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CHANGING ASPECTS OF INCORPORATION – CAPITAL GAINS ON GOODWILL IN THE LATEST FINANCE ACT

The advent of the 10% rate of capital gains tax (previously through taper relief and currently entrepreneurs' relief) has encouraged the owners and partners of many unincorporated businesses to transfer their businesses to a limited company.

As an alternative to having gains taxed at 10%, hold-over reliefs have also been utilised to 'delay' the tax accruing on capital gains arising on the chargeable assets transferred, such as property and goodwill, by electing under one of two provisions in the Taxation of Chargeable Gains Act 1992:

1. Section 162 where all of the assets of the business were transferred to the company in exchange for shares, with the possible exclusion of cash and bank balances;
2. Section 165 where assets were gifted, or sold at under value, and the gains held over.

As noted above, for trading businesses, the possibility of obtaining taper relief and entrepreneurs' relief has encouraged many not to make use of Section 162 or Section 165 but, instead, to sell the chargeable assets at market value, producing capital gains and creating a tax liability at a rate of 10%. This must have produced a fair number of unexpected capital gains tax payments for the Exchequer.

However, businessmen were only paying a 10% rate of tax gladly because when their companies made profits and had surplus cash, then instead of remuneration being paid or dividends being declared with resultant income tax and national insurance liabilities, the director's loan accounts created by the sale of assets at market value could then be drawn tax free.

Furthermore, in many circumstances, the goodwill acquired by the company could be amortised and tax relief obtained in respect of this.

The *Finance Act 2015* contains two provisions which will put an end to this kind of tax planning:

1. Section 42 applies to prevent the possibility of entrepreneurs' relief being available where goodwill is disposed of to a related close company. It will still be possible to sell goodwill for market value but a capital gains tax liability at 28% will arise. Most people would take the view that it is pointless to pay capital gains tax up front at 28% when, instead, a series of dividends can be drawn in the future taxable at 25%, provided that the recipient is willing to keep his total income below £150,000.
2. Section 26 prevents goodwill acquired from a related party being

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amortised and corporation tax relief being obtained.

Incorporation is still a good idea in certain circumstances including:

- Where the protection of limited liability is desired, although a similar result should be possible using a limited liability partnership.
- Where the business is very profitable and the proprietor does not need to extract most of the profits by way of personal drawings. At the very worst, he can defer payment of the tax by drawing only the level of salary and dividends which he requires, leaving the balance of profits to be taxed only at the 20% corporation tax rate in the company.

Before taper relief, capital gains tax was always one of the major considerations when looking at the incorporation of a business. It will continue to be so, but it is likely that Sections 162 and 165 will be looked at much more regularly.

DEATH AS A PLANNING OPPORTUNITY

Following the 2014 Autumn Statement and the subsequent Budget proposals allowing individuals to access their pension funds, there has been much comment on the additional flexibility that this offers but also words of caution that some people may blow their retirement fund on exotic holidays or luxury items such as their dream cars, or be taken advantage of by unscrupulous advisers.

Other opportunities and flexibilities open up in another circumstance – death.

Things have come a long way since the old days when individuals were forced to buy an annuity and, on their subsequent death, subject only to there being perhaps a five-year guaranteed period or widows benefits, pension providers fell heir to any remaining funds were the individual to die within their actuarial life expectancy.

Whether death occurs before or after age 75 remains an important factor as will be covered below.

Where the policy holder dies before age 75

1. Where benefits have not been taken in the form of an annuity or drawdown:
   - Any lump sum can be paid tax free to the beneficiaries.
   - If the beneficiary decides to take income by way of drawdown or annuity then, if the funds are transferred to the beneficiary's own fund, the income will be tax free.
2. Where the policy holder has taken an annuity, then this can be paid tax free to beneficiaries.
3. Where the deceased policy holder had been in drawdown then the beneficiary can:
   - Take a lump sum tax free, or
   - Take tax free income drawdown or a tax free annuity. No tax liability arises on the transfer of the fund at the death of the original policy holder to the beneficiaries' fund.

Where the policy holder dies after age 75

1. If the policy holder has not taken a tax free lump sum, an annuity or an income drawdown, then there are 2 options:
   - The beneficiaries can transfer the fund of the deceased to new funds for themselves without a tax liability arising. However, income drawn from these funds whether by way of annuity or drawdown will be subject to income tax at the beneficiaries' marginal rate.
   - Take a lump sum which will be subject to income tax at their marginal rate after 5 April 2016 but at 45% until then.
2. Where the policy holder was in receipt of an annuity, then any lump sum received by his beneficiaries will be taxed at their marginal rates after 5 April 2016, but at 45% until then.
3. Where the policy holder was in receipt of pension drawdown, then if the beneficiaries;
   - Take a lump sum this will be subject to income tax at their marginal rate;
   - Take annuity income or drawdown income, this will be subject to income tax at their marginal rate and the transfer of funds from the policy holder to new funds for the beneficiary is not subject to tax.

Matters do not end here however, as there are further choices to be made in anticipation of the subsequent death of the beneficiary (Beneficiary #1) and then, whether he dies before or after age 75 is equally important.

1. Where Beneficiary #1 dies before age 75.
   - Any lump sum taken by the next beneficiary (Beneficiary #2) can be paid tax free;
   - Where Beneficiary #1 has been taking income, there is no tax on the transfer of the pension fund to the new fund for Beneficiary #2 and subsequent income taken from the fund will be tax free.
2. Where Beneficiary #1 dies after age 75
   - Where Beneficiary #1 has taken a lump sum, this will be subject to income tax at his marginal rates.
   - Where Beneficiary #1 has taken income, then there is no tax on the transfer of the fund to the fund for the next beneficiary Beneficiary #2, but the income which he (Beneficiary #2) draws is taxed at his marginal income tax rate.

Needless to say, there are additional factors that have to be considered; in particular, if the first beneficiary (Beneficiary #1) decides to take a lump sum on the death of the original policy holder, who has died before age 75, then the lump sum is tested against the life time allowance. Unless he has elected for fixed, primary or enhanced protection, benefits in excess of the lifetime allowance (£1.25 million for 2015/16) lump sums will be taxed at 55% and income payments other than scheme pensions will be taxed at 25%. This is regardless of whether the original policy holder has taken any benefits or not.

The changes seem entirely equitable in that a pension fund which an individual has built up will be available to his descendants, rather than, as in the old days, falling into the hands of an insurance company. Depending upon the exact circumstances, a tax free lump sum receipt may be possible but may well be subject to inheritance tax on the subsequent death of the beneficiary.

The main alternative is to keep the funds within the pension fund, and, depending on the circumstances income drawn from it may be tax free or taxable at marginal rates.

The worry is that, with Governments having a history of changing pension regulations as some people change their socks, beneficiaries may be tempted to take the money in a lump sum when they can, rather than keeping the money in a pension fund, just in case, once more, the Government changes the rules.

ACCELERATED PAYMENT NOTICES – MORE GUM IN THE WORKS

The announcement and subsequent introduction of Accelerated Payment Notices (APNs) were greeted with disbelief by the 65,000 or so taxpayers who had participated in schemes or made investments disclosed under the Disclosure of Tax Avoidance Schemes (DoTAS) regime largely because of the 'retrospective' manner in which the APNs are to be issued.

Had the Government announced that the APNs would only be issued in respect of notifiable tax avoidance arrangements entered into in the future, this would have generated little controversy and achieved the objective of reducing, if not entirely eliminating, the number of taxpayers participating in these schemes and investments of which the Government disapproved.

Where a company has been involved in a tax scheme then, in the event of a possible sale, the purchaser will most likely require warranties or indemnities, together with monies being held on escrow until the situation is resolved. This can take many years, with the resultant uncertainty.

Accelerated payment notices have worsened this particular situation as:

- If an APN has not been issued and related tax has not been paid, then the purchaser will require additional indemnities and almost certainly an amount of money to be left in the company to meet this.
- If the tax has been paid following an APN, then the vendor will carry on having a vested interest in the outcome of the scheme, and should the appeal eventually be successful, would want to be credited with the benefit of any repayment of tax by HM Revenue & Customs (HMRC).

In the latter case, the question arises as to how best to deal with this from the vendor's point of view? Does he leave some money behind on the balance sheet and, bearing in mind the long period that it will probably take for appeals to go through the Courts, accept that there is a risk of the company failing in the meantime and that he might not get his money back? It might be possible for him to take some legal charge over any repayment from HMRC.

Alternatively, does he sell the shares for a sum of money plus a further sum payable in the event the litigation is decided in favour of the taxpayer? The vendor may have paid capital gains tax upfront, albeit at the entrepreneurs' relief rate. **Marren v Inglis** principles may come into play here, with the possibility of subsequent receipts being subject to capital gains tax at 28% at a later date.

It may be that the cleanest route is to reorganise so that the trade and assets are transferred to a new parent company, which is sold to the purchaser with the vendor retaining ownership of the shares in the subsidiary whose only asset might be the right to receive repayment from HMRC on a successful conclusion of the litigation.

As a chubby chap in a bowler hat might have said to his adviser, "*that's another fine mess you've gotten me into*".

PENSIONS CHANGES IN 2015 – INCOME TAX IMPLICATIONS ON DRAWDOWN

It is now possible for people aged 55 or over to drawdown their entire pension pot (for funds accumulating under defined contribution schemes) and use the money to pay for holidays, new cars, house extensions, or to give to family, rather than going down the traditional route of buying an annuity for their retirement.

What a lot of people don't seem to realise is that a large proportion of this drawdown (75%, in fact) is chargeable to income tax when it is drawn down. Taxpayers' awareness of this seems to be pretty poor judging by the number of articles in the media about people planning to draw down funds who were not aware that some of their withdrawal would be taxed at 40%.

So, by way of reminder, 25% of a drawdown of £200,000 (ie £50k) would be tax free, but the other £150k would be taxable as if it were earnings. If the individual drawing this has substantial other income, for example from savings or property letting, which pushes them into the 40% band for income tax, then they will have to pay a one off amount of £60,000 on this withdrawal. This is clearly substantial and anyone planning a large drawdown needs to be aware of the consequences of this choice.

There is definitely an opportunity here for accountancy firms to expand their service offering. Although not all firms will be Designated Professional Body (DPB) licensed and so although their ability to get involved in investment business will be limited, they can still help clients with personal financial planning in the looser sense and this could be a good way for firms to differentiate themselves from their competitors.

HMRC UPDATE

Disclosure facilities reviewed

The closure of the Liechtenstein Disclosure Facility (and the other facilities put in place for the crown dependencies) originally planned for the end of March 2016 has been brought forward to 31 December 2015.

From 1 January 2016 through to mid-2017, they will be replaced by the Common Disclosure Standard (CDS), which is significantly tougher with a minimum penalty of 30%, in addition to any tax owed and interest, and no immunity from prosecution (unlike the previous facilities). HM Revenue & Customs' (HMRC) intended message is therefore clear – taxpayers should get their affairs in order sooner rather than later, or it could cost them considerably more.

Digital tax accounts

The Government has announced a plan to abolish tax returns by 2020, when taxpayers will have their own "digital tax account" (DTA) which they will need to review and approve. By then HMRC expect to have much more information available about all taxpayers and will be able to pre-populate the fields in their DTA. It will then be up to the taxpayer to review and approve their accounts. Understandably, there has been some concern about what this will mean for advisers and the growth of DIY tax returns, and whether taxpayers will lose out because they don't check their DTA properly. It is likely that the Treasury will need to continually review and adapt this project according to the limitations placed on them by budgeting, technology, etc and we will update the readers on this issue periodically.

Tax avoidance

Tax avoidance has been in the headlines in recent months and the Chancellor has announced that 21,000 more Advance Penalty Notices have been issued than was predicted. The Government also announced several further initiatives to clamp down on the promoters of tax avoidance schemes (particularly those who are seen as serial promoters) including:

- Consulting on proposals to introduce "new information disclosure and penalty powers" to make it more

Clarification

A critical point in the Auto Enrolment article in Issue 129 (Final Thoughts - Page 18) may be ambiguous. To clarify the position on whether or not you require FCA authorisation or a DPB licence to advise clients, the position is as follows:

- If you are advising a BUSINESS on their choice of scheme, you DO NOT need FCA authorisation or a DPB licence. This activity is unregulated. However, you should ensure that you have sufficient knowledge and experience to give competent advice.
- If you are advising an EMPLOYEE in relation to any scheme, you DO need FCA authorisation. A DPB licence is not sufficient. This activity is regulated. If you do not have a FCA authorisation, you should NOT give ANY advice and simply refer the employee to an IFA.

difficult for the promoters of "abusive" schemes to continue to market them in the future.

- Introducing tougher measures for "serial avoiders" who persistently enter into tax avoidance schemes which fail, including a special reporting requirement, and a surcharge on those whose latest tax return is inaccurate as a result of a further failed avoidance scheme.
- Stopping employment intermediaries exploiting the tax system to reduce their own costs by clamping down on the agencies and umbrella companies who abuse tax reliefs on travel and subsistence.
- Legislating in a later Finance Bill to increase the deterrent effect of the general anti-abuse rule (GAAR) by introducing a specific tax-geared penalty that applies to cases tackled by the GAAR.

Let property campaign shortfall

This campaign has yielded less than what would perhaps have been expected by HMRC, with approximately £20m being recovered from 9,000 disclosures. This equates to just over £2,000 per disclosure, which is surprisingly low. HMRC stated that they knew of around half a million landlords who would be eligible for the scheme, and yet the number coming forward is less than 2% of this total. Could they all be compliant or do HMRC's numbers need a reworking? Either way, this indicates that a different approach might be adopted to target this group in the future.

WHAT IS BEHIND THE ACCELERATED PAYMENT NOTICES NOW UNDER JUDICIAL REVIEW?

A new suite of powers for HM Revenue & Customs (HMRC) was introduced by the Finance Act (FA) 2014 under the terms of Follower Notices and Accelerated Payments. These two measures are intended to remove the cash flow advantages obtained by users of tax avoidance schemes, who could, hitherto, adopt a 'wait and see' approach while the scheme they had subscribed to went through protracted litigation under a lead case, as they would be under no obligations to pay any of the disputed tax until the scheme was finally defeated judicially.

The Act received Royal Assent on 17 July 2014, and on 21 July HMRC published guidance on Follower Notices and Accelerated Payment Notices (APNs). By October 2014, HMRC had sent over 600 APNs, and estimated that some 13,000 notices would have been issued by 31 March 2016. However, the issue of some of the APNs has been challenged by an action for judicial review in relation to their lawfulness.

Judicial review is a court proceeding whereby a decision or action of a public body exercising a public function is reviewed by the judiciary on the grounds of *illegality, irrationality, or procedural impropriety*. In respect of the APNs, it would appear that the challenge is on the ground of illegality, by calling into question the lawfulness of the issue of APNs whereby taxpayers are asked to pay millions of tax upfront in some instances before litigation started on the substantive case, and where there is no right of appeal against the APNs. The Judicial Review hearings are expected to be held this summer.

Below is a summary of the legislative provisions under Part 4 (ss.199-233) of FA2014 that have given HMRC the powers to issue Follower Notices and the APNs.

Follower Notices - Conditions of issue

The following three conditions must apply for a Follower Notice to be issued:

(a) The taxpayer's return or claim is under enquiry (enquiry cases), or the taxpayer has appealed against a closure notice or discovery assessment (appeal cases);

(b) The taxpayer's return, claim or appeal is made on the basis that a particular tax advantage arises from the tax arrangements implemented;

(c) HMRC is of the opinion that there is a final judicial ruling relevant to the taxpayer's tax arrangements.

A ruling is final if it is a decision of the Supreme Court or another court or tribunal (including the First-tier Tribunal) where all appeal rights have been exhausted or abandoned. A governance panel of senior HMRC officers will decide whether a judicial ruling is relevant, and HMRC's guidance (**https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/366809/acc-pymts-f-notices.pdf**, at paragraph 1.5.2) confirms that no attempt will be made to extract a wide principle from a judicial ruling where the context and facts are substantially different.

Effect of a Follower Notice

The issue of a Follower Notice makes the taxpayer a 'follower' of that judicial ruling pertaining to the particular tax arrangements that he has relied on. The notice requires the taxpayer to take 'corrective action' in respect of his return, claim or appeal, and failure to do so by the time limit can incur a penalty of up to 50% of the value of the 'denied advantage' under s208 FA2014. The denied advantage is the amount of tax due on the assumption that the tax advantage is countered following the judicial ruling. Section 212 FA 2014 imposes a capping limit on the amount of penalties that can be charged under different penalty regimes in relation to the same amount of tax. However, the amount of penalties related to error (FA2007), failure to notify (FA2008) and failure to file returns (FA 2009) are not reduced by the Follower Notice penalty (or s208 penalty).

The taxpayer has 90 days from the date the Follower Notice is given to send written representations objecting to the Follower Notice on the basis that one of the conditions are not met. An HMRC officer, after considering the objections, must either confirm or withdraw the Follower Notice and the taxpayer has no right of appeal if HMRC confirms the notice. The taxpayer does have the right to appeal against a decision to charge a s208 penalty and the amount of s208 penalty charged, and is not required to pay the penalty before bringing the appeal.

Accelerated Payment Notices - Conditions of issue

Three conditions are to be met, with the first two conditions being the same as those for Follower Notices:

(a) The taxpayer's return or claim is under enquiry (enquiry cases), or the taxpayer has appealed against a closure notice or discovery assessment (appeal cases);

(b) The taxpayer's return, claim or appeal is made on the basis that a particular tax advantage arises from the tax arrangements implemented;

(c) **One of** the following requirements must also be met:

- The taxpayer has been issued with a Follower Notice in relation to the same return, claim or appeal regarding the same tax advantage arising from the same tax arrangements;
- HMRC has allocated a Disclosure of Tax Avoidance Schemes (DOTAS) reference number for the tax arrangements, making the arrangements notifiable;
- HMRC has issued a counteraction notice under the GAAR and at least two members of the GAAR Advisory Panel have expressed the opinion that entering the tax arrangements was not a reasonable course of action.

Effect of an Accelerated Payment Notice

The purpose of issuing an APN is to collect the additional amount of tax considered to be due on the assumption that the relevant tax advantage is counteracted. The amount of the accelerated payment is to be assessed by a designated HMRC officer to the best of his information and belief. The taxpayer has 90 days (beginning with the date on which the APN is given) to send written representations to HMRC objecting to the amount of the accelerated payment, or to the notice, on the ground that the APN has not met the necessary conditions for its issue.

An HMRC officer independent of the team issuing the APN will consider the taxpayer's representations objecting to the notice or the amount for accelerated payment. The review officer will confirm or withdraw the notice, or confirm and amend the amount of the payment. Again, there is no right of appeal against the outcome of such consideration.

APN in enquiry and appeal cases

Under s223 FA2014, for an enquiry case, if an APN is given and not withdrawn, the taxpayer must make payment by the payment date, which is the end of:

- 90 days beginning with the day on which the APN is given (if the taxpayer has not objected to the notice or to the amount);
- 30 days beginning the day on which HMRC notifies the taxpayer of its determination of the taxpayer's objection (if this is later and the taxpayer has so objected).

For appeal cases, ss224-225 FA2014 provide that where payment has been postponed before an APN is served, when the APN is issued, the payment ceases to be postponed. Provisions are inserted into relevant tax enactments to: (1) prevent taxpayers from seeking to postpone payment of tax pending on outcome of an appeal where an APN has been issued; (2) allow HMRC to withhold repayment of tax that it must ordinarily make when a taxpayer is successful on appeal but HMRC is making a further appeal. If the eventual outcome is that the taxpayer is successful on the substantive appeal, then the tax paid under APN will be repaid with interest.

APN and Penalties

Under s226 FA2014, where an APN is issued in an enquiry case and the taxpayer fails to pay the amount due under an APN demand by its due date, then a penalty of 5% of the unpaid amount is chargeable, with further 5% penalties on any amount remains unpaid at 5 and 11 months after the first penalty date. Schedule 56 FA2009 provisions apply to 'accelerated payments' that are paid late, and include HMRC's discretion for penalty reduction under 'special circumstances' and the taxpayer's defence of 'reasonable excuse'.

From DOTAS to APNs to Judicial Review

Given that one of the conditions for the issue of an APN is that the scheme is under DOTAS, the centrality of the DOTAS regime was behind HMRC's targeted effort in October 2014. APNs were issued to subscribers of tax avoidance schemes with a DOTAS number appearing on the list of 1,200 named schemes published by HMRC in July 2014, including more than 100 film scheme investors. It was the investors of 'Ingenious Media' – a film scheme currently going through appeal on substantive issues – who have obtained permission from the High Court to bring an action for judicial review of HMRC's APN demands. APNs in relation to the Ingenious Media scheme are suspended pending on the judicial review proceedings.

Since the regime came into force, APNs seeking payment of tax of over £1 billion have been issued. Depending on the outcome of the judicial review action of the Ingenious Media investors, it is possible that the case may encourage more taxpayers to seek judicial review as a remedy against APNs. .

HMRC guidance on Follower and Accelerated Payment Notices can be accessed at: **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/366809/acc-pymts-f-notices.pdf**.

EMPLOYMENT CORNER - FERRARI, ANYONE?

The changes to the pension regime have brought about many changes for employers and employees as well as for the pensions markets, annuity providers and Independent Financial Advisers (IFA). In this article we examine what the most important considerations are for employers and employees in the context of pensions "freedom", and how accountants can maximise on available opportunities.

The amount of press column inches devoted to pensions flexibility has turned the nation into thinking that swathes of employees who are over 55 will suddenly feel as if they have won the lottery since they are no longer required to buy an annuity.

That said, it is perhaps only a minority few who will spend their 55th birthday flicking through the pages of 'Which Yacht?' or swapping their Vauxhall for a Ferrari. The reality is perhaps more sanguine. With the scrapping of the default retirement age, student debts running to tens of thousands of pounds for graduate workers, and with many first-time home buyers in the UK unable to afford to buy until they are in their late twenties and early thirties, it is unlikely that anyone reaching 55 in the next two decades will feel sufficiently financially secure to touch their pension pots early.

What is clear however, is that employees need advice like never before, as more 'freedom' involves choices, and relevant advice is essential in evaluating each possible option in the context of an individual's circumstances. What are some of these possible options?

From 6 April 2016, anyone aged 55 and over with a pension fund is entitled to withdraw 25% of their pension pot tax free. However, most people are unaware that these "tax free" payments still required to be paid net of basic rate tax by the pension provider, which means the individual has to go through the process of reclaiming the tax deducted at source from HM Revenue & Customs. Any payments from the remaining 75% are subject to tax at the employee's marginal rate of tax. One potential area of confusion is for the employee to assume that the amount of tax deducted at source when the pension was cashed is the end of his or her liability as far as the drawdown is concerned. This may not be the case, as the taxable portion of the withdrawal should be taxed at the employee's marginal tax rate. Even if the employee is normally a basic-rate taxpayer, the likelihood is that the withdrawal in excess of the tax-free 25% will push his overall taxable income into the higher rate tax bands. This will result in further tax being due after the end of the tax year. Advice is needed for an employee wanting to draw down in excess of 25% on the potential further tax liability on the excess. Furthermore, it may also mean in some instances, that an employee without a standing obligation to file a Self-Assessment Return may need to make a return in the year of drawdown due to the additional tax payable on the excess withdrawal.

Avenues for free advice include Citizens' Advice Bureau (where a telephone consultation or face-to-face meeting is available), or by accessing the **pensionswise.gov.uk** website and following the links to request a meeting. It should be noted that neither the Citizens Advice Bureau, nor the Pension Wise website will offer investment advice. Their advice will be more akin to explaining the jargon and helping people understand what they need to do, take into consideration, and reflect upon before deciding how to draw down their pension pot.

However, it is highly unlikely that that the available free advice will be sufficient for most people. IFAs and appropriately authorised accountants will have the opportunity to provide more detailed advice, either by hiring suitably qualified staff or creating in-house knowledge and skills bases by providing staff with relevant training and qualifications on how to advise clients.

A note of caution though to any accountant thinking of going into pension advice: pension advice falls under financial advice, and is regulated by the Financial Conduct Authority (FCA), and firms should ensure they have appropriate authorisation from the FCA before advising clients on any aspect of their pension.

As many people will be retiring later and later yet have access to their entire Defined Contribution (DC) pension fund from age 55, it is fairly obvious that this opens up a huge market for detailed and specific advice. It is clear though that pension advice in this area will become a standing feature of the investment market, and not just a short-term issue brought about by the change in the regulations.

As many employers today are offering the option of an enhanced pension contribution, over and above what they are obligated to make under the Auto-Enrolment legislation, instead of a pay rise, it seems only fitting that the employees should see the value in what the employer is doing. Therefore, the employer needs to consider an effective way of communicating its pension plan to employees and decide whether he wishes to provide suitable assistance to the workers in terms of investment advice and planning and management after retirement. Providing this advice in addition to pension contributions, if seen as valuable offerings which support their general financial wellbeing and future security, is likely to enhance employees' regard for the employer. Trust is hard to earn in the workplace so it is important that employers concentrate on this aspect of an employee's whole life experience if he wants to be perceived as truly taking employee welfare seriously. It is worth advising clients to engage wholeheartedly in a communications process which educates staff to give them maximum opportunity to handle their pension pot responsibly and make sound decisions about investment choices. Far from being a return to paternalistic employer styles, this should create an environment of adult collaboration.

Employers whose schemes do not qualify as suitable under the auto-enrolment legislation, or who wish to convert from a Defined Benefit (DB) scheme to a Defined Contribution (DC) scheme, should take note of an interesting recent case, **IBM United Kingdom Holdings Ltd & Anor v Dalgleish & Ors (Rev 1) [2015] EWHC 389 (Ch)**. This case illustrates why employers who wish to make changes to existing pension schemes need to tread carefully in terms of duty of good faith towards employees. Originally, the High Court found that IBM had breached trust and confidence during a consultation by consciously deciding not to disclose the reasons why it had decided to make changes to its DB scheme. This resulted in the employees being misled. Additionally, rather than offering compensation to employees for certain changes, some employees were offered salary increases or early retirement provisions. It was later decided that a) these salary increases should also be pensionable; b) early retirement agreements should also be subject to damages payments and c) damages were also appropriate where future accrual of pension benefits were halted as a result of the changes. IBM has thus had to find additional funding for these remedies. Clearly, transparency is the key to effective communication.

Some further points of note are:

The transfer of funds from DB schemes to DC schemes is to be permitted going forward but does not apply to pensions which are already being drawn down. For public sector employers with unfunded schemes, transfers from DB to DC schemes will only be permitted in certain circumstances.

The Government has also brought in an income tax exemption covering payments made for professional advice relating to the transfer of funds from DB to DC schemes.

An unused DC pension pot can now be inherited free of tax by beneficiaries of the estates of those who die before they are 75 years old, as can future payments of joint life or guaranteed annuity pots.

Alongside the Budget 2015, the then Chancellor George Osborne and the then Pensions Minister Steve Webb published a consultation paper on the creation of a secondary annuities market which would also potentially remove the tax charges which are currently imposed on pensioners who sell an annuity. These regulations would be effective from 6 April 2016 and the consultation can be found at: **https://www.gov.uk/government/consultations/creating-a-secondary-annuity-market-call-for-evidence**. The consultation closes on 18 June 2015.

JOOST-ICE AT LAST

Regular readers of Technical Bulletin may remember the case of **Joost Lobler (UKFTT 2013 TC 2539)**, which was covered back in 2013 (Issue 121). As a reminder, Mr Lobler had moved from the Netherlands to the UK in 2004, and in 2005, sold his house in Holland. He invested the proceeds of £350,000 in a Zurich offshore life assurance bond. He borrowed an additional £350,000 from HSBC and added this to his existing investment. His total investment at this point totalled $1.44m. Rather than the investment being in a single policy, it was in a series of policies, called segments.

In 2007, Mr Lobler decided to buy a house, which was funded by 'segments' of his investment policy, totalling approximately $1.39m in the years 2007 and 2008. Due to the structure of the investment, he had a choice of (a) surrendering a number of policies ie segments, or (b) partially surrendering all the policies. He chose the latter, and subsequently surrendered the remainder of the bond in July 2008 for $35,000.

Although he made an overall loss of $15,000, Mr Lobler was assessed to tax on the partial surrenders of the bond (except for an allowable amount of 5% of the premium per annum). Under Income Tax (Trading and Other Income) Act 2005, each withdrawal had produced a deemed gain. He therefore found himself having to pay tax on the full amount, which amounted to $560,000. Had he chosen differently, he would have had much less tax to pay. It was literally a matter of ticking the correct box on the claim form when making the surrender.

The result of this was pretty catastrophic with Mr Lobler having his entire life savings wiped out. As we know, HM Revenue & Customs (HMRC) has no discretion to waive amounts due in situations like these, even though the end result would appear to be grossly unfair.

However, there is a happy end to this story. Mr Lobler obtained professional advice from the Chartered Institute of Taxation and lodged an appeal against the First-tier Tribunal decision, and finally succeeded on the grounds of rectification ie that his choice of box had been a serious mistake which should be rectified (**2015 UKUT 0152 TCC**). The upper tribunal findings can be viewed at: **www.tribunals.gov.uk/financeandtax/Documents/decisions/Lobler-v-HMRC.pdf**.

THE AGRICULTURAL WAGES ORDER - RAISING AWARENESS

The Agricultural Wages (Scotland) Order (No. 62) ("The Order") came into effect on 1 October 2014 and sets out a number of conditions and minimum rates of pay for agricultural workers in Scotland. The key features of the order are:

- A minimum hourly rate of £6.50 for all workers in the first 26 weeks of employment (£9.75 for overtime), increasing to £7.14 for all workers employed for more than 26 weeks (£10.71 for overtime) by the same employer.
- A minimum hourly rate of £3.96 per hour for workers who undertake a level 2 Modern Apprenticeship in Agriculture.
- A dog allowance of £5.41 per week for each dog up to a maximum of 4; the allowance is available to a worker (eg a shepherd) who needs to keep and feed a dog (or dogs) to enable him to do his job.
- An additional sum of £1.08 per hour payable to workers with appropriate qualifications, such as a Scottish (or National) Vocational Qualification in an agricultural subject .
- A daily rate of accommodation off-set for accommodation other than a house of £5.01.

Further details of the order can be accessed at: **www.gov.scot/Resource/0045/00459061.pdf**.

The Order forms a legal requirement and any employers who fail to comply with the requirements of the order could face action to recover arrears on behalf of the worker as well as financial penalties and criminal proceedings. Firms with farming clients should make themselves and their clients aware of the requirements of the order as there is a view that this law has come in somewhat "under the radar".

TRIVIAL BENEFITS IN KIND ORDER – AN UPDATE

Despite some expectation that it would, the Government decided not to legislate for the new exemption to income tax for trivial benefit in kinds (BiKs) in Finance Bill 2015. Instead, the plan is to legislate for this in a future Finance Bill. This means that the income tax exemption did not come into force on 6 April 2015 as was previously expected.

There are, however, other changes to benefits and expenses being introduced, including:

- the abolition of the £8,500 threshold
- collection of income tax on BiKs in real time (payrolling); and
- the paid and reimbursed expenses exemption

These were legislated in Finance Bill 2015, more details of which can be accessed at: **http://services.parliament.uk/bills/2014-15/financeno2.html**.

TAX CASES

Timothy Clayton Hutchings v the Commissioners for HM Revenue & Customs (2015 UKFTT 9 (TC04221))

Point at issue: Whether a beneficiary was at fault for failing to disclose information about lifetime gifts to the executors of his father's will.

Background: Clayton Hutchings was the main beneficiary of the will of his father, Robert Hutchings, who was a businessman with an estate worth in excess of £3m. Although he had five children, two of these had been disinherited, and the other two received relatively small inheritances at £150,000 each. The will nominated two professional executors.

As part of the probate preparation, the executors wrote to the family beneficiaries asking if they had received any gifts from their late father in the preceding seven years. No disclosures were made (in fact, only one person replied to the request, saying that they were not aware of any gifts). Apart from the letter requesting for information on any gifts received, there was also a meeting between a representative of the executors and the family soon after the death; during this meeting, the family were asked to disclose any lifetime gifts. Again, no disclosures were made. The executors duly submitted an IHT400 form on this basis.

Nearly two years later, HM Revenue & Customs (HMRC) received an anonymous tip off that Clayton Hutchings had an undisclosed offshore bank account. HMRC wrote to him and the executors of his father's will, asking for disclosure.

After taking legal advice, Mr Hutchings duly made a disclosure and it emerged that he had received almost £450,000 from his father shortly before his death, this money being transferred from an undisclosed account belonging to the father into an undisclosed account under the son's own control.

This disclosure led to an additional £47,000 of inheritance tax being levied on Clayton Hutchings personally as well as a penalty of 65% on the potential loss of Inheritance tax revenue linked to the gift. This came to £113,794, although HMRC later reduced this figure to £87,533. Although Mr Hutchings paid the additional IHT bill attributed against him, he appealed against the penalty.

Argument: It was Mr Hutchings' position that he had not deliberately withheld information and that he did not know how much money was in the Swiss bank account. He presented notes of conversations which he had with his solicitors which indicated that he believed that gifts of overseas assets were not subject to UK tax and therefore did not need to be declared. He also stated that the executors of his father's will had not made it clear to him that he must declare all lifetime gifts (despite being asked twice) and that the letter which he received asking about disclosure of gifts was "*gibberish*". He went further, even suggesting that the executors ought to have searched his father's home to find details of such gifts and that they had submitted form IHT400 unnecessarily early.

Judgement: The tribunal disagreed with Mr Hutchings, ruling that executors are not normally expected to search the house of the deceased but should expect to receive information from their family and advisers. In any case, it was unlikely that there would be any documents about the Swiss account in the house, as it was a "mail-only" account. As far as submitting the return early, the tribunal found that, contrary to the view of the appellant, doing so amounted to good practice. The tribunal therefore rejected his appeal and upheld the penalty.

Regarding the executors, they were found to have appropriately addressed the issue of lifetime gifts as a result of the correspondence between themselves and the family which they were able to demonstrate. As a result, they avoided any penalties for filing an inaccurate return. The blame fell on the person who misled them in the first place.

Commentary: This is the first case of its kind to be tested in the courts and demonstrates the importance of making and properly documenting thorough enquiries when completing an inheritance tax return. As for beneficiaries, it is a sharp warning to those with a blasé attitude to such matters, and that reticence can be construed as misleading the executory.

Full details of the case can be found at: **http://www.bailii.org/uk/cases/UKFTT/TC/2015/TC04221.html**.

Leekes Ltd v the Commissioners for HM Revenue & Customs (2015 UKFTT 0093 TC)

Point at issue: Whether a company was permitted to claim loss relief as a result of its acquisition (succession) of the business of another company which was loss making.

Background: Leekes Ltd, the appellant, carries on a trade of running out-of-town department stores. At the time it owned 4 (3 in Wales and 1 in Wiltshire). On 18 November 2009 it acquired the entire share capital of Coles of Bilston Ltd for £1. Coles' trade at this point comprised 3 furniture stores and warehousing in the West Midlands. In the 8 months of trade prior to the acquisition, Coles had generated sales of £12.7m, and a trading loss for the period of £950,321. It had trading losses carried forward of £2,262,120.

On 19 November 2009 the business of Coles was hived-up to the appellant at fair value which was deemed to be £892,928. At this point, Coles became dormant following the transfer of its business. One of the Coles stores was renovated and re-opened in November 2010, selling Leeke's products. All three Coles stores were re-branded as Leekes Ltd Stores and continued to trade selling the same types of products. According to Leekes Ltd's accounts, the three Coles stores sustained an aggregate trading loss of £176,258 for the accounting period ending 31 March 2010. The appellant's corporation tax computation for the period ended 31 March 2010 showed overall adjusted trading profits of £1,655,756, offset against trading losses of the same amount (said to be brought forward under s393 Income and Corporation Taxes Act 1988 (ICTA 1988). The notes to the tax computation explained that the Appellant had succeeded to the Coles trade and had losses available for offset under s343 ICTA 1988 of £3,167,441, of which £1,655,756 were offset in the current period.

HMRC opened an inquiry into the Appellant's corporation tax return for the period ended 31 March 2010 and issued a Closure Notice on 17 September 2013 disallowing the losses claimed.

Argument: HMRC and Leekes Ltd agreed that there was a succession of a trade and that Leekes Ltd had only one trade following the succession. Both parties also agreed which legislative provisions applied. HMRC maintained that those provisions required Leekes Ltd to 'stream' profits so that tax losses transferred on the succession to Coles' trade could not be offset against profits of the enlarged trade. They argued that references to 'a trade' should be taken to refer to the trade of Coles and that therefore, in determining what profits the losses transferred were available to use against, only profits generated from the 'old' Coles trade should be considered

The taxpayer argued that there was no justification for restricting the offset of losses available to the successor company and that Leekes Ltd should be allowed to offset the losses transferred against all profits of its enlarged trade post-succession. It contended that it was a "whole trade" succession and therefore fell within s343(1) and there is therefore no question of any streaming being applied.

Judgement: The Tribunal decided that the preferable interpretation of the legislation, on the premise that a succession has occurred, is that all the losses of the predecessor's trade which has been subsumed with the successor's trade should be available for offset against the combined profits of the single trade of the successor company and therefore allowed the appeal.

The full case report can be found at: **http://www.bailii.org/uk/cases/UKFTT/TC/2015/TC04298.html**.

Commentary: This was a surprising decision as it does not accord with what has been understood for many years that losses of a trade transferred to a successor company can only be offset against the part of the profits of the successor which are attributable to the predecessor trade. It seems likely therefore that HMRC will appeal this decision on a point of law. Nevertheless, it may be worth making protective claims to utilise brought forward losses where the facts justify it.

VAT QUERY – PROPERTY RENOVATIONS

Query: *I have a client who is embarking on a renovation and extension of a house which he and his wife have recently purchased. The client mentioned that the property had been unoccupied for over two years prior to its acquisition and would like to know what VAT is reclaimable in relation to the project, how he goes about doing this and whether there are any aspects of the build where he will not be able to reclaim/benefit from a lower VAT rate. Are you able to provide any guidance?*

Answer: Under these circumstances, it is important that you confirm the exact nature of the works being performed, as projects have different treatments for VAT depending on what they involve. For example, a private individual who builds his own home will be able to reclaim most of the VAT, as will those who are converting a property into a home that was not previously used for residential purposes in the preceding 10 years. Information can be obtained in HM Revenue & Custom's (HMRC) VAT Notice 431 "VAT refunds for 'do-it-yourself' builders and converters". From the information that you provide, however, this is unlikely to apply to your client as it sounds like a renovation.

For a renovation and extension, the situation is slightly different in that the works will still be chargeable to VAT but certain aspects of eligible projects will be chargeable at the reduced rate (5%). To be eligible for the reduced rate, the property must not have been lived in for 2 years prior to the works commencing and must be an eligible dwelling; ie one built for residential use. Crucially, if works commenced at a point where the premises were being lived in, however, all works would be standard rated.

HMRC indicate in their guidance how an individual might go about proving that their property has been unoccupied, stating that "*proof of such can be obtained from Electoral Roll and Council Tax records, utilities companies, Empty Property Officers in local authorities, or any other source that can be considered reliable. If you hold a letter from an Empty Property Officer certifying that the property has not been lived in for two years, you do not need any other evidence. If an Empty Property Officer is unsure about when a property was last lived in he should write with his best estimate. We may then call for other supporting evidence.*" The property owner should obtain this and pass to the builders at the outset, so that the builders have the proof to enable them to charge VAT at the reduced rate. (Builders can be reluctant to use the reduced rate as they end up with a huge shortfall, if the property is found to be ineligible for the rate reduction).

In these circumstances, unlike those for conversions and new builds, the client is not able to reclaim the VAT at the end of the project. The onus is on the builder/developer (assuming that they are VAT registered) to charge the individual the reduced rate of VAT on the works that are completed.

Broadly speaking, the main ***structural*** aspects of such works are eligible for the reduced rate:

- Any works of repairs, maintenance (such as redecoration), or improvement (eg the extension) carried out to the fabric of the dwelling. This also includes the construction of a garage.
- Works in the immediate site of the dwelling in connection with the provision of:
  - water, heat, light and access
  - drainage or security
  - waste disposal

All other items are standard rated, for example:

- the installation of goods that are not building materials, for example carpets or fitted furniture
- erection and dismantling of scaffolding
- hire of goods
- landscaping
- provision of professional services (eg architects and surveyors)

As your client is not able to reclaim VAT overpaid that he thinks he may be due (and this includes VAT that may have been billed to him erroneously at 20% rather than at 5%), it would be sensible for him to approach his builders at the earliest opportunity and ask if they would be able to buy the materials on his behalf (eg timber, bricks, cement, windows) as they will be able to reclaim the VAT which they pay on them, at 20%, but will be able to charge the client the reduced rate of 5%.

If the client has already been billed for some of the works, which he believes should have been at the reduced rate, then he should approach the contractors and ask them to re-invoice and credit him with the balance of 15%. Getting the contractors to do this may be difficult to achieve in practice if the works dated back some months as this would necessitate the contractors adjusting their VAT returns which is a task they would try to avoid if at all possible. Time is therefore of the essence in such a situation.

I assume that, should it be a requirement of the works performed, your client has obtained planning permission or consent? If this is the case, but your client has not obtained consent, then the works would need to be standard rated for VAT. Again just as with the empty property certificate, getting the right procedural documents in place are crucial in allowing the tax authorities to grant the reduced rate treatment for the works being performed.

HMRC's guidance on this subject can be obtained at section 8 of HMRC's builders guidance **www.gov.uk/government/publications/vat-notice-708-buildings-and-construction/vat-notice-708-buildings-and-construction#reduced-rating-the-renovation-or-alteration-of-empty-residential-premises**.

FRS 102 – SHARE-BASED PAYMENT AMENDMENTS

The Financial Reporting Council (FRC) has issued for comment amendments to Financial Reporting Standard (FRS) 102, section 26 – share-based payment. The amendments are very narrow in scope and address only share-based payment transactions with cash alternatives.

The decision to issue these amendments was taken by the FRC because the accounting for share-based payment transactions where the entity can choose to settle in cash or equity instruments under FRS 102 differs from that under International Financial Reporting Standards (IFRS) and previous UK GAAP. As a result, the FRS 102 is more onerous to apply and could lead to inappropriate accounting outcomes. Under the existing version of FRS 102, it was likely that transactions would be treated as cash-settled, whilst under FRS 20 and IFRS 2, they would have been treated as equity-settled. Treating a transaction as cash-settled is more onerous because the liability requires to be measured at fair value at each balance sheet date.

The FRC is therefore proposing to amend FRS 102 so that, where share-based payment transactions may be settled in cash or by the transfer of equity instruments, the entity should determine whether it has a present obligation to settle in cash and if so, should account for the transaction as wholly cash-settled.

An entity has a present obligation to settle in cash if:

- The entity does not have an unconditional right to avoid settling in cash or other assets (eg because the counter-party has a settlement choice)
- The option of settlement in equity instruments has no commercial substance (eg because the entity is legally prohibited from issuing shares); or
- The entity has a past practice or a stated policy of settling in cash, or generally settles in cash whenever the counter-party asks for cash settlement.

If the entity determines that it does not have a present obligation to settle in cash, the transaction should be treated as wholly equity settled. Note that the treatment proposed in FRS 102 is a simplified version of the accounting under IFRS 2/FRS 20 which requires such transactions to be treated as compound instruments (ie split into separate cash and equity components.)

Therefore, in most cases where the counter-party (eg employee) has the option to receive payment in cash or shares, the transaction will be treated as cash-settled, as the entity does not have an unconditional right to avoid settling in cash (unless the option to settle in shares has no commercial substance). This would be the same treatment as under the existing version of FRS 102. If the option to settle in cash or shares lies with the entity itself, then it is less likely under the amendments to FRS 102 that the transactions will be treated as cash-settled as the entity will generally have the right to avoid settling in cash. It is important that the overall commercial substance of the arrangement is fully considered in determining the appropriate accounting treatment.

This amendment closed for comment until 1 June, and it is proposed that it will be effective for accounting periods beginning on or after 1 January 2015 (ie have retrospective application). The Exposure Draft is available from: **https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRED-61-Draft-Amendments-to-FRS-102-Share-based.aspx**.

CHANGES TO THE EXTERNAL SCRUTINY ARRANGEMENTS AND GROUP ACCOUNTS PREPARATION REQUIREMENTS FOR CHARITIES IN ENGLAND AND WALES

This article does not specifically address the scrutiny arrangements which apply to exempt charities. Exempt charities are those exempt from registration with the Charity Commission for England and Wales (CCEW). Most exempt charities have their own 'principal' regulator. Therefore, the legal requirements which apply to the audit of an exempt charity depend on how the charity is constituted and the regulatory regime under which it operates.

Threshold increases

For periods ending on or after 31 March 2015, there are changes to the external scrutiny and group accounts preparation requirements for charities registered with the Charity Commission for England and Wales (CCEW). The Charities Act 2011 has been amended to:

- Increase the audit threshold for individual charities from gross annual income of £500,000 to gross income of £1 million.
- Increase the group accounts preparation threshold for parent charities from gross annual income of £500,000 to gross annual income of £1 million. Gross income for this threshold is based on income after consolidation adjustments.
- Increase the audit threshold for parent charities to the level of the revised group accounts preparation threshold.

There is no change to the requirement that a charity with gross assets of more than £3.26 million which also has gross annual income of more than £250,000 must receive an audit.

Auditors should also check charity clients' constitution documents to check whether an audit may be required even when the audit threshold is not exceeded.

Interpretation of the term audit for constitutions approved before the 1993 Charities Act

If a charity's constitution was approved before the 1993 Charities Act, then 'audit' means 'the appropriate external scrutiny required by the current legislation'. In this case a charity can have an independent examination if is below the current audit threshold even if its constitution refers to an 'audit' being required.

However, if the constitution clearly states or stipulates that a professional auditor must carry out an examination or audit, such a charity will need to have an audit, or amend its constitution. Unless the trustees have the power to amend the constitution, the trustees will need CCEW approval to make the change.

Charity audit threshold for periods ending on or after 31 March 2015

For charities registered with the CCEW and receiving an audit under the Charities Act 2011:

- Gross annual income greater than £1million; or
- Gross assets of more than £3.26 million and a gross annual income of more than £250,000

In addition, a charity will need an audit if:

- its constitutive documents require one; or
- in the case of a charity with a pre-1993 constitution, that constitution contains a requirement for an audit or examination by a professional auditor

Accounts preparation and audit threshold for charitable groups for periods ending on or after 31 March 2015

For parent charities registered with the CCEW complying with the Charities Act 2011:

- Gross income greater than £1 million after consolidation adjustments

Impact on the independent examination regime

Any charity which does not receive an audit following these changes must receive an independent examination by an appropriately qualified person.

Once a charity's gross annual income exceeds £250,000, the examiner must be a person who is a member of one of the following bodies listed in the Charities Act 2011 and is permitted by the rules of that body to undertake the role of independent examiner:

- Institute of Chartered Accountants of Scotland (ICAS)
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Institute of Chartered Accountants in Ireland (ICAI)
- Association of Chartered Certified Accountants (ACCA)
- Association of Authorised Public Accountants (AAPA)
- Association of Accounting Technicians (AAT)
- Association of International Accountants (AIA)
- Chartered Institute of Management Accountants (CIMA)
- Institute of Chartered Secretaries and Administrators (ICSA)

- Chartered Institute of Public Finance and Accountancy (CIPFA)
- Fellow of the Association of Charity Independent Examiners (ACIE)

For periods ending on or after 31 March 2015, members of the Institute of Financial Accountants (IFA) and the Certified Public Accountants Association (CPAA) are added to the above list.

Impact of the audit threshold changes on concessions available under the Charities SORP 2005 and the new Charities SORPs

Charities which fall below the audit threshold following the recent changes are entitled to take advantage of certain reporting and accounts concessions.

The Charities SORP 2005 and the new Charities SORPs include concessions for charities below the audit threshold in relation to:

- The content of the trustees' annual report
- The presentation of the SoFA

The concessions apply to any charity which:

- receives an independent examination; or
- receives an audit even though it falls below the audit threshold which applies to it

Details of these concessions are set out in the section on the 'Content of the Trustees' Annual Report' and Appendix 5 of the SORP 2005 and modules one and four of the new SORPs.

Cross-border charities

A cross-border charity is a charity registered with the CCEW or the Charity Commission for Northern Ireland which is also registered with OSCR under the Charities and Trustee Investment (Scotland) Act 2005.

Cross-border charities registered with the Office of the Scottish Charity Regulator (OSCR) should continue to apply the audit and accounts preparation thresholds of the Charities Accounts (Scotland) Regulations 2006 (as amended).

The audit threshold in the 2006 Accounting Regulations (as amended) applies in relation to the accounts preparation concessions available under the applicable Charities SORP, discussed above.

The audit and group accounts preparation thresholds under the Scottish 2006 Regulations (as amended) are stricter than the new thresholds for England and Wales.

Charity audit threshold for cross-border charities

For charities registered with OSCR complying with the Charities and Trustee Investment (Scotland) Act 2005:

- gross annual income of £500,000 or more;
- gross assets of more than £3.26 million at the balance sheet date

Accounts preparation and audit threshold for cross-border charitable groups

For parent charities registered with OSCR complying with the Charities and Trustee Investment (Scotland) Act 2005

- Gross annual income of £500,000 or more after consolidation adjustments.

ICAS guidance on the audit of charitable companies

The Financial Reporting Council and the CCEW take the view that a charitable company (either standalone or a parent not required to prepare group accounts), which is below the company audit threshold but above the charity law audit threshold, can receive an audit solely under charity law and elect for audit exemption under company law.

ICAS, however, takes the view that it is good practice where any piece of legislation requires a charity to be audited that the charity is audited under all applicable legislation. Therefore, our guidance to members on the legislative basis for the audit of charitable companies is as follows:

- For individual charitable companies below the company audit threshold but above the Charities Act 2011 audit threshold, an audit should be undertaken under both the Charities Act 2011 and the Companies Act 2006.
- For individual charitable companies above the company law audit threshold, an audit should be undertaken under the Companies Act 2006.
- For individual charities below the Charities Act 2011 audit threshold, an audit should be undertaken under the Companies Act 2006.
- For a parent charitable company preparing group accounts, an audit should be undertaken under both the Charities Act 2011 and the Companies Act 2006.

The rationale for ICAS guidance in respect of the legislative bases of audit is that:

- A charitable company receiving an audit should always be audited under the Companies Act 2006.
- A charitable company should not receive an audit under the Charities Act 2011 unless specifically required to do so under that Act.

As referred to above, charitable companies which are cross-border must also comply with the requirements of Scottish charity law.

CONSIDERATION OF ICAEW GUIDANCE ON THE CLASSIFICATION OF DONATIONS FROM A COMPANY TO ITS PARENT CHARITY

In November 2014, ICAEW issued guidance on the classification of donations from a company to its parent charity (TECH16/14BL).

The guidance reflects a legal opinion ICAEW obtained on the classification of donations which concludes that, for accounting purposes, donations are distributions rather than expenses.

It has been the custom and practice for donations to be treated as expenses of the trading subsidiary: this treatment had also been supported by the Charity Commission in its guidance note CC35. However, the Charity Commission has now withdrawn its guidance note following the publication of TECH16/14B.

There are potential tax implications arising from changing the classification of donations. These arise from company law as there is a possibility that previous years' donations may have exceeded distributable profits thus raising the question of unlawful distributions.

Independent legal advice may need to be obtained to identify how to remedy any donations made in the past six years which are deemed unlawful as a consequence of recent developments. Six years is the period specified as this is the length of time companies are expected to retain records for tax purposes.

With regard to the tax implications which could arise, particularly in relation to donations made after TECH 16/14B was published, ICAS, along with ICAEW, has been in discussion with HM Revenue & Customs (HMRC) to establish an understanding as to what HMRC's approach to this issue will be.

The reclassification of donations in the accounts of trading subsidiaries doesn't impact on the treatment of donations for tax purposes. Therefore, trading subsidiaries should continue to treat donations as qualifying charitable payments and therefore as expenses in their corporation tax computation.

Note on accounting treatment by the charitable parent

In terms of the Charities SORP, the old SORP required gift aid payments from trading subsidiaries to be treated as investment income (paragraph 141(c)) by a charitable parent. The new SORPs are silent on the matter and do not specify how such gift aid payments must/should be classified. This suggests that there is greater scope for judgement under the new SORPs on the classification of such gift aid payments. However, the legal opinion probably shuts down any scope for judgement, meaning that gift aid payments from trading subs should continue to be classified as investment income.

ACCOUNTING AND AUDITING QUERY

Query: *I am a partner in a small firm of chartered accountants. I am currently preparing the financial statements of a small private limited company company with a year end of 31 March 2015, which during the year has declared a dividend of £600,000 with reference to the statutory accounts for the year ended 31 March 2014. Those accounts showed accumulated Profit & Loss Reserves of £450,000 and a revaluation reserve of £350,000 wholly attributable to the company's property. I initially thought the dividend was illegal, as the revaluation reserve is not distributable, however the dividend has been directly linked to the company's property and is therefore an in specie distribution of an asset to the company's sole shareholder (£600,000 is the book value of the property). The property has not been formally conveyed to the shareholder as at 31 March 2015, and no consideration is being paid by the shareholder. I understand that in such cases, the Companies Act enables any revaluation surplus in the accounts in respect of the distributed asset to be treated as distributable.*

Please can you advise if the revaluation reserve can indeed be treated as distributable, and if so how would this transaction be accounted for?

Would there be any further considerations to be taken into account on the ultimate transfer of the property to the shareholder in a subsequent period?

Answer: Section 846 of the Companies Act 2006 covers distributions in kind/in specie, and provides as follows:

Distributions in kind: treatment of unrealised profits

(1) This section applies where—
 (a) a company makes a distribution consisting of or including, or treated as arising in consequence of, the sale, transfer or other disposition by the company of a non-cash asset, and
 (b) any part of the amount at which that asset is stated in the relevant accounts represents an unrealised profit.

(2) That profit is treated as a realised profit—
    (a) for the purpose of determining the lawfulness of the distribution in accordance with this Part (whether before or after the distribution takes place), and
    (b) for the purpose of the application, in relation to anything done with a view to or in connection with the making of the distribution, of any provision of regulations under section 396 under which only realised profits are to be included in or transferred to the profit and loss account.

This section provides that where a company makes a distribution in kind, and any part of the amount at which the asset is stated in the accounts relevant to the distribution represents an unrealised profit, that profit is to be treated as realised for the purposes of the distribution. Therefore, the company only needs to have distributable reserves representing the historic cost element of the property. The part of the book value of the property that represents a revaluation surplus and is included in the revaluation reserve is treated as a realised profit for the purposes of the distribution.

In the present case, the accounting entries would be:

Dr P&L reserve £250,000 (the historic cost element of the property)
Dr Revaluation reserve £350,000 (the revalued element of the property)
Cr Creditors £600,000 (as the property has not yet been formally transferred to the shareholder).

It is important to note that while the relevant accounts for the purposes of determining profits available for distribution are the last published financial statements, the position at the date at which the distribution is proposed and made should also be considered to ensure losses have not been incurred in the intervening period.

You will also need to give consideration to the date of the distribution – if the dividend has been proposed but not declared at the year end, it will not be recognised until it is actually paid (ie when the transfer of property is legally binding). The accounting entries above will not be made until that point.

If however the dividend has been declared at the year end, rather than just proposed, it is treated as a liability, and debited to reserves at this point. The disposal of the property would not be recognised until legally binding, therefore the unpaid dividend will sit as a creditor until then. When the transfer of the property is complete, it will then be removed from the company's books.

The particulars of the transaction should also be disclosed within the related parties note in the financial statements in the year the transfer of the property takes place, as well as in the year of when the distribution in specie is proposed/declared.

Dividends in kind are covered at section 2.8F onwards of the ICAEW/ ICAS guidance on distributable profits - **https://www.icas.com/__data/assets/pdf_file/0012/2604/Distributable-Profits-Guidance-ICAS.pdf**.

Please note that the treatment of dividends in kind is governed by company law and as such, will not change upon implementation of FRS 102.

TOP PRACTICE TIPS – MARKETING

This is the second piece in our practice excellence series and focuses on firms' marketing. (The first article was published in Issue 131) A recent practice technology conference highlighted a number of issues for practitioners to be wary of in relation to how they market themselves. Although perhaps not an area that practitioners habitually spend a lot of time on, marketing your firm effectively and creating a strong brand name are critical for the long-term success of your practice.

1. Use the technology that is out there. This means making sure that your website is mobile-friendly, can 'grab' the attention and engage with prospective clients. With the speed of technology rapidly progressing, it is more important than ever that your web presence is compelling. The next level of technological development is expected to be wearable technology, with both Apple and Android watches now on the market, together with glasses and wristbands – will your digital presence be able to cope with this?
2. In an accountancy firm, your brand is your people since they are the individuals who are the faces of your practice, interacting with the clients and providing the services. Therefore it is your people that are going to make the difference to prospective clients – you need them and the way they operate to distinguish you from Joe Bloggs Chartered Accountants. This means that you need your staff to care about what they do and be engaged with the business. They need to advocate the business and tell people what they are doing. This all helps with developing a brand. Keeping staff happy and feeling involved in the business is a key part to this.
3. Some characteristics of successful brands are:
    • Clarity – a clear vision
    • Coherence – what you look like compared to what you do
    • Leadership – the most important aspect ie the "tone at the top"

If you are able to instil these characteristics you are on the way to creating a successful brand.

4. Focus on what it is you are providing as a service and the customer's experience. If you are able to picture your service in terms of the stages or processes, what are the key parts to the customer's journey where you can make a difference or make yourself stand out?
   An example was given by an individual who was visiting his accountant for the first time. The office was very clean, simple and functional, with a front desk, somebody there to greet him, and a large television screen with the news on it. He was asked what his favourite biscuits were. On his next visit to the firm he was presented with a cup of tea and some biscuits –his favourite ones. The firm had used a customer relationship management (CRM) system to record the information. The client was pleasantly surprised. This is just one example of how you can improve your client's experience. It will help grow your brand, turn that client into an advocate and potentially bring in new work.
5. Be clear what you stand for – in other words, make sure there is consistency in what you do, and that your staff share the collective vision of the business and buy into the overall culture.
6. One point that accountants probably don't always think too much about is the use of jargon. Most clients probably don't know the difference between capital allowances and depreciation, they just nod when you explain something to them. Firms should therefore try and put an emphasis on making things understandable to their clients.
7. Personal branding should not be forgotten. Do your staff present themselves in a way that is consistent with the firm's brand image as a whole? It is likely that what is appropriate will vary from firm to firm – location and clients will have an impact. This is an area that needs to be handled reasonably sensitively.
8. Be flexible – what works for one firm will not necessarily work for everyone. It is important therefore that you are willing to consider different options when it comes to marketing and shape your approach according to your own personal skills and attributes. If you are quite a shy person, then perhaps it is not so effective to spend a lot of time doing networking events. Your time could be better spent via social media channels, for example.
9. Consider a niche. More and more firms are going down the "niching" route to develop a specialism and in dealing with particular types of clients. The advantages of niching are that you can focus some of your attention on marketing to, and networking in, a particular section of the population and become known in that sector. Being involved in a niche can also lead to you to become more involved in your clients' businesses which can mean more rewarding and more interesting work for your firm.
10. Finally, don't neglect your branding. As Warren Buffet once said, "*only when the tide goes out do you discover who's been swimming naked*". That is to say – neglect your brand when the times are good and, sooner or later, when the lean times come, your business will struggle.

ICAS is supporting its practices through the Trusted in Business campaign (**https://www.icas.com/technical-resources/trusted-in-business**). Eligible CA firms can access additional marketing materials for their practice – such as the CA Roundel for use on marketing materials; window stickers; and "*A Guide to Choosing a Chartered Accountant*"— by emailing **practicesupport@icas.com**.

MONEY LAUNDERING UPDATE

When undertaking money laundering identification checks or customer due diligence, you can no longer rely on third party due diligence undertaken by members of The Chartered Institute of Public Finance and Accountancy (CIPFA), as it is no longer a Supervisory Authority for money laundering purposes. However, you can rely on third party due diligence undertaken by members of the Chartered Institute of Legal Executives (CILEx) which has become a Supervisory Authority. Remember that before relying on any third party due diligence, you must obtain their consent to be so relied upon for each individual and on each separate occasion

MONEY LAUNDERING QUERY

Query: *I have a new client whom I am attempting to verify for due diligence/ know your client purposes. The program that I am using is an electronic offering which checks the identity of the individual by verifying him to publicly available information (voters roll etc) but unfortunately this has failed to corroborate his identity twice. What is the procedure here – can I take on the client or does this prevent me from doing so? What are my options?*

Answer: There is no reason for you not to take on this client, provided that you can verify his identity to a suitable degree and in conjunction with your risk assessment attaching to him. Using an online method is just one way of verifying someone's identity and there is nothing stopping you from using another program or using the more traditional approach of obtaining copies of driver's licences, passports and utility bills.

One note of caution, the fact that this individual is not identifiable as per your online search may prompt you to consider modifying your risk assessment of this client, and your alternative "know your client" processes may wish to address this. If you are still unable to verify the client adequately then you should consider not being engaged by him.

Detailed information on know your client can be obtained in the accountancy sector-specific guidance at: **http://www.ccab.org.uk/PDFs/070612%20CCAB%20Guidance%20Clean.pdf**.

TECHNICAL BULLETIN

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