will cease or change on 30 April 2016 and these are:

- the €10 waiver of customs duty for free circulation customs declarations – there will no longer be a de-minimis exemption. This change does not affect any Community System of Duty Reliefs (CSDR) duty reliefs
- goods being declared to Onward Supply Relief (customs procedure code 42 series) – these can only be entered using a full customs declaration or the Simplified Declaration Procedure after the changes
- the use of Information Sheets for Special Procedures documents with an Entry in Declarant's Records
- Inward Processing Drawback and Low Value Bulking Imports authorisations will no longer be valid and these authorisations cannot be used to import goods regardless of any expiry dates shown on authorisations
- Processing under Customs Control authorisation holders will be given an Inward Processing authorisation number which must be used for new importations after 30 April 2016
- type D customs warehousing authorisation holders will be given a new authorisation number - these must be used for entries to customs warehouses after 1 May 2016
- goods being declared to Low Value Bulking Imports will only be entered using a Simplified Declaration Procedure authorisation

There is more information on the HMRC website at: **https://www.gov.uk/guidance/introduction-of-the-union-customs-code-ucc** and the EU material can be found at: **http://ec.europa.eu/taxation_customs/customs/customs_code/union_customs_code/index_en.htm**.

TAX TREATMENT OF TERMINATION PAYMENTS

Last year HM Revenue & Customs (HMRC) and HM Treasury ran a consultation on "*Simplification of the tax and National Insurance treatment of termination payments*". The purpose of the consultation was stated to be "*to explore how the tax and National Insurance Contributions (NICs) treatment of termination payments can be made simpler and fairer*." The proposals were in part based on recommendations from the Office of Tax Simplification (OTS).

The main proposal discussed was the removal of the current £30,000 exemption and the introduction of a new exemption which would increase proportionately with the number of years of service the employee had completed. This would proportionately reward long serving, lower paid employees. It was suggested that linking the availability of relief to the length of service of the employee would be easy to understand and easy for employers to administer.

The proposals also suggested aligning the tax and NIC treatment of termination payments, the possible removal of some exemptions and removing the distinction between contractual and non-contractual payments (which the OTS had identified as causing confusion and complexity).

Responses to the 2015 consultation have not been published at time of writing. However on Budget day the Red Book included the following announcement:

"***Tax and NICs rules for pay-offs***

1.145 Certain forms of termination payments are exempt from employee and employer National Insurance contributions and the first £30,000 is income tax free. The rules are complex and the exemptions incentivise employers to manipulate the rules, structuring arrangements to include payments that are ordinarily taxable such as notice and bonuses to minimise the tax and National Insurance due.

1.146 From April 2018, the government will tighten the scope of the exemption to prevent manipulation and align the rules so employer National Insurance contributions are due on those payments above £30,000 that are already subject to income tax. *The government will continue to support those individuals who lose their job. The first £30,000 of a termination payment will remain exempt from income tax and the full payment will be outside the scope of employee NICs.*"

The legislation is to be included in Finance Bill 2017 and a NICs bill.

Much later in the day the Overview of Tax Legislation and Rates (OOTLAR) was published and it became clear that the 'tightening' referred to would include "*introducing legislation to clarify that all payments in lieu of notice and certain damages payments are taxable as earnings and removing foreign service relief*".

It seems that the more radical simplification options discussed in the consultation document have been dropped in favour of more limited measures. Part of the reason for this may be found in the Budget Policy Costings document which suggests that the Government expects that the changes to termination payments will raise revenue of £1.42 billion by 2020/21.

There is an element of simplification in the abolition of the distinction between contractual and non-contractual payments in lieu of notice (PILONs) and in the alignment of the tax and NIC rules so that employers' NIC will be due on taxable payments over £30,000. However the extra NIC will represent an additional cost for employers and may result in some employees finding their redundancy payments reduced as employers seek to minimise the cost.

Foreign service relief is undoubtedly complex but its removal may not lead to simplification or fairness for employers and employees. They will presumably want to consider how double tax treaties will apply where termination payments are made to employees with considerable foreign service.

OOTLAR notes that further details will be outlined in a forthcoming technical consultation over the summer. ICAS responded to last year's consultation and would welcome any thoughts to inform a response to the technical consultation in due course (comments can be sent to **tax@icas.com**).

Overall this seems to be a missed opportunity for radical simplification of a complex area. Last year's consultation stated that "*the government thinks that it is not right to have a system that is so complex that many people are not able to have certainty that they have paid the correct amount of tax and NICs when they leave a job.*" Unfortunately unless the technical consultation contains some surprises this seems unlikely to change.

ERRATUM

In the article entitled "Rental Income Changes – Landlords Under Attack" [Technical Bulletin Issue 136] we incorrectly stated at page 5 that the 3% Land and Buildings Transaction Tax ("LBTT") supplement on properties costing over £40,000 does not apply to companies. The LBTT supplement will apply to all purchases of residential properties by companies and other such "non-natural persons", whether or not they already own a residential property.

EMPLOYMENT CORNER

HM Revenue & Customs (HMRC) relentless digitisation programme is forging ahead in spite of unintended consequences and unusual scenarios which simply can't be dealt with unless you speak to a real person. In this issue of Employment Corner, we discuss the implications for the digital tax account for the employer. We also look at HMRC's latest round of anti-avoidance proposals, including who HMRC classifies as "serial tax avoiders", its attitude to "disguised remuneration" practices, and what it is proposing to do to tackle them.

Digital Tax Accounts

According to the Financial Secretary to the Treasury, David Gauke, and despite petitions to scrap them, digital tax accounts are going ahead. He insists that "*...tax returns will be replaced by digital tax accounts for millions of individuals and businesses. They will bring together each taxpayer's details in one place, just like an online bank account, so they can register for new services, update their information, and understand quickly and easily what they need to pay — without ever having to complete a tax return again*".

He states that "*by early 2016 five million small businesses and ten million individuals will have access to their own digital tax account, and by the end of the next Parliament every individual and small business in the UK will have one*". All of this, together with the promise of having a digital account which is simple to understand, secure and even personalised sounds too good to be true though, doesn't it?

The question is, can HMRC really achieve such an ambitious goal and make itself one of the most advanced tax collecting organisation in the world? We all know about the problems with Real Time Information, which despite the many success stories is still not functioning as it should, and Universal Credit is not (yet) anywhere near the silver bullet it promised to be, having encountered, and still encountering, many digital challenges along the way.

The new digital tax account system - which is set to eventually replace tax returns and will require the co-operation of millions of individuals and businesses to function properly, relies on one fundamental thing - correct, real time information. The Government is currently aiming to achieve this by experimenting with blockchain and distributed ledger technology (**http://www.scribd.com/doc/295987915/Distributed-Ledger-Technology-beyond-block-chain**), which according to the UK Government Office for Science "*provides the framework for government to reduce fraud, corruption, error and the cost of paper-intensive processes. It has the potential to redefine the relationship between government and the citizen in terms of data sharing, transparency and trust.*"

For employers, accuracy will be crucial and will require HMRC to go beyond its current poorly structured internal system of reconciling Real Time Information, which is not actually processed by HMRC in "real time" at all and consistently mis-matches what employers are sending them, producing confusing and incorrect results.

All information provided by employers under the Real Time Information reporting system will feed into the digital tax account for every individual on PAYE and it is thus essential that it is correct from both the employer's and HMRC's perspective. If an individual's tax account is dependent upon accuracy with no intervention from them personally other than to check what tax they owe, this places a lot of responsibility on an employer's shoulder - perhaps even more than the current system does. It may require employers to maintain ever more open channels of communication with employees to ensure the information being submitted is not going to affect them adversely, and it will likely place an even heavier knowledge, training and compliance burden on them, with less available support from HMRC

Serial Tax Avoiders and Disguised Remuneration

The Autumn Statement included a warning at paragraph 3.87 that future tax avoidance measures might be retrospective from 25 November 2015. This confirms the message that the Government clearly thinks there are further measures which need to be taken to counter this behaviour, in spite of the measures already taken in Part 7A Income Tax (Earnings and Pensions) Act (ITEPA) 2003, which concerns itself with disguised remuneration. No further details have been released, but we may see further announcements in the next Budget and future Finance Bills on this subject. HMRC got serious about disguised remuneration regulation after the famous Dextra case, **MacDonald (Her Majesty's Inspector of Taxes (Respondent)) v Dextra Accessories Limited (Appellants)[2005] UKHL 47** and started to scrutinise Employee Benefit Trusts (EBTs), which had been around since the 1970's, in much more detail. The recent "Rangers case", **Advocate General for Scotland v Murray Group Holdings Ltd [2015] CSIH 77** demonstrated how seriously HMRC is about pursuing disguised remuneration - even though the previous two hearings of this case found in favour of the taxpayers, HMRC were not prepared to give up. Nevertheless, opinion is split as to whether this precedent heralds the end of the EBT, and it seems the ongoing battle between tax avoidance scheme promoters and HMRC is set to continue.

The Government will also introduce measures to counter avoidance by what they term "serial avoiders" - that is to say, those who have previously used avoidance schemes which have been found to fail in the courts but who have gone on to utilise other tax avoidance schemes and have been issued with a warning notice by HMRC. It appears that additional reporting and surcharges will apply to failed schemes going forward - and if HMRC decides that an individual has serially tried to abuse the tax system, they could face further sanctions.

HMRC UPDATE

Talking points session

Thursday 21 April 2016 13:00 - 13:45

Subject: Security Awareness for agents – A look at how Agent interactions can affect HM Revenue & Customs (HMRC) systems and the security issues affecting Agents today.

Please click **here** to register for this meeting.

Single director companies excluded from £3,000 NIC employment allowance

From 6 April 2016 the Employment Allowance increases from £2,000 to £3,000, but the allowance will not be available to offset against the employers' NIC liability of companies where the director is the only employee.

RTI concessions for small employers to end from 6 April 2016

The two year temporary reporting relaxation ended on 5 April 2016. The relaxation permitted employers who, at 5 April 2014, employed no more than 9 employees, to report their PAYE information for the tax month 'on or before' the last payday in the tax month instead of 'on or before' each payday. This aligns the reporting obligations for micro employers with all other employers who are currently required to report payments 'on or before' each payday. As a consequence 'Late reporting reason code E' is invalid from 6 April 2016.

Contracting out of additional state pension ends 5 April 2016

From 6 April 2016 employees of contracted-out defined benefit (DB) schemes will automatically be brought back into the State Pension scheme and will no longer be able to use a contracted-out salary related (COSR) occupational pension scheme to contract out of the State Scheme. Employees will, depending on their level of earnings, start to accrue entitlement to the new State Pension instead.

Eligibility for the contracted-out National Insurance contributions (NICs) rebate of 3.4% for employers and 1.4% for employees also ceased from this date. This brings with it some changes in what and how you report to HMRC:

- from 6 April 2016: You will not be able to use your Contracted-out Salary Related (COSR) occupational pension scheme to contract employees out of the new State Pension scheme
- there will no longer be a requirement to report the Employers Contracting-out Number (ECON) and Scheme Contracted-out Number (SCON) details on Full Payment Submission (FPS) for tax years commencing 6 April 2016 and onwards
- there will no longer be a requirement to separate the National Insurance (NI) earnings between the Primary Threshold (PT) and Upper Accrual Point (UAP) & UAP to Upper Earnings Limit (UEL)
- there will be a requirement to report NI earnings between the PT and UEL as there was prior to 2009
- there will be one less column to complete on forms P11 and P60. These forms will be updated in due course and available on the Basic PAYE Tools or can be ordered from the Employer order-line. All HMRC systems will be amended to reflect these changes and the UAP data field will be removed from the FPS and Earlier Year Update (EYU).

All payroll software will need to be amended.

National Insurance categories from 6 April 2016

Contracted-out National Insurance tables/categories D, E, I, K, L, N, O and V will be replaced by Standard National Insurance tables/categories A, B, J, M, P, Q, R, T, Y and Z

Tax charge on annuity sales to be reduced from April 2017

The Government has confirmed that from 6 April 2017, tax restrictions for people looking to sell annuities will be removed, giving those with an existing annuity, and anyone who purchases an annuity in the future, the freedom to sell their right to future income streams for an upfront cash sum. Currently, people wishing to sell their annuity income face a 55% tax charge, or up to 70% in some cases. This charge is to be removed, so that people will only be taxed at their marginal rate. Under the new changes, retirees will be able to take the annuity as a lump sum, or access the new flexible drawdown products introduced in April 2015.

VAT ON VISITORS FEES: THE CONCLUDING EPISODE

HM Revenue & Customs (HMRC) have at last accepted defeat in the matter of the VAT treatment of visitors' fees earned by sports clubs.

By way of reminder Bridport and West Dorset Golf Club, a non-profit making members' golf club, successfully challenged HMRC's view that visitor fees were liable to VAT at the standard rate. It was argued that these supplies are exempt from VAT as a supply of sporting services, just like the playing members' subscriptions.

HMRC fought hard, and even after accepting the European Court of Justice's view that the income is indeed exempt from VAT, they went on to challenge the amount of VAT repayments due on the grounds of unjust enrichment. In addition, they tried to argue that course maintenance costs had no direct and immediate link to tee advertising and buggy hire (thereby resulting in input tax on course maintenance becoming wholly attributable to exempt activity, thus reducing the amount of VAT repayable to clubs under the Bridport appeal). Further they challenged the VAT treatment of green fees to corporate bodies and to tour operators under the Tour Operators Margin Scheme (TOMS).

The Berkshire, Glen and Wilmslow Golf Clubs successfully appealed to the VAT tribunal on the unjust enrichment issue, and also against HMRC's three further arguments. HMRC have decided not to appeal this decision and thus the matter should now be settled.

Although these appeals have been fundamentally successful for the tax payer, the Tribunal did decide that there was an element of unjust enrichment for clubs that would not repay the over charged output tax back to the respective visitor and therefore concluded that a 10% restriction should be placed on repayment claims. Further, the Tribunal decided that supplies of green fees to tour operators are subject to VAT at the standard rate (the tour operator supplies these rights to use the club on to individuals) as is the supply of corporate day packages. Also, course maintenance costs were held to be properly treated as residual where the club also makes taxable sales in the way of corporate days, provides advertising at tees and hires golf buggies.

Claims for overpaid output tax should be sent to VAT Bridport Claims S0483,PO Box 200,Bootle L69 9AH.

VAT REGISTRATION – CROSSING THE THRESHOLD

The rules for determining when the VAT registration threshold has been crossed are fairly well known. Perhaps less well known are the circumstances under which it may be possible for a business to avoid having to become VAT registered even when it has gone over the threshold.

The basic rule is that a business becomes liable to register for VAT at the end of any month if the value of taxable supplies (being supplies made at any rate of VAT including the zero-rate) made in the twelve months then ending exceeds the registration threshold. This is known as the Table A limit and is currently £83,000, with effect from 1 April 2016. In addition, if there are reasonable grounds for believing that the value of taxable supplies in the period of 30 days then beginning will exceed the current threshold of £83,000, then the business must become VAT registered.

However, a business is not obliged to register for VAT if it can satisfy HM Revenue & Customs (HMRC) that the value of taxable supplies in the period of one year beginning at the time at which he was liable to be registered as a result of having crossed the threshold in the first scenario described above, will not exceed the Table B limit, currently £81,000 as of 1 April 2016. This allows for circumstances where a business temporarily crosses the threshold due to a one-off large order, when it would ordinarily continue to trade under the threshold.

For example, take a small retail business that has cumulative taxable sales in the year ended 31 January 2016 of £84,000, after an unusually buoyant January sales period. The business would be obliged to register for VAT from 1 March 2016. However, projected sales for the year ended 28 February 2017 are only £76,000. It would thus be possible to apply to HMRC for exemption from registration. It would be necessary to justify the reasons behind the projected figures being lower than actuals for the year ended 31 January 2016 and provide necessary evidence. Therefore any business in such a position must contact HMRC's VAT Registration Services in order to discuss the matter.

This therefore allows HMRC to effectively grant retrospective exemption from registration. However, it is still necessary for the relevant business to continue to monitor the value of cumulative monthly taxable supplies on a rolling 12 month basis in order to identify if the threshold is crossed again.

Any business that is monitoring its level of taxable supplies should also be aware of what constitutes "taxable supplies" for VAT registration purposes. As would be expected, taxable supplies include all sales of goods and services that would be liable to VAT at the standard, reduced or zero-rates, should the business be registered. It is the VAT exclusive value that is relevant. Taxable supplies also include the value of all reverse charge services received from abroad. This makes sense because if this amount were excluded, an otherwise unregistered small business could avoid VAT costs by purchasing services from overseas, gaining an unfair tax advantage over larger VAT registered businesses who are unable to reclaim all of the VAT that they suffer for whatever reason, perhaps due to its attribution to non-business or exempt activities.

Taxable supplies for registration purposes should exclude supplies of capital assets (although this definition of capital assets excludes any standard rated supply of any interest in land). For a tour operator, the value of taxable supplies for registration purposes, is the value of the margin on margin scheme supplies rather than the full selling price.

SIMPLIFICATION TO VAT MOSS SCHEME FOR BUSINESSES BELOW THE VAT REGISTRATION THRESHOLD

HM Revenue & Customs (HMRC) has announced simplifications to the VAT MOSS scheme for businesses trading below the VAT registration threshold that make supplies of digital services to private consumers in other member states.

On 1 January 2015 the VAT place of supply for digital services supplied to private consumers and other non-business customers was changed to where the customer belongs. Businesses making these supplies became liable to register for VAT in each country where they supplied digital services. "Digital services" includes telecommunications, broadcasting or other electronically supplied services. HMRC has produced guidance on the definition of this term here in the section on defining digital services: **https://www.gov.uk/government/publications/vat-supplying-digital-services-to-private-consumers/vat-businesses-supplying-digital-services-to-private-consumers#define-digital**.

To reduce the compliance burden on businesses, the VAT Mini One Stop Shop (MOSS) system was introduced. Businesses that use this system can declare and pay the VAT due on their sales of digital services to non-business customers across the EU using a single return and make a single payment in their home state. The VAT MOSS system removes the need to register in each member state where the business has customers.

HMRC has allowed UK businesses below the VAT registration threshold (£83,000 currently) to register for VAT MOSS to charge and account for VAT in respect of their EU cross-border B2C supplies of digital services. Additionally they are able to reclaim any VAT charged on business expenses which are directly related to their cross-border digital service supplies. Businesses in this category do not have to charge and account for VAT on their UK domestic supplies.

HMRC has now announced some simplifications to the current arrangements. These are as follows:

- **Evidence of where the customer belongs** - businesses have to determine where their customer belongs to work out where their services are supplied and the appropriate VAT rate. For supplies of digital services, the normal rule is that businesses must collect two pieces of non-contradictory evidence on the location of their customer. HMRC has allowed businesses below the VAT registration threshold some leniency and has asked them to have one piece of evidence, but these businesses have found that this creates difficulties. HMRC has now indicated that it will allow businesses to exercise their best judgement to determine the location of their customer – so an address alone would be sufficient.
- **Consideration of where there is actually a business being carried on** - there is no registration threshold on cross-border supplies of digital services but VAT is only due on supplies made in the course or furtherance of a business. HMRC does not normally regard activity undertaken as a hobby as constituting a business. The analysis of the VAT MOSS returns submitted to date indicates that some of the VAT MOSS registrations may be for activities that are not a business – so that no return is required or any payment due. There is guidance on the distinction between business and non-business activities at: **http://www.hmrc.gov.uk/manuals/vbnbmanual/VBNB21000.htm**.

You can read the full HMRC Brief at: **https://www.gov.uk/government/publications/revenue-and-customs-brief-4-2016-vat-moss-simplifications-for-businesses-trading-below-the-vat-registration-threshold/revenue-and-customs-brief-4-2016-vat-moss-simplifications-for-businesses-trading-below-the-vat-registration-threshold**.

TAX CASES

Discovery assessments

With an increasing number of Accelerated Payment Notices being issued by HMRC, the question of discovery assessments is worth looking at again. Usually, HM Revenue & Customs (HMRC) has four years from the end of tax year for which a Self-Assessment return is due in which to open an enquiry. For CTSA, the time limit is within 4 years of the end of the company's relevant Accounting Period.

But what happens if there was something unusual about the return? What if it included a marketed tax 'reduction' arrangement, which was widely available at the time? What if this happened some years ago before the taxpayer became your client? The same principle applies to any areas of subjectivity, disagreement, or differing interpretations of the law. So, in what circumstances can HMRC re-open the case and, going forward, what do we need to disclose on a return now to be reasonably sure of finality?

This question was recently examined in the case of **Mr David Sanderson (Court of Appeal [2016] EWCA Civ 19)**. The fact that the case concerns Mr Sanderson's tax return for the year ended 1999 (seventeen years ago) and submitted in February 2003 (thirteen years ago) highlights the benefits of closure. Losses claimed in the return arose in April 1997, so there has been close on nineteen years of uncertainty. A discovery assessment was raised on 11 December 2005.

A convenient loss

The facts of Mr Sanderson's case involved a failed scheme which purported to create a £2 million capital loss to offset against a capital gain of £1.8m. The taxpayer used the 'white space' on the return to give details of the loss-making arrangement.

The question at issue was – did this disclosure prevent HMRC from raising a discovery assessment under s29 Taxes Management Act (TMA) 1970?

The point of law in regard to the losses in this case, concerned Taxation of Chargeable Gains Act (TCGA) 1992 s.71 (unrelieved capital losses of Trustees being attributable to beneficiaries), but as this section was subsequently changed, the detailed arguments about creation of the loss need not concern us.

Making HMRC aware

The key section under the microscope here is s29(5) TMA 1970, which includes the phrase "*the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation.*" The taxpayer has submitted a return. The normal enquiry window has closed. Information about an unusual or subjective issue has been disclosed in the return, usually in the white space. HMRC is <u>prevented</u> from making a discovery assessment, if the information could reasonably have been expected to make an HMRC official aware that income or gains have been under-assessed or missed completely, or that a relief given is excessive.

(**Note:** there are additional protections against discovery assessment, such as that under s29(2) that the information in the return was '*in accordance with the practice generally prevailing at the time when it was made.*')

Information – actual knowledge or inferred?

What is sufficient to ensure that available information makes HMRC 'aware'? There is actual information which HMRC is given, and there is information which can reasonably be inferred.

S29(6) defines the 'information' referred to as including returns, together with any accounts, statements or documents accompanying the return. Claims and other documents submitted by the taxpayer are also included.

There is another, harder to define category in s29(6)(d). This is "*information the existence of which, and the relevance of which as regards the situation*" .... "*could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above*" viz information in returns and supporting papers (emphasis added).

In the Sanderson case, reference was made in the return to "*The loss is part of a loss of £1,000,000,000, which accrued to the Trustees of the Castle Trust on 8th April 1997, on the disposal of a European Average rate Option (Trade No. 82831) relating to shares in Deutsche Telecom.*"

HMRC was aware of the Castle Trust scheme, and it was making enquiries into it before the usual enquiry window for Mr Sanderson's return had closed. Was this enough to protect Mr Sanderson from a discovery assessment? Could a reasonable HMRC office have <u>inferred</u> from the return that there might be more information about Castle Trust within HMRC, that this would be worth looking into, and which might suggest the loss claim in the return was excessive?

Various scenarios

Mr Sanderson's legal team put forward three scenarios:

Scenario 1 – the HMRC official has only the information on the tax return

The argument here was that the neatly balanced losses and gains, the disparity between the size of the loss claimed at £1,825,663 when compared to the income from the Castle Trust of only £16.04; the fact that that the loss arose from an asset which Mr Sanderson had held for only one day; the existence of a £1 billion loss attributable to the disposal of a derivative; surely all this was enough to raise the suspicions of the average HMRC officer?

But the Appeal Court confirmed the Upper Tribunal approach, that this was not enough. The information in the return "did not contain enough information to make the officer aware of an "actual insufficiency" or to justify the making of an assessment."

To do this, more disclosure was needed. Specifically, it was thought that the tax return 'failed to disclose the simultaneous entry into the counter-option; the termination of the "in the money" contract on 4 April 1997 which created the gain that largely funded the liabilities on the "out of the money" contract; and the change from Guernsey to UK trustees on 7 April 1997; and that '*without this information it would not have been possible for the officer to form the view that the Scheme as a whole lacked commercial reality.*'

So, to be secure from discovery, it would, in this view, have been necessary to say more: to at least make clear the possible 'non-commerciality' of the arrangements; even perhaps even to openly state the possibility that the scheme might fail.

Scenario 2 - the HMRC official should have been aware of HMRC's publicly stated views about the Castle Trust tax scheme

The argument here is that a HMRC official should, on the s29(5) and s29(6)(d) principle, be able to infer from information in the return, that there was a problem.

In support of this view, it was advanced that HMRC's Special Compliance Office and Specialist Investigation Services were investigating the Castle Trust scheme, even before Mr Sanderson's return was filed. Enquiries had started in 1999 and continued until 2007.

The case was essentially that '*the knowledge and understanding of the notional officer must extend to include knowledge of HMRC's then published thinking about the effectiveness of the Scheme.*'

The Court decided otherwise. '*The exercise postulated by s29(5){which covers s29(6)} is a consideration by the officer of the information disclosed by the taxpayer by reference to the relevant legal principles: not by reference to what some particular department or officer at HMRC may at the time have thought about the efficacy of the Scheme then under investigation.*'

In this view, it would not be until the Castle Trust case was decided by the Special Commissioners in 2008 (**Corbally-Stourton v HMRC [2008] STC (SCD) 907**), that a 'notional HMRC officer' could infer from mention of the name 'Castle Trust' that there was likely to be an under-assessment in Mr Sanderson's case.

Before the decision of the Special Commissioners, there was 'no published determination about the effectiveness of the Scheme'.

Scenario 3: the notional officer also has attributed to him the results of HMRC's investigations into the Castle Trust

The argument here is that to the notional HMRC officer, should be attributed information already held within HMRC.

HMRC's internal research showed that Mr Sanderson was not the only taxpayer connected with the scheme. Noticing the words 'Castle Trust' should have been sufficient disclosure in these circumstances.

But, following the Upper Tribunal, the Appeal Court supported the view that any inference should:

- be reasonably drawn
- relate to the insufficiency of tax, and cannot be a general inference of something that might, or might not, shed light upon the taxpayer's affairs
- be drawn only from the return (and other documents) provided by the taxpayer

How far does this go? In the **Charlton** case (**Charlton v HMRC [2013] STC 866**), disclosure of a reference number relating to a scheme in the taxpayer's return, was considered sufficient for s.29(6)(d)(i). '*The taxpayer need not state it all, but must state enough for the existence of more relevant information to be inferred*'.

Conclusion

Closure is in everyone's interest. When submitting returns, it is well to stand back and consider what the 'hypothetical HMRC officer' would make of any 'white space' entries. While not needing to be longwinded, consideration should be given to clear disclosure not only of the facts, but also to making HMRC aware, or at least reasonably able to infer, the possible consequences of alternative interpretations.

AUDIT EXEMPTION

Background

On 26 January 2016, the UK Government announced that the test for determining whether a company is entitled to take advantage of audit exemption would remain aligned to the small company definition contained in section 382 of the Companies Act 2006. Therefore, there is no need for any amendment to the Companies Act 2006 as 'The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015' enacted in April 2015 already retained the alignment approach which had been in place since 2012. These Regulations were introduced to implement the bulk of the requirements contained in the 2013 EU Accounting Directive in the UK and apply to accounting periods commencing on or after 1 January 2016 (certain aspects were available for early adoption for accounting periods commencing on or after 1 January 2015 but audit exemption was not one of these).

Therefore, for accounting periods commencing on or after 1 January 2016, the audit exemption test remains that a stand-alone company (ie one which is not a member of a group) must meet the definition of a small company.

In summary, this means that it must meet the following revised qualifying conditions taking account of the two-year rule (see below), and must not be ineligible.

Qualifying conditions

For accounting periods commencing on or after 1 January 2016 the revised qualifying conditions are shown in Table 1 below.

The qualifying conditions are deemed to have been met in a year when an entity meets at least two of the three criteria in that year. However, consideration has to be given to the two year rule (obviously excluding a company's first year). The wording of section 382 of the Companies Act 2006 (the Act) was amended by the Small Companies (Micro-Entities' Accounts) Regulations 2013. This, however, did not result in a change in substance. The revised wording of section 382 of the Act - "*that affects its qualification as a small company only if it occurs in two consecutive years*" - is intended to have the same meaning in substance as the previous wording ie:

(a) if the qualifying conditions are met in that year and the preceding financial year;

(b) if the qualifying conditions are met in that year and the company qualified as small in relation to the preceding financial year;

(c) if the qualifying conditions were met in the preceding financial year and the company qualified as small in relation to that year.

This provision is also relevant when determining whether a company qualifies for audit exemption in the first year that the new Regulations take effect, ie for accounting periods commencing on or after 1 January 2016. The transitional provisions on first application are that the current year and previous years need to be assessed on the basis of the revised qualifying conditions. If we assume that a stand-alone company has a year end of 31 December 2016 then the simplest way of applying the transitional rules is to see whether the company satisfies the revised qualifying conditions in both the years ended 31 December 2015 and 31 December 2016. If it does, then the company will be entitled to take advantage of audit exemption provided it is not ineligible.

Table 1

Qualifying Conditions

	New Threshold	Previous Threshold
Turnover	Not more than £10.2 million	Not more than £6.5 million
Balance Sheet Total[1]	Not more than £5.1 million	Not more than £3.26 million
Number of Employees[2]	Not more than 50	Not more than 50

[1]Balance sheet total means the sum of all the amounts shown as assets in the balance sheet (ie fixed assets plus current assets) without any deduction for liabilities.

[2]Number of employees is calculated by summing the number of persons employed under contracts of service by the company in each month (whether throughout the month or not), dividing by the number of months in the financial year.

Ineligible Companies – Section 384 of the Companies Act 2006

The small companies' regime does not apply to a company that is, or was at any time within the financial year to which the accounts relate:

(a) a public company;

(b) a company that:
   (i) is an authorised insurance company, a banking company, an e-money issuer, a MiFID investment firm or a UCITS management company, or
   (ii) carries on insurance market activity; or

(c) a member of an ineligible group.

A group is ineligible if any of its members is:

(a) a traded company;

(b) a body corporate (other than a company) whose shares are admitted to trading on a regulated market in an EEA State;

(c) a person (other than a small company) who has permission under Part 4 of the Financial Services and Markets Act 2000 (c. 8) to carry on a regulated activity;

(d) a small company that is an authorised insurance company, a banking company, a MiFID investment firm or a UCITS management company;

(e) a person who carries on insurance market activity; or

(f) an e-money issuer.

Stand-alone company

On first application of the new increased audit exemption thresholds, in the simplest terms a company will qualify as small and hence be eligible for audit exemption if it satisfies the revised qualifying conditions in its current financial year and its previous financial year. Therefore, let us look at a private non-ineligible company with a year end of 31 December with the figures for 2015 and 2016 shown in Example 1 above.

Example 1

	2016 £	2015 £
Turnover	10, 200,000	10,150,000
Balance Sheet Total	5,100,001	5,000,000
Number of employees	50	50

For the year ended 31 December 2016, the company satisfies 2/3 of the criteria and therefore passes the revised qualifying conditions. In 2015, the company satisfies all of the criteria and therefore satisfies the revised qualifying conditions. For the year ended 31 December 2016 the company qualifies as a small company and is therefore entitled to take advantage of audit exemption for that year. On this occasion whether the company satisfied the qualifying conditions in 2014 is irrelevant as by satisfying them in both 2015 and 2016, it has satisfied them in two successive years and hence meets the test.

The next issue of Technical Bulletin will explore this subject matter in more detail.

UPDATED GUIDANCE ON TRADING SUBSIDIARIES OF CHARITIES

The Charity Commission, HM Revenue & Customs (HMRC) and ICAEW have published revised guidance relating to the trading subsidiaries of charities and tax which should be considered by charity trustees of UK charities, directors of trading subsidiaries of UK charities and their advisors. The revised guidance is relevant where donations have been paid or will be paid in future by a wholly-owned trading subsidiary to a parent charity.

Why has the guidance been revised?

It has been common practice for companies which are wholly-owned trading subsidiaries of charities to donate all their taxable profits to their parent charity and to claim relief for the donation using the company Gift Aid scheme. This was the case even where, in some cases, the amount of the donation exceeded the amount of distributable profits of the company calculated in line with the Companies Act 2006.

The ICAEW obtained a legal opinion which concluded that payments of this nature, received by a parent charity from a wholly-owned trading subsidiary, are distributions under company law. This means that any part of such a payment made by a subsidiary company that exceeds the subsidiary company's distributable profits is considered unlawful under the Companies Act.

Charity Commission guidance – Trustees, trading and tax

The Charity Commission for England and Wales has published a new version of CC35 – Trustees, trading and tax which can be found at: **www.gov.uk/government/publications/trustees-trading-and-tax-how-charities-may-lawfully-trade-cc35**. The previous version of CC35 had previously been withdrawn shortly following the legal opinion being received by ICAEW.

The main change to CC35 is the insertion of a new section 4.5: "*Can trustees expect their charity's wholly-owned trading subsidiary to always Gift Aid all the profits shown in the profit and loss account to its parent charity?*" The short answer given is "No".

"*Company law makes it unlawful for any company to make distributions in excess of distributable profits. If the accounting profit is higher than the value calculated for distributable profits, only the lower* *figure can be paid across under Gift Aid."*

The revised section goes on to note that a consequence of this is that when the taxable profits of the trading subsidiary are greater than its distributable profits, the trading subsidiary may have a tax liability.

HMRC guidance – Trading and business activities

HMRC has also updated its guidance for charities set out in *"Annex IV: Trading and business activities – basic principles"* which can be found at: **www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-iv-trading-and-business-activities-basic-principles**. Sections 45 and 47 have been updated to make clear that any part of a donation payment made by a wholly-owned subsidiary company to its parent charity which exceeds the subsidiary's profits available for distribution is unlawful under the Companies Act 2006. In addition, such a company will not obtain a tax deduction for any unlawful distributions for accounting periods commencing on or after 1 April 2015.

ICAEW guidance – Donations by a company to its parent charity

The ICAEW updated its technical release on the subject *"Tech 16/14BL: Guidance on donations by a company to its parent charity"* which can be found at: **www.icaew.com/~/media/corporate/files/technical/technical%20releases/legal%20and%20regulatory/tech16%2014bl%20guidance%20for%20donations%20by%20a%20company%20to%20its%20parent%20charity.ashx** setting out the background to the changed approach and considering the steps which need to be taken by charities and their trading subsidiaries to remedy any unlawful distributions.

Practical implications of the revised guidance

The new Charity Commission guidance states that parent charities with wholly-owned trading subsidiaries must bring their operations into compliance with the revised position for any accounting period starting on or after 1 April 2015. It goes on to suggest that where wholly-owned trading subsidiaries have previously paid a higher figure under Gift Aid the charity's trustees may need to take advice from a suitably qualified professional advisor.

The amended HMRC guidance notes that if unlawful distributions have been paid by a subsidiary company to a charity in earlier accounting periods, the ICAEW technical release sets out that, subject to time limits, the parent charity has a liability to repay the unlawful distributions and the company has a right to receive the sums. HMRC states that the repayment of such prior unlawful distributions by the charity to the company will not be taxable income in the hands of the company.

ACCOUNTING AND AUDITING QUERIES

Query: *I am a partner in a small firm of chartered accountants. We act for two sisters who each own 50% of the ordinary share capital of two separate medium-sized private limited companies, A and B respectively. The sisters are also the only directors of both companies. Both companies adopted Financial Reporting Standard (FRS) 102 for the first time in their accounts to 31 December 2015. Currently the group is considering undertaken a reconstruction in which the co-owned companies will be combined into a group via a share exchange with the shareholders in B exchanging their shares for further shares in A. The client intends to treat this transaction as a merger if it goes ahead. Can they do so? If so, does the client require to create comparative figures for the previous year ie a year in which the parent company did not exist?*

Answer: FRS 102 allows but does not require group reconstructions to be accounted for using merger accounting. In order to do so the following criteria must be satisfied:

(a) the use of the merger accounting method must not be prohibited by company law or other relevant legislation;

(b) the ultimate equity holders must remain the same, and the rights of each equity holder, relative to the others, must remain unchanged; and

(c) no non-controlling interest in the net assets of the group is altered by the transfer.

Therefore, provided that the above conditions are satisfied, the company will be able to use merger accounting should the group reconstruction go ahead. From the information provided it would appear that the proposed transaction would qualify to apply merger accounting. The Companies Act requirements are contained in the 'Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 Schedule 6:10. The main issue is normally to ensure "*that the fair value of any consideration other than the issue of equity shares given pursuant to the arrangement by the parent company and its subsidiary undertakings did not exceed 10% of the nominal value of the equity shares issued*"

If we assume that the group reconstruction does go ahead, then the approach in paragraphs 19.29-33 of FRS 102 requires that the comparative amounts in the consolidated accounts should be stated as if the entities had been combined throughout the previous period and at the previous balance sheet date. This therefore requires a restatement of the comparative figures to include the results for all the combining entities for the previous period and their balance sheets for the previous balance sheet date, as if all the companies had been combined throughout the previous period adjusted as necessary to achieve uniformity of accounting policies, despite the group not having been in existence in the prior year. This can be explained in a note.

The rationale for this approach is that the aim of the consolidated accounts in merger accounting is to reflect the combining companies' results and financial positions as if they had always been combined.

Query: *I am a manager in a medium sized firm of chartered accountants. I am presently working on the accounts of a UK private parent company which has 3 trading private company subsidiaries. Each of the subsidiaries is material in terms of the UK group. The holding company is owned 100% by a parent company in Luxemburg which is not listed (see Diagram 1 below). Each UK company is a small company in their own right but the combined "UK group" is medium sized. The group is medium-sized under both the old Companies Act qualifying conditions and the new qualifying conditions.*

My queries are:

(i) Do the directors of the UK Holding Company have to produce consolidated accounts for the UK group? Is this dependent on whether the companies' figures are included in group accounts prepared by the Luxembourg parent?

(ii) Can I apply the Financial Reporting Standard for Smaller Entities (2015) to individual UK companies on the basis that they are all individually small or are they all covered by FRS 102 on the grounds that the UK group to which they all belong is not small?

Answer:

(i) In order to assess whether the UK Holding Company has to prepare group accounts consideration has to be given as to the requirements for group accounts. If a group is not small, then it has to prepare group accounts. In your situation the group is not small and hence group accounts would normally be required subject to any other available exemptions as per section 399 of the Companies Act 2006. The most appropriate exemption in this scenario is that contained in section 400 of the Act (company included in EEA accounts of larger group).

Section 400

This exemption is applicable where the UK parent is a wholly-owned (also available to a majority owned subsidiary) and its immediate parent is established under the law of an EEA State. However, additional criteria as set out in section 400(2) of the Act need to be met. These are:

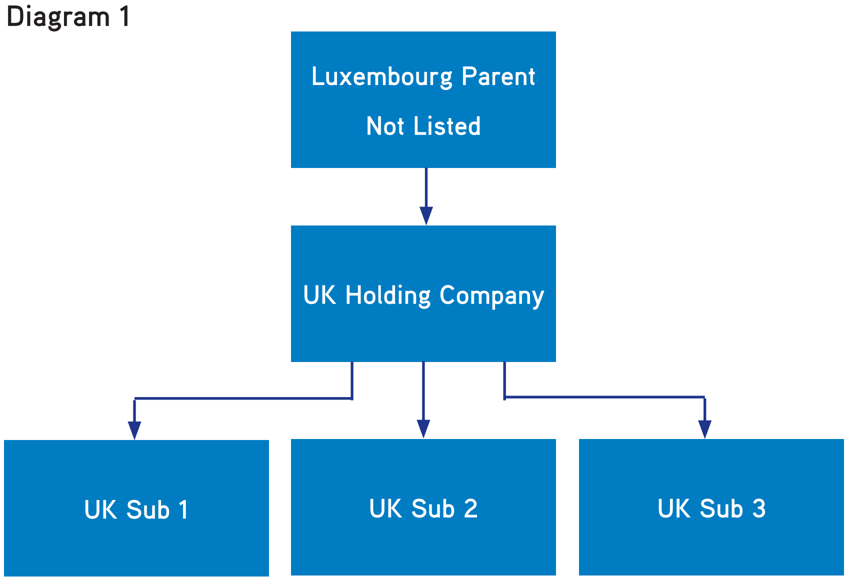
(a) the company must be included in consolidated accounts for a larger group drawn up to the same date, or to an earlier date in the same financial year, by a parent undertaking established under the law of an EEA State;

(b) those accounts must be drawn up and audited, and that parent undertaking's annual report must be drawn up, according to that law:
   - (i) in accordance with the provisions of the Seventh Directive, or
   - (ii) in accordance with international accounting standards;

(c) the company must disclose in its individual accounts that it is exempt from the obligation to prepare and deliver group accounts;

(d) the company must state in its individual accounts the name of the parent undertaking that draws up the group accounts referred to above and:
   - (i) the address of the undertaking's registered office (whether in or outside the United Kingdom), or, or
   - (ii) if it is unincorporated, the address of its principal place of business;

Diagram 1



(e) the company must deliver to the registrar, within the period for filing its accounts and reports for the financial year in question, copies of:
  (i) those group accounts, and
  (ii) the parent undertaking's annual report, together with the auditor's report on them;

(f) The exemption does not apply to a company which is a traded company.

Luxembourg is an EEA State therefore this exemption is a possibility. However, in order to take advantage of this exemption the directors need to ensure that all of the above conditions will be met.

(ii) The subsidiaries of the UK parent company would be eligible to report under the FRSSE. The UK parent company cannot prepare individual small company accounts because it heads a medium-sized group.

ETHICS ARE FOR EVERYONE!

The ICAS Code of Ethics, which replaced the Guide to Professional Ethics issued in 1997, came into force on 1 January 2014. It can be viewed at: **https://www.icas.com/__data/assets/pdf_file/0008/2006/F8001-ICAS-Code-of-Ethics.pdf.**

The Code applies to all members of the Institute; affiliates; students; employees of a member firm or an affiliate; and member practices.

CAs are required to ensure that work for which they are responsible, which includes work undertaken by others on their behalf, is carried out in accordance with the requirements of the Code.

Member firms are reminded that this Code applies to their employees, whether those employees are members or not, and that principals of the firm are responsible for ensuring that their staff are aware of the provisions of the Code and that they apply it in their work.

Ethics should be an integral part of the training given to all staff. Any in-house training should preferably involve senior personnel to ensure that an appropriate "tone from the top" is clearly established and, where possible, to share any ethical dilemmas that they may have encountered (appropriately anonymised).

CAPS TECHNICAL BULLETIN

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