CAPS TECHNICAL BULLETIN

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ZOO TIME – THE CLASSIFICATION OF GOODWILL

The question as to whether goodwill attaches to business premises, the proprietor, or is freely transferable is important for a number of tax aspects including:

- For stamp duty land tax (SDLT) purposes when, for example, a hotel or nursing home is purchased, and if it is possible to separate the "bricks and mortar" from the goodwill, SDLT is payable on the bricks and mortar while stamp duty is not due on the goodwill.
- On incorporation of businesses such as a photographer, is it possible to transfer all of the goodwill to the new limited company, or does some of it adhere personally to the proprietor?
- For the purposes of roll-over relief take the case of **Balloon Promotions Ltd and Others v Wilson [2006] SSCD 167 (SpC524)** where the franchisees of Pizza Express outlets sold their businesses to the franchisor.

As accountants, the recent case of **Graham Michael Wildin v the Commissioners for HM Revenue & Customs (TC 2010/06391)** will be of some interest. The case focused on the correct methodology for practice valuation and, specifically, goodwill.

In **Whiteman Smith Motor Co Ltd v Chaplin (1934 2 KB 35)**, four different types of customers were identified by using the analogy of animals, often referred to as the zoological classification:

- The dog. This type of customer is faithful to the person rather than the location. Therefore, for example, if a motor repairer sells his premises and relocates his business to new premises, perhaps some distance away, this type of customer will stay loyal to the business proprietor.
- The cat. This customer remains loyal to the location, even on change of proprietor. Examples may be petrol stations, hotels and restaurants because the location is convenient.
- The rat who has no loyalty to either a person or a location.
- The rabbit. This customer patronises a business based on no other reason than it is close at hand. If this customer wishes to buy, for example, a newspaper he will buy it from the nearest newsagent.

HM Revenue & Customs (HMRC) classify goodwill into three categories:

1. Personal goodwill which attaches to the photographer mentioned above or a consultant. This type of goodwill is generated by the business having dog-type customers who are loyal to the individual.
2. Inherent goodwill which attaches to the location. This is based on there being cat type customers but also rabbit customers. Petrol stations on busy main roads and convenient local restaurants fall into this category.
3. Free goodwill which is related to the overall worth of the business. HMRC tend to separate this into adherent

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and separable free goodwill. In their view, it is only the separable free goodwill which does not stick to the property and arises from rat type customers. In their view, adherent goodwill can only be transferred if the premises and business are also transferred at the same time.

On incorporation of a business, many people seem happy to pay capital gains tax at the 10% entrepreneur's relief rate on the sale of goodwill. There are a number of issues here:

- Has the value of goodwill been overstated?
- Is it possible to transfer goodwill at all where it is personal? HMRC are likely to resist this but there may be an argument where the proprietor is bound in for a period by a service contract. The legal documentation will be important here.
- In some instances, the proprietor retains ownership of the business premises personally, transferring only the business to the new company. What is the inherent goodwill and can this be transferred? A long lease will help the argument so again the legal documentation will be important.
- If the transferor and the company are related parties, the company is only able to claim a tax deduction in respect of the amortisation of goodwill under s29, Finance Act 2002 where the goodwill was created wholly after 31 March 2002.

In the special Commissioners decision in **Balloon Promotions**, it was held that the payment made by Pizza Express, described as goodwill in the sale agreement, was just that and not compensation for termination of the franchise agreements. This is a very good case to review and under the subheading "my conclusions on the construction of goodwill" from paragraph 159, the special Commissioner states:

159 - Taxation of Chargeable Gains Act (TCGA) 1992 does not define the term goodwill.

160 - Goodwill must be construed in accordance with the principles as published by the legal authorities on goodwill.

161 - Whether goodwill exists is a question of fact.

162 - Goodwill is a type of property.

163 - Goodwill should be looked at as a whole and includes whatever adds value to the business by reason of situation, name and reputation, connection, introduction to old customers and absence from competition. The precise composition of goodwill will vary in different trades and in different businesses in the same trade.

164 – Goodwill realises profits for the business.

165 – Goodwill cannot subsist by itself it must be attached to a business.

166 – Goodwill distinguishes an established business from a new business and is built up by years of honest work and investment in the business. Goodwill is created by trading activities.

167 – The value of goodwill will be enhanced if the business and the premises in which the business is carried on are sold together as a going concern.

168 – Goodwill can be sold separately from the premises in which the business is carried on.

169 – The authorities caution against an over-analytical approach to goodwill (**CIRC v Muller and Co's Margarine Limited (1901 AC217)** and **Whiteman Smith Motor Co (1934 KP35)**). In view of these authorities I question the applicability of the approach adopted by HMRC in their capital gains tax manual and by their Counsel which categorises goodwill into three types with the third type broken down into two sub-categories. The thrust of the categorisation is to restrict roll-over relief to specific categories of goodwill. The categorisation is partly derived from the zoological definition of goodwill which was considered to be of limited value in **Whiteman**.

170 – A covenant restricting the trade of the trader selling the goodwill is a means by which all the advantages that the purchaser intended to have by taking over the goodwill of the business are secured to him. The existence of such a covenant is indicative that goodwill was sold by the vendor.

The First Tier Tribunal decision in **Wildin**, which concerned the 1982 value and the 2003 value of goodwill of an accountancy practice demonstrates that there can be issues where goodwill is sold to a new company on incorporation if the values are not agreed with HMRC at the time.

Where the goodwill has been undervalued, then it may be possible for a hold-over election under s165 TCGA 1992 to be made.

Where it has been overvalued then the excess may be:

- Earnings or a benefit-in-kind, although perhaps unlikely;
- A distribution subject to income tax;
- A loan to a participator.

Where a sale and purchase agreement has been drawn up in respect of the business transfer, the consideration for goodwill could be phrased in terms of a value of such lesser amount as may be agreed with HMRC. Even where the contract does not have such a clause, HMRC may accept that the excess amount is repaid to the company with a benefit in kind arising in respect of the "interest free loan".

PRINCIPAL PRIVATE RESIDENCE RELIEF RULES – SHORTENING OF FINAL EXEMPTION PERIOD

An important change to Capital Gains Tax (CGT) rules for property disposals has been introduced for tax years beginning on 6 April 2014 onwards. This rule will affect individuals who dispose of property that is not their sole private residence (for example a second home or a property that they have lived in for some time but then let out prior to disposing of it).

The relief that has been changed is Principal Private Residence Relief (PPR). This relief applies to property that has been owned and lived in at some point as an individual's principal residence. The relief is calculated based on the time it was inhabited plus a fixed period prior to its disposal.

Previously, an individual who had lived in a property and had later vacated to live elsewhere would be automatically treated for CGT purposes as if they had been resident in that property for the period when they were resident and the final 36 months of ownership of the property. This meant that, for example, a person who owned a property for 8 years, having lived in it for the first 2 years, would be eligible for PPR for 5 out of the 8 years (2 years plus 3 years at the end) of ownership of that property. After this change, the owner in this scenario would only be eligible for PPR for 3½ years out of the 8 and so would have possibly a significant increase in tax to pay, depending on the size of the gain.

The main motivation for this change in legislation is to curb perceived "abuse" by buy to let (BTL) investors who may, for example, only have lived in a property as their PPR for 1 year but would be eligible for 4 years of PPR when disposing of the property. Those most likely to be caught out by this change other than BTL investors include people who have struggled to sell a property but have needed to move so have let the property out in the meantime until the sale could be completed, or those relocating, for example for a new job, who decide to keep and let the property and dispose of it at a later date.

It is also important to remember that an individual, married couple or civil partnership may only have one principal private residence. If more than one property is owned then an election as to which is the main residence must be made.

Full details on the reliefs available to CGT on the sale of residential property can be found at: **www.hmrc.gov.uk/cgt/property/sell-own-home.htm**.

This change to the legislation is likely to affect specific groups within the population and we would be interested to hear any feedback from firms regarding how this change is affecting their clients. Feedback should be directed to **tax@icas.org.uk**. The Government has acknowledged that changing the final 36 months to the final 18 months will have an impact on social groups who are not the intended targets for the changes. In response to this concern, the new legislation contains exemptions to the rules for disabled persons and individuals in care homes. Individuals who meet the definitions will still have the final 36 month rule applied.

HMRC SERVICES FOR AGENTS – IMPROVEMENTS STILL IN THE PIPELINE

HM Revenue & Customs (HMRC) is continuing with its "digital by default" agenda and is continuing to work on its Agent Online Self-Serve (AOSS) and other digital services.

Regarding AOSS, HMRC is hoping to be able to run testing of the following services by the end of the year:

- A secure digital agent registration service
- A new service which allows agents to inform HMRC when they take on a new client and amend client authorisations
- A personalised agents "homepage" or "dashboard" for existing clients that enables them to view and manage their individual clients' tax affairs, access guidance and provide a secure messaging service
- As part of AOSS development, existing client data will be migrated to the new service

IDA

The next initiative that HMRC is working on is Identity Assurance (IDA). IDA is a cross-government service that will allow people to verify their identity online so that they can sign into digital services. The testing phase for this programme ended in June.

Third party software

One concern for practitioners relates to HMRC's plan to migrate services away from the Government Gateway and the impact that this will have on existing third party software compatibility for things like online tax return filing. HMRC is designing a "prototype" that will allow it to replicate the existing government gateway functionality so that agents using certain software types will be able to continue as usual.

Other digital services

HMRC is also working on "your tax account", "digital self-assessment" and "PAYE for employees".

Your tax account is a digital service that enables small businesses to access everything they need to manage their tax affairs through a single, secure online page. It will have a higher degree of functionality and will include information such as an overview of tax records, summary of current liabilities, direct links to actions and transactions that need to be completed and access to guidance and tools.

The new PAYE for employees service will enable PAYE customers to tell HMRC online about changes affecting their tax code. Initially it will be limited to car and car fuel benefits but HMRC is planning on adding further functionality later in the year to enable customers to report other changes affecting their tax codes.

CAPS CA PRACTITIONER SERVICE

Road shows 2014 - Dates for your Diary

Inverness - 9 September (12-2pm)
Aberdeeen - 15 September (12-2pm)
Dundee - 15 September (5.30-7.30pm)
Edinburgh - 17 September (5.30-7.30pm)
Glasgow - 7 October (12-2pm)
Ayr - 7 October (5.30-7.30pm)

To enrol, please contact Linda Laurie on +44 (0) 131 347 0249

HMRC RELEASES INFORMATION ON ADVISORY FUEL RATES FOR COMPANY CARS

The new fuel rates are applicable from 1 June 2014 and apply where employers either reimburse employees for business travel in their company cars, or require employees to repay the cost of fuel used for private travel.

The rates for petrol and Liquid Petroleum Gas (LPG) cars are as follows:

Engine Size	Petrol - p/mile	LPG – p/mile
1,400cc or less	14	9
1,401 to 2,000cc	16	11
Over 2,000cc	24	16

The rates for diesel cars are as follows:

Engine Size	p/mile
1,600cc or less	12
1,601 – 2,000cc	14
Over 2,000cc	17

BRAINSTORMING WITH EIS

Given the current attitude to tax avoidance, even the most adventurous of taxpayers will be thinking twice upon embarking on a tax scheme notifiable under Disclosure of Tax Avoidance Schemes (DOTAS), which will be subject to the new measures of follower notices and accelerated payment. Now is perhaps a good time to think about the Enterprise Investment Scheme (EIS) and innovative ways to use it. The most important thing, as always, is to try to identify a suitable investment. This is however outwith the scope of this article, which concentrates purely on the taxation position.

The main tax advantages of investing under EIS are:

1. A 30% income tax saving if the investment is retained for at least three years. It is always important to ensure that sufficient tax is paid to make use of the relief which is given against tax paid or payable.
2. Deferral of capital gains into an EIS investment, potentially deferring payment of capital gains tax at 28% (or more than this if the rate of Capital Gains Tax (CGT) is raised from 28%) until the investment is disposed of. Provided that the shares in the scheme have been held for the minimum qualifying period, any gain on these shares will be exempt from CGT.
3. Availability of inheritance tax business property relief after two years.

The following examples are not exhaustive but are illustrative of the types of situation where an EIS investment can be considered:

- To offset against the higher or additional rate tax liability on extraction of a large dividend from a company. The dividend may be paid, for example, to remove surplus cash from a company prior to an outside investor buying in or to prevent a build-up of cash which could ultimately have an impact on the company shares qualifying for entrepreneur's relief or business property relief.

An additional rate taxpayer who receives a dividend of £100,000 will have to pay income tax of £30,555. If he invests the entire £100,000 into EIS investments, he will obtain tax relief of £30,000. If he does no more than get his money back after three years, on sale or liquidation, then the cost of extracting the £100,000 will only have been £555.

- If someone realises a capital gain of say £200,000 on the disposal of an investment property, having already utilised his annual exemption, he will have a capital gains tax liability of £56,000. He has three calendar years from the date of realising the gain to make EIS investments which could be done in one year or spread over the available three calendar year period after the date on which the gain arose. In this example, he could invest £200,000 under EIS and fully defer the gain. In which case, as a by product of this move for CGT deferral, he would also receive £60,000 of income tax saving in the tax year of making the EIS investments, subject to claw-back if the investments are not held for the qualifying three-year period. It is worth noting that, if the £60,000 exceeded the available liability for the year when the investment was made, then the maximum relief would be restricted to this amount.

  Alternatively, instead of investing the gain of £200,000 in full, the individual could invest only £96,552. His 30% income tax relief and 28% capital gains tax deferral would amount to £56,000 and he will have effectively mitigated the CGT payable on the property sale.
- If a company wishes to distribute some of its profits by paying a bonus of say, £50,000 to a director who is a 40% taxpayer, he will receive £29,000 after PAYE and NIC. In addition to his bonus, the company could lend him £50,000 which he utilises in making an EIS investment. The income tax relief under EIS will amount to £15,000, giving him effectively additional disposal income of £44,000 (ie: £29,000 net from bonus, and £15,000 from tax relief). There will be a benefit in kind in respect of the loan which will cost him £650 per annum in tax (3.25% x £50,000 x 40%). After three years, he disposes of the EIS investment for £50,000 and repays the loan to the company. Out of his £50,000 bonus, he will have effectively retained £42,050, being the net bonus of £29,000 plus the £15,000 EIS relief less the tax payable on the beneficial loan of £1,950.
- As a means to correct skewed quoted share portfolios. We all have clients who are “over-weight” in one particular share, perhaps acquired many years ago and pregnant with gain. This has discouraged many from correcting the imbalance in their portfolios other than making use of their annual capital gains tax exemptions and any capital losses which can be generated. Just like the property disposal example above, quoted shares can be disposed of and some of the proceeds utilised in making an EIS investment to produce sufficient income tax relief and capital gains deferral to match the CGT payable on the quoted share disposal. An added bonus here is that the EIS investment will qualify for inheritance tax business property relief after two years.
- Entrepreneurs selling shares in quoted trading companies will generally qualify for entrepreneur’s relief and a 10% rate of capital gains tax. While most agree that a 10% rate of capital gains tax is acceptable, where the capital gain is say £5m, then £500,000 of capital gains tax is still a lot of money. One possibility to defer the capital gains tax is to make an EIS investment. However, the EIS deferral relief could have the effect of converting the 10% entrepreneur’s relief rate into a 28% capital gains tax charge when the EIS shares are sold. An investment is still worth considering, however, since EIS investments come with the Inheritance Tax (IHT) replacement property provisions, which means that business property relief will be available on the EIS investment immediately for the entrepreneurs, rather than having to hold this for two years. Additionally, if the vendor has a substantial income, perhaps as a result of a presale dividend, the 30% income tax relief on his EIS investments can go a long way to mitigating the tax effect of the pre-sale dividend.

  Unless the entrepreneur intends to retain the EIS shares indefinitely or, if they are sold, make further EIS investments, it is unlikely, however, that the individual will claim the EIS deferral relief, for the reason explained above, that it is more costly in the longer run by converting a 10% capital gains tax rate to a future capital gains tax rate of 28%, or whatever rate is in force at the time of disposal of the EIS investments.
- Most investors would view an EIS investment as being riskier than investing in the stock market, for example. There are, however, circumstances where a taxpayer can be better off with an EIS investment if it should fail completely. Take the case of a resident but non-domiciled individual who is taxed on the remittance basis, if he remits £100,000 of income he will suffer £45,000 of income tax leaving him with a net £55,000.

  Such individuals can however remit sums to the UK and claim business investment relief and EIS relief in respect of the same investment. If the £100,000 which is remitted is invested under EIS then the individual can claim £30,000 income tax relief. Clearly, at this stage, the cash flow is not as good as having a net £55,000. If however the EIS company subsequently fails and the investor gets nothing at all back, then he is able to claim a capital loss of £70,000, being the amount of his £100,000 investment less the £30,000 income tax relief already obtained. He can then elect for this £70,000 loss to be offset against his income which will save tax at a rate of 45% giving him further relief of £31,500.

At the end of the day, rather than having a net £55,000 out of his £100,000 remittance, by making an EIS investment which fails completely, he is left with £61,500! We are not advocating that investors should use poor investment advisers, but in the above circumstances, there is very little downside. This strange result also opens the door for an investor to invest in what appears to be a very high risk EIS investment where there may either be spectacular returns or complete failure, confident that, at the end of the day, in either event, he will be better off and with potentially large gains completely sheltered from CGT.

- Many people have invested in offshore insurance bonds which have the advantage of a gross rollup of investment gains. It is possible to extract 5% of the amount originally invested for each year that the bond is held without an income tax liability arising. However, for simplicity, assume that an individual invested £200,000, in an offshore bond a number of years ago and that this is now worth £300,000. He wishes to encash the bond but will be faced with a 45% additional rate tax charge on the gain of £100,000, that is, an income tax liability of £45,000. He could cash the bond, utilise half of the proceeds for other purposes and invest the other £150,000 under EIS. This will give him a 30% income tax relief of £45,000. If he disposes of his EIS investment for £150,000 in three years, he will have effectively repatriated all of the proceeds of his offshore bond at no tax cost. If however the value of the EIS investment has grown in the meantime then this gain is tax free.

The tax implications of the above examples are predicated on the EIS investor achieving neither a profit nor loss on the investment. If the advisor is worth his fees and the EIS investments have grown in capital value, then combined with the tax advantages conferred by EIS investments, the results can be spectacular.

INTERNATIONAL TAX AGREEMENTS - ORDERS ENFORCED

A number of international tax agreements, which facilitate automatic information exchange, have been brought into effect from June 2014. The agreements now in effect relate to Anguilla, Uruguay, the British Virgin Islands, Gibraltar and the Turks and Caicos Islands. A full list of all agreements that are in force can be found at: **www.hmrc.gov.uk/taxtreaties/tiea/inforce.htm**.

HMRC CAMPAIGNS & TASKFORCES

"Nudge" letters continuing

HM Revenue & Customs (HMRC) has continued targeting specific sectors with its benchmarking or "nudge" letters. The letters, which have a focus on guiding the taxpayer at the outset, have now been targeted at painters and decorators, presumably due to the perception that they may have unrecorded cash sales. The letters include a net profit percentage range for the sector in question (for painters and decorators this is given as 59-79%).

HMRC will issue a second letter if it feels that a return that has been filed shows a net profit percentage (ie net profit margin) that falls outside the expected range. The recipient is urged to call HMRC to either:

1. Explain what amendments are needed to his/her tax return.
2. Confirm that the return is correct and explain why the return falls outside the expected range of profit.

Presumably, if the taxpayer does not amend his/her return and HMRC feels that the taxpayer has not offered a good enough explanation for why the return is outside the expected range, this will lead to a possible enquiry. Importantly, because HMRC has already warned the taxpayer with the issue of these two letters, HMRC would argue that the errors were "deliberate" and so the corresponding penalties on any underpaid tax would be higher.

HMRC is sending these letters directly to taxpayers and so you may wish to inform any clients in any of the affected sectors that they may be targeted. If your clients have received any of these letters, ICAS would be very interested to hear and we would urge you to contact our tax team at: **tax@icas.org.uk**.

NEW TECHNICAL BULLETIN EDITOR

ICAS would like to welcome its new Technical Bulletin Editor, Dr Heidi Poon. Heidi is a tax specialist who lectures at Edinburgh University and also sits on tax tribunals. Heidi brings a very broad range of technical knowledge to the publication and we are delighted to have her on board.

ACTING FOR TALENT

The Media and Entertainment industry is changing rapidly as a result of the digital transformation and emergence of new platforms for content distribution. Whether your client is an actor, director, musician, photographer, producer or a writer, their business is creative. So first things first, encourage them to engage the services of a good Chartered Accountant (you) and instruct a lawyer familiar with the sector. Here is a reminder of a few things relevant to working with talent.

Structure

Get the structure right from day one. As a Chartered Accountant you must be on hand to offer advice on setting up their business and identifying the most relevant and tax-efficient structure, whether that is as a sole trader, limited liability partnership or a limited company.

The importance of good record keeping should not go unmentioned. If you are not engaged to do this for your client, provide them with a simple spreadsheet to record income and expenditure. If they are technology savvy, consider teaching them how to use a fool-proof cloud-based package to manage the books and scan their petty cash receipts. This will help you and them when it comes to year-end reporting.

As with many owner-managers, the lines between "personal" and "business" can often become blurred. It is important to teach them on day one to distinguish the two, opening a business bank account being the first step, and maintaining a separate business credit card the second (if you can persuade them).

Principal versus agent

It is important to clarify how the business will account for its day-to-day activities. Many creative people cannot understand the concept of revenue recognition. For talent, much of this is driven by the distinction between the principal versus agent relationship. This assessment will impact how turnover and gross profit margin is disclosed in the financial statements. It is important to teach them to get this right.

There are two categories of relationship to characterise an entity which acts "on behalf of" the creative talent. A company or an individual is considered an Agent where it collects revenues on behalf of third parties. Only the commission or margin that it charges on each deal would then be shown within its own reported turnover, much like an estate agent. However, if it can determine the selling price, perform part of the service provided, and assumes a credit risk, then a Principal relationship exists. Application Note G "*Revenue Recognition*" supports FRS5 "*Reporting the Substance of Transactions*" and gives further guidance on this matter.

Understanding and accounting for their Rights

Accounting for royalty arrangements is inherently challenging. The complexity of arrangements can vary significantly. It is important to establish what is being received, and whether this is received net or gross of any third party payaways (or "participations due") which are deducted from royalties at a fixed proportion.

A number of Firms specialise in performing royalty audits, ranging from a desktop review to a full scale audit. Media businesses see royalties as the "holy grail". It is important to them (and you) that the correct royalty payments are being made and received in accordance with the agreements in place.

As media are bought, sold and consumed in ever-changing and new ways, the accounting of income and tax for the creative talent will become increasingly complex. For example, royalties are now enjoyed across a variety of income streams such as product placement, mobile applications and on-demand services.

Creative industry tax reliefs

Creative tax reliefs have bolstered the media sector. Following the success of the Film tax relief (introduced in April 2007), High-end TV relief, Animation relief and the more recent Video Games development relief have since followed. A fifth strand, the Theatre tax relief, is expected in Autumn 2014 and there are new campaigns towards a relief for Children's TV.

The reliefs allow qualifying companies to claim a larger deduction (or a payable tax credit) when calculating their taxable profits. Provided your client is liable to corporation tax and meets the strict set of qualifying conditions, this is an area where you can provide invaluable business advice and support. More information can be found at: **www.hmrc.gov.uk/ct/forms-rates/claims/creative-industries.htm**.

Certification and qualification are administered by the British Film Institute on behalf of the Department for Culture, Media and Sport. Ultimately the value of the relief is an additional deduction that is incorporated into the company's corporation tax computation for submission to HMRC.

International tax and transfer pricing

Entertainers regularly travel the globe for their work. Whether they suffer overseas tax as an individual or on behalf of their production company, they may receive a foreign tax credit on their overseas earnings, which can be deducted against their UK tax liability. The foreign tax credit relief is restricted to the amount that they would have suffered if that income (less allowable expenses) had been earned within the UK.

The Foreign Entertainers Unit (FEU) is HMRC's specialist unit set up to ensure that production companies correctly account to HMRC for tax due when non-UK entertainers perform in the UK.

The FEU says that where "*an overseas resident entertainer works in the UK then they are subject to UK taxation on these earnings and on their UK expenses [...] withholding tax must be taken from the performer at the prevailing basic rate of UK tax*".

Tax deductible expenditure

Understanding what is, and what is not, allowable can be a minefield for your clients working in the Media and Entertainment sector. This can be more complex for talent given the number of aspects to their trade.

In general, expenses can be claimed where they are "*wholly and exclusively incurred for the purpose of the trade*". Of course it is not always quite so clear cut. If your client attends the BAFTA awards and spends £1,000 on a Vera Wang dress, is that allowable as a business expense to collect her award? Whilst the taxman would not allow this for everyday attire, a piece of clothing for a particular performance or rehearsal in some instances would be considered allowable. The general rule, however, is to apply caution and not to abuse the situation. Remind the client that HMRC have the powers of investigation.

Personal tax returns

The usual 31 January and 31 July payment dates can create a real headache for talent. If you are working with actors, their income is certainly not regular and reliable and they often have to cope with long spells of unemployment. A gentle reminder and encouragement to set aside a little bit each month will help when it comes to your relationship with them.

NIC status of entertainers

Entertainers (actors, singers, musicians and other performers) are engaged under self-employment terms and their employment status, for both tax and NICs purposes, is therefore self-employment. As the industry has evolved, earlier regulations were creating uncertainty and problems in identifying how NICs should be deducted and accounted for.

The recent case of **ITV Services Limited v Commissioners of HM Revenue & Customs [2013] EWCA Civ 867** found that in most situations, including contracts for walk-ons, the actor's remuneration included '*any payment by way of salary*' as defined in the Entertainers Regulations. As such, if a contract provides for remuneration which does include salary, then Class 1 NICs is payable on all remuneration payable under the contract.

Subject to Parliamentary approval, effective from 6 April 2014, producers engaging talent for their performance services will not be required to deduct Class 1 NICs from payments made to them. This includes additional payments such as royalties. Talent will instead receive payment gross of tax and NICs and will then need to declare this as part of their usual self-assessment tax return. The Revenue has issued supporting guidance notes to these changes available at: **www.hmrc.gov.uk/briefs/national-insurance/brief3513.htm**.

Image Rights

At this point, get a good lawyer involved. Image Right arrangements can be used to reduce the tax liability of key talent. 'Image rights', 'personality rights', or 'publicity rights' are an expression of personality in the public domain. The law ensures that the value of these rights is protected against unauthorised use and commercial exploitation.

The focus ought to be on the commercial justification for the arrangement. For the moment, HMRC has left these arrangements alone, having been unsuccessful in recent court cases. However, with many offshore companies being set up to hold the image rights, it is only a matter of time before this area receives heightened publicity which could then lead to HMRC challenging the magnitude of any image rights payments.

And finally

As Chartered Accountants we are in a position to guide our clients through a complex range of accounting and tax issues. When working with people within the Media and Entertainment sectors, it is worth reminding them that whilst they might happily take risks on stage, it is advisable not to take risks when it comes to their reputation.

Understanding the niche within which they operate and learning the language and vocabulary that is unique to the sector will put you in a good position from which you can advise.

OECD PROPOSALS ON REPORTING FOR TAX – COUNTRY BY COUNTRY REPORTING

Background

As practitioners will be aware, the tax affairs of large multi-national companies have become headline news and there has been a call from politicians that "*something must be done*". The view is that national tax laws have not kept pace with the globalisation of corporations and the digital economy, leaving gaps that can be exploited by multi-nationals to artificially reduce their taxes. The G8 summit in June 2013 at Lough Erne made a commitment to tackle the position. In the communique issued at the end of the summit there was a commitment to work with the Organisation for Economic Co-operation and Development (OECD) on its work on "base erosion and profit shifting" (BEPS). This project is intended to be a global roadmap to allow governments the tax revenue they need and give certainty to businesses.

The OECD have issued an action plan demonstrating how they intend to deal with the BEPS issue which can be viewed at: **www.oecd.org/ctp/BEPSActionPlan.pdf**.

Where is the OECD now?

The OECD is on schedule with its plan to deliver the actions. The most directly relevant for most businesses with an international presence is the action on transfer pricing documentation. This action also covers the proposals to introduce country by country reporting in response to calls for greater transparency from multi-national enterprises.

What is the substance of the country-by-country reporting proposal?

The revised proposal for transfer pricing and country by country reporting is based on a system of files to give a picture to tax authorities of the operations of the group. The multi-national enterprise will be required to prepare the following:

- A country by country template
- A master file for the entire group
- A file for all the entities in the country

The information will be made available only to tax authorities; the information in the master file is shared with all the countries where the group has operations whilst the country file is shared only with the tax authorities of the relevant country.

What are likely to be the practical outcomes for businesses?

It is difficult to give guidance on the impact as there is no clarity at the moment as to what the size of the entities that will be required to comply with the requirements will be. It seems likely that it will cover large multi-national businesses but it is not clear whether these will be public companies only and the actual criteria – turnover, balance sheet, employee numbers etc - to apply to groups who will be affected. Without these guidelines there is no certainty for multi-national businesses if they will be required to comply with the new requirements. We will therefore revisit this issue once the finer details of the regime are confirmed.

PRENUPTIAL AGREEMENTS

There has traditionally been a perception that prenuptial agreements are in some way distasteful, a sign that the relationship is already doomed. Conversely, family lawyers regularly encounter cases where the existence of a prenuptial agreement would have avoided protracted and costly litigation, with all the attendant emotional fall-out. Prenuptial agreements are becoming increasingly popular, perhaps as a result of some high-profile cases where they have been shown to be effective.

A prenuptial agreement, sometimes known as an ante-nuptial agreement, is simply a contract entered into before a couple marry or enter into a civil partnership. It commonly seeks to “ring-fence” assets, so that they are excluded from the pot of assets on separation or divorce. It can also make specific provision for what one party should receive on separation or divorce.

The advantages of having a prenuptial agreement are as follows:

- Secures parties’ positions for the future;
- Avoids uncertainty, and in turn disputes;
- Provides reassurance that parties are together for the right reasons, and not simply because one is wealthy.

The position regarding prenuptial agreements is different north and south of the border.

In Scotland, properly prepared prenuptial agreements are enforceable and legally binding. Parties are free to oust the jurisdiction of the courts to make financial provision on breakdown of the marriage. However, the agreement can be varied and even overturned if it can be shown it was not fair and reasonable at the point it was entered into. The test for variation is high, and it is not enough to argue that the terms of the agreement alone are unfair. The classic case where a prenuptial agreement is at risk of being deemed unenforceable is the “shotgun” one; entered into very close to the date of the wedding, one or other party not receiving legal advice, the terms of the agreement far removed from the basic legal position on breakdown of the marriage and based on inaccurate or incomplete information.

In England & Wales, prenuptial agreements are not automatically legally binding. The test is whether it would be fair to hold the parties to their agreement. The parties cannot agree to oust the jurisdiction of the courts. Weight is given to the fact that when parties entered into the agreement, they intended it to have effect. The overarching question of fairness is decided by looking at the circumstances prevailing at the time the marriage breaks down. So, it is the position at the end of the marriage that is looked at south of the border, not at the outset as in Scotland. The Scottish position is therefore less helpful to the person who seeks to challenge the agreement at the point when his or her marriage has broken down.

In saying that, recent cases are demonstrating a narrowing in the difference between the approaches of the two jurisdictions. The English case of **Radmacher v Granatino (2010 UKSC42)** has made it more likely that a prenuptial agreement will be taken into account, provided that it would not be unfair to do so. The onus is firmly on the person seeking to extricate themselves to prove that the terms of the agreement are so unfair, either in whole or in part, that it would not be fair to hold parties to them. The English Law Commission has recently recommended that prenuptial agreements should be deemed legally binding, provided certain criteria are met.

Prenuptial agreements can be tailored to meet individual needs, and offer scope for creative drafting. Some couples simply want a list of what each owned prior to marriage, to "ring-fence" those assets and avoid confusion at a later date about who owned what. Others want their prenuptial agreement to set out in detail what should happen where a pre-marriage asset changes shape during the marriage, for example if it is used to purchase a jointly owned family home. In some cases, the agreement is used to set out in detail exactly what should happen on breakdown of the marriage, in terms of who gets what, when and how. These are the most complicated, because they generally depart the furthest from the basic legal position on breakdown of the marriage.

A well-drafted prenuptial agreement should involve careful consideration of the future, and parties' aspirations and plans. Thought should be given to a wide variety of possible outcomes, such as having children, financial disparity, disability, illness and the like. The more complicated agreements can require input from financial and tax advisers and even lawyers from different jurisdictions. Where in the world the couple intend to settle is an important point to consider, since that can impact on the enforceability of the agreement.

The key is to be clear about what the client wants out of the agreement, through careful and tactful discussion. Where necessary, the family lawyer must flag up the parts which s/he considers will not be capable of enforcement. A poorly drafted agreement will only increase the problems if the marriage later breaks down. It could also result in a negligence claim many years later. Some legal firms will not undertake prenuptial agreement work for that reason. Practitioners need to be alert to the risks when drafting agreements, and in that way ensure the final version is as robust as possible.

Common situations where prenuptial agreements are entered into include:

- A young couple, where one or other comes from a wealthy family, and either is already independently wealthy, perhaps as a result of a trust, or stands to inherit considerable sums. Here, it is often the parents who are anxious to protect family wealth.
- An older couple, with children from previous relationships. Here, the driver for the agreement is to ensure that wealth can be safeguarded for the benefit of the younger generation.
- A couple who know that on marriage they are likely to use funds which one or other has generated from before the marriage. For example, sale proceeds from a property owned by one from before marriage might be used towards purchase of a jointly owned family home. Here, the aim is to ring fence those pre-marriage funds even although they will change shape and become matrimonial property.
- A couple where one has complicated business interests, which may be subject to re-structuring during the marriage.
- Where there is an international aspect.

Parties should be encouraged to keep the terms of the agreement under review throughout the marriage. They should be alert to changes in circumstances which might result in the agreement becoming unclear, or unfair. If that happens, a postnuptial agreement can be entered into.

Prenuptial agreements are a useful safeguard to consider when contemplating marriage. Handled sensitively, there is every reason why they should be seen as just another part of the wedding preparations.

In this article reference to prenuptial agreements should also be taken to include civil partnership agreements, and reference to marriage includes civil partnerships.

EMPLOYMENT RIGHTS – UK SUPREME COURT RULES THAT LLP MEMBER CAN BE A PROTECTED WHISTLE-BLOWER

The recent case of Elizabeth Spahn (a whistle-blower), adds another dimension to the changes to the treatment of members of LLPs.

Spahn was initially employed by a UK law firm to develop a joint venture with a Tanzanian law firm. Following a merger, she became a member of the LLP which took over the joint venture. Shortly after this, she reported to the LLP that the managing partner of the Tanzanian Law firm had admitted paying bribes to secure work and case outcomes.

As a result of making this disclosure, she claimed that she was mistreated and this formed the basis of her claim. The LLP disputed her claim, contending that as a member of the LLP she did not fit the definition of a "worker" under the Employment Rights Act 1996.

The Lower Courts sided with the LLP but when the appeal went to the Supreme Court, it went in favour of the appellant. The Supreme Court referred to a sub-section in the Limited Liability Partnerships Act 2000, which states that a member of a LLP who was under a contract personally to perform any work or services would not be precluded from entitlement to extended whistleblowing protection.

It is unlikely that this treatment would be extended to partners in conventional partnerships, with previously decided cases implying that a partner cannot be treated as an employee of a partnership.

More information on whistleblowing can be found on the GOV website at: **www.gov.uk/whistleblowing/overview**.

The lead judgement related to this case, which addresses the question of whether a member of an LLP can be classified as an employee, is **Clyde & Co v Bates Van Winkelhof (2014 UKSC 32)** and can be viewed at: **http://supremecourt.uk/decided-cases/docs/UKSC_2012_0229_Judgment.pdf**.

Readers will no doubt be aware of the new salaried members legislation that is effective from 2014/15 tax year. Guidance on this can be obtained at: **www.gov.uk/government/uploads/system/uploads/attachment_data/file/287655/EN_Partnerships_Salaried_members.pdf**.

RESEARCH REPORT – THE TAX IMPLICATIONS OF SCOTTISH INDEPENDENCE OR FURTHER DEVOLUTION

With the independence vote a little over a month away, ICAS's Research team have produced a comprehensive overview of the tax implications should Scotland vote for Independence on 18 September 2014, or if further devolution of tax powers were to take place. The full report can be accessed on the ICAS website at: **http://icas.org.uk/Frecknall-hughes/**.

VAT ON VISITORS FEES: BRIDPORT AND WEST DORSET GOLF CLUB UPDATE

On 26 June 2014, HM Revenue & Customs (HMRC) released Business Brief 25/2014 setting out their position with respect to this important decision (**European Court of Justice C-495/12**) which has an impact for non-profit making sports clubs.

Essentially, the Business Brief indicates that HMRC are accepting the decision in Bridport, in that the supply of sporting services to both members and non-members by non-profit making sports clubs is to be exempt from VAT. In the Brief, HMRC set out that they will first deal with repayment claims by members clubs, which will be reimbursed for the output VAT charged to non-members. Secondly, HMRC say that they will examine the scope for restricting repayments, on unjust enrichment grounds, to clubs which will not have the facilities, or will be impractical, to pass on the reimbursed output VAT from HMRC direct to the non-members as the ultimate bearers of the output VAT that is now ruled to have been "over-charged" to them.

The full details of this case were covered in Issue 117, December 2012. As a reminder, Bridport and West Dorset Golf Club is a non-profit making members' golf club. Under EU Law, supplies by non-profit making bodies of services closely linked and essential to sport and to persons participating in sport, are exempt from VAT. However, in UK law, where the body operates a membership scheme, any supplies to non-members are excluded from the exemption on the basis that the fees received represent "additional income" for the purposes of EU Law and are therefore liable to VAT at the standard rate.

Bridport made a claim for repayment of VAT on green fees paid by visitors, arguing that the exclusion of supplies made to non-members was not permissible under EU law.

The European Court of Justice (CJEU) agreed. It found that it is immaterial whether a supply of the right to participate in sport by a non-profit making body is provided to a member or a visitor. The CJEU said that a Member State has no power to exclude certain groups of recipients of services from the benefit of the exemption.

The CJEU also rejected the argument that the exclusion of supplies to non-members was allowable because it had the effect of reducing distortion of competition between members clubs and commercial organisations.

It is expected that UK law will be changed by 1 January 2015 to reflect the CJEU decision.

Many sports clubs have made claims for overpaid output tax to HMRC and the Brief sets out HMRC's view with respect to these claims.

HMRC intends to deal with claims for the repayment of overpaid tax for previous periods in two "phases":

Phase 1 – claims will be settled for all members' clubs that will reimburse non-members who were incorrectly charged VAT on sporting services supplied to them. It is, of course, difficult to imagine any sports club able to administer such a feat. Thus it is unlikely that many claims will be settled in the short term. However, helpfully, the Brief provides an address to which all such claims should be sent (VAT Bridport Claims S0483, PO Box 200, BOOTLE, L69 9AH).

Phase 2 - with respect to claims made by clubs that do not adopt reimbursement arrangements, HMRC will be examining all such claims for the scope to restrict repayments on the grounds of unjust enrichment. Seemingly, further advice will be issued on these claims after a conclusion has been reached by HMRC on this point.

In the meantime, submitted (and where necessary, appealed) claims should be updated in order to maximise any repayment. Claims should, of course, include the effect of any changes to the partial exemption calculations resulting from the change of VAT treatment.

Any new claims should be sent to the same address as for phase 1 claims above.

With respect to HMRC's hesitation over repaying claims on the possible grounds of unjust enrichment, it should be noted that it is HMRC's responsibility to prove that the relevant claimant would be unjustly enriched by receiving a repayment. Where clubs do not reduce the price charged to visitors following this change in VAT treatment, HMRC will have more of a battle in proving unjust enrichment (as maintaining charges for visitors, the club is demonstrating that during the time when the fees were liable to VAT, the VAT burden was being borne by the club).

UPDATE: RELEASE OF HMRC GUIDE TO PLACE OF SUPPLY OF DIGITAL SERVICES AND VAT 'MINI ONE-STOP-SHOP' (MOSS)

On 16 May 2014, HM Revenue & Customs (HMRC) released further details as to how the mini one-stop-shop (MOSS) would work for registered suppliers of digital services. A broad outline of this new system was described in Technical Bulletin Issue 126.

The full guidance note may be found on HMRC's website (**www.hmrc.gov.uk/posmoss/**). Here, we summarise some of the practical details pertaining to being VAT registered under the MOSS.

By way of reminder, from January 2015, the place of taxation of broadcasting, telecommunications and e-services (digital services) when supplied to non-business customers (B2C) will be determined by the location of the consumer (currently the location of the supplier determines the place of supply), who will be taxed at the VAT rate applicable in the consumer's member state. Under the MOSS, it will be possible for suppliers to register for VAT in any one member state (the Member State of Identification – MSI) and account for VAT, via one, all inclusive VAT return at each of the relevant member states' rates, depending on the location of each customer.

This is a significant change, and in the absence of the MOSS, would be far more administratively complicated and costly.

Practical issues to consider

Suppliers of digital services will need to be able to determine both the status (business or non-business) and location of every customer.

If the customer does not provide a VAT Registration Number then the customer should be treated as non-business. In the UK, alternative evidence of business will be accepted by HMRC although this may not be acceptable for all Member States and if a Member State does not accept that alternative evidence then the supplier will be responsible for VAT in that country in the absence of a VAT Registration Number.

In terms of the location of the customer, it will be necessary to identify the place where he is established, has his permanent address, or usually resides.

In Issue 126 of Technical Bulletin, the rules pertaining to specific circumstances in order to determine the place of supply of digital services have been detailed, and these are repeated below:

Where supplies are made:

Through a telephone box, a telephone kiosk, a wi-fi hot spot, an internet café, a restaurant or a hotel lobby, the consumer location will be the place where the services are provided; for example, the Member State where the phone box/kiosk etc is located.

On board transport travelling between different countries in the EU (for example, by boat or train), the consumer location will be the place of departure for the consumer's journey.

Through an individual consumer's telephone landline, the consumer location will be the place where the landline is located.

Through a mobile phone, the consumer location will be the country code of the SIM card.

Through a decoder, the consumer location will be the postal address where the decoder is sent or installed.

Where one of these presumptions listed above applies to determine the place of supply, the supplier is only required to retain evidence showing the relevant place, (as determined by the evidence retained).

The supplier may choose to rebut any of the presumptions listed above and if he does, alternative evidence must be provided (three different pieces of evidence would be required).

If digital services are provided in circumstances which are different from those as listed by HMRC, it will be necessary for suppliers to provide two pieces of non-contradictory commercial evidence that determines the customer's location.

Examples of suitable evidence include the billing address of the customer, the Internet Protocol (IP) address of the device used by the customer, the location of the bank, the country code of SIM card used by the customer, the location of the customer's fixed land line through which the service is supplied to him and other commercially relevant information (for example the product coding information which electronically links the sale to a particular jurisdiction).

It will be necessary to raise VAT invoices in accordance with the published requirements of each Member State where consumers are located. However, most Member States, including the UK, do not require VAT invoices to be issued for cross-border B2C supplies.

Transitional rules

If a customer has taken out and paid for an annual subscription in full in April 2014, the supply will be taxed under the current rules. However, if the customer takes out an annual subscription in April 2014, paying for it quarterly, the first three payments will be accounted for under the current rules and the final payment will be taxed under the new rules.

Exchange rates

When a customer is invoiced in a currency other than the one used by the MSI, the VAT MOSS return will need to show the billed currency amount converted into the MSI currency using the rate published by the European Central Bank (ECB) on the last working day of the calendar quarter.

Union and Non-Union VAT MOSS simplification schemes

Any EU based business making B2C digital supplies to EU consumers can opt to use the Union VAT MOSS online service from 1 January 2015. Suppliers making B2C supplies may register for this service from October 2014.

Non-EU suppliers of digital services, making supplies to EU consumers, should register for the current VAT on E-Service Scheme and from October 2014 will be able to register for the non-Union VAT MOSS Scheme and use the online service to account for VAT on all digital supplies made on or after 1 January 2015.

Businesses with multiple establishments or VAT registrations

The EU VAT MOSS online service cannot be used to account for VAT on B2C digital supplies in any Member State where a supplier has business establishment. In this case, it is necessary for the supplier to declare and account for any VAT on those digital service supplies through that establishment's local VAT return in the relevant Member State.

VAT groups

Only one member of a VAT Group (normally the representative member) can register for VAT MOSS. When the VAT Group applies for VAT MOSS registration, the fact that the business is a member of a VAT Group must be disclosed on the VAT MOSS Registration Application Form. Other members of the VAT Group will be able to use the VAT MOSS scheme and account for the VAT on their B2C digital supplies in other Member States, by arranging for their supplies to be recorded on the VAT MOSS return.

MOSS VAT returns

The VAT MOSS return must be submitted electronically to the MSI within 20 days of the end of the calendar quarter return period. There is no change to the deadline for the submission of the return if this date falls on the weekend or a public holiday. Nil returns should be submitted if no relevant supplies are made in a period.

Total supplies for each member state of consumption must be recorded at their standard and reduced rates on the VAT MOSS return. VAT standard and reduced rates for each Member State will be published by the Commission on its DGTAXUD Website.

There are no de-minimis rules in the VAT MOSS scheme, low value sales must all be declared and VAT paid.

Any required adjustment needed to be made to the VAT MOSS return must be made by making a correction to the original return and not by an amendment to a later return.

The time available to make an amendment after becoming aware of a discrepancy will depend on national rules in the Member State of Consumption.

VAT payments

VAT payment should be made at the same time as the VAT MOSS return is filed. If the payment is not made when the return is filed, it should be made at the latest, when the VAT MOSS return is due. Payments will be accepted electronically, the details of how to make this payment will be provided on the VAT MOSS system. There will be no direct debit facility for VAT MOSS payments.

The payment is considered to be made when it reaches the bank account of the MSI. The MSI cannot offer any payment plans, or similar delayed payment mechanisms.

Failure to make a payment on time or in full will result in the MSI sending an electronic reminder on the 10th day following the day on which the payment was due.

Tax authorities will refund any overpayment in its own official currency.

In the period between 1 January 2015 and 31 December 2018, all MSI tax authorities are entitled to retain, as an administrative handling fee, a specified percentage of the VAT.

Record keeping

VAT MOSS records must be kept for a period of 10 years from 31 December of the year in which the transaction has been carried out.

Input tax recovery

The VAT MOSS simplification scheme only allows payment of output tax on cross-border B2C supplies. Any attributable input tax should be recovered via the domestic VAT return. Any input tax incurred in the member state of consumption in which a supplier is not VAT registered should be reclaimed via the electronic cross-border VAT refund scheme.

This change in the Place-of-Supply rules and the introduction of the MOSS system will be administratively demanding, particularly for smaller businesses. If there are any further announcements in advance of the implementation date of 1 January 2015, these will be provided in Technical Bulletin.

TAX CASES

HMRC Commissioners v The Executors of Lord Howard of Henderskelfe [2014] EWCA Civ 278)

Point at issue: Whether a painting displayed in Castle Howard for the purposes of tourism qualified as plant and therefore capital gains tax exemption on its disposal.

Background: The late Lord Howard of Henderskelfe, who died in 1984, owned a painting by Sir Joshua Reynolds which had been on display at Castle Howard since 1950. The Castle was open to paying visitors who had the opportunity to view the painting, which was by an "old master". The painting, which was owned by Lord Howard but whose costs of upkeep were borne by the Castle Howard Estate Limited, was eventually sold in 2001 for £9.4m and the executors claimed that the gain on disposal was exempt under section 45 of Taxation of Capital Gains Act 1992(TCGA), on the basis that it was a wasting asset with a predictable life not exceeding 50 years.

HM Revenue & Customs (HMRC) refused this claim, arguing that the asset did not qualify as plant, and the First Tier Tribunal (FTT) upheld HMRC's position and dismissed the executors' appeal. The executors appealed to the Upper Tribunal, which overturned the FTT's decision. Unsurprisingly, HMRC appealed and it was heard at the Court of Appeal.

Argument: Section 44 of TCGA 1992 defines wasting assets for Capital Gains Tax (CGT) purposes, and under section 45(1) TCGA tangible moveable property which is a wasting asset is exempt from CGT. The painting was clearly "tangible moveable property". Was it a "wasting asset"? The term is defined by the Act as meaning "*an asset with a predictable life not exceeding 50 years*", which certainly does not apply to a Reynolds painting. However the Act goes on to say that "*plant and machinery shall in every case be regarded as having a predictable life of less than 50 years*". In other words, anything which is either "plant" or "machinery" is automatically a wasting asset for the purposes of the Act.

The executors argued that the painting had been hung in a public area of Castle Howard and was therefore a permanent piece of the company's business apparatus and fulfilled the definition of "plant". The Upper Tribunal had concluded that Castle Howard Estate Limited, which owned Castle Howard and therefore the painting, had sufficient interest in it for it to qualify as plant.

The classic case which defined "plant" was set out in **Yarmouth v France (1887 19 QBD 647)**. In this case, it is described as "*whatever apparatus is used by a business man for carrying out his business, - not his stock-in-trade which he buys or makes for sale; but all goods and chattels, fixed or moveable, live or dead, which he keeps for permanent employment in his business...*"

Decision: In dismissing HMRC's appeal, the Judges at the Court of Appeal concluded that the asset, having qualified as plant, "*was 'in every case' deemed by s44(1)(c) to be a wasting asset; and for HMRC to argue that an item of plant enjoying unusual longevity is not plant at all is to advance an argument that the section expressly excludes and which amounts to no more than a pointless beating of the air*".

Commentary: This is an interesting case for its peculiarity of circumstances, because in normal circumstances, an individual who, having acquired a piece of artwork and having enjoyment of it for several years before it is sold for a large gain, would expect to pay CGT arising thereon (note though that the CGT arising would be on the difference between the value at the time of death in 1984 compared to the disposal proceeds because, in this case, inheritance tax would have already been paid on the value at the date of death). In this case, the peculiar circumstances surrounding how this painting by Reynolds has been put to use as part of the display for a stately home that attract paying visitors allow this invaluable painting to be classified as "plant" for CGT purposes. On being so classified, the sale proceeds were able to obtain CGT exemption under s44, as so construed according to the terms of the legislation, to enable the taxpayer to enjoy this favourable outcome.

The full case decision can be viewed at: **www.bailii.org/ew/cases/EWCA/Civ/2014/278.html**.

Call Centre Works Limited v HMRC Commissioners [2014] UKFTT 408

Point at issue: Whether the appellant had a reasonable excuse for late submission of its Employer annual return.

Background: As an employer, the appellant had a statutory obligation to file an employer annual return before 20 May following the end of the tax year. The company had instructed their agent, Tax Link Accountants, to file the return on their behalf. In late 2013, Tax Link installed new software to comply with the requirements for Real Time Information (RTI) filing. The migration of data to new software caused the disruption of computer records, including PAYE reference numbers.

The employee at Tax Link Accountants who filed the appellant's annual return provided a file note which she had made showing that she had filed the return before the due date. However, this file note was not made available for the Tribunal hearing. The employee has since left the agent's employment. The return was finally submitted in October 2013, and a penalty of £500 was issued for the 5 months that the return was late (£100 for each month late). This penalty was subsequently reduced to £100 and it is this amount which the appellant seeks to have struck off.

Argument: The appellant contended that they had a reasonable excuse for the late submission because the clerk who made the submission honestly believed that the return had been made before the due date. Furthermore, their records had been compromised by the software changes.

The respondents point out that the appellant did not obtain a confirmation message which confirmed receipt.

Decision: The Tribunal, in rejecting the appeal, cited two factors:

1. The filing clerk, in the circumstances, should have sought confirmation of receipt before assuming that the return had been successfully filed. There was no evidence that such confirmation was received.
2. Although the agent had experienced computer difficulties which brought about a loss of data, the Tribunal would have expected that Tax Link to have sought advice and assistance from HMRC before the due date so as to address any concerns that they might have had regarding the submission. Again, there was no evidence that this had taken place.

The appeal was therefore dismissed.

Commentary: This is one of the many appeals against HMRC penalties for late filing and reasonable excuse. The agent seems to have buried its head in the sand to a certain extent here, and did not take the necessarily proactive and contingent measures to ensure that the data would migrate from the old system to the new without undue loss. Furthermore, once it became clear that data loss was a problem, the agent should have contacted HMRC to notify the problem and for some agreements to be reached about the timing for the filing of their clients' returns. This dialogue could have resulted in a relaxation of the filing deadlines which would have offered some measures of protection to its clients' position under statutory obligations.

A further point concerns firms changing their systems over to be RTI compliant. Firms need to ensure that they have sufficient "bedding-in" time for new system implementation and should therefore build in a degree of "buffer" so that their systems are not struggling to cope with returns filing at certain times during the year.

The full case can be accessed at: **www.bailii.org/uk/cases/UKFTT/TC/2014/TC03537.html**.

REMINDER FOR AUDIT FIRMS PROVIDING TAX SERVICES ON A CONTINGENT FEE BASIS

In December 2010, changes were introduced to the Ethical Standards for Auditors, which prohibit auditors from providing tax services to existing audit clients on a contingent fee basis. A transitional period was granted to allow firms to complete engagements of this type that were still work-in-progress at the time the changes were introduced, and this transitional period had subsequently been extended to 31 December 2014. It has been confirmed that this period will not be further extended, and firms with existing contracts structured on a contingent fee basis will need to take the necessary steps to complete, terminate or amend such contracts by 31 December 2014 to avoid infringement of the Ethical Standards.

FRS102 webinar – UK GAAP is dead, long live UK GAAP

ICAS will be running a webinar covering the transition from UK GAAP to FRS102 on 4 September at 12:30. The webinar will be hosted by ICAS' Director of Technical Policy, James Barbour, who will provide an overview of the key differences between the old and new reporting framework and there will also be an opportunity to ask questions. The webinar is free to ICAS members or £25 to non-members. More details on the webinar are available at: **http://icas.org.uk/Events/UKGAAPisdeadlongliveUKGAAP/Webinar/**.

AGREED UPON PROCEDURES

Introduction

In Issue 126 we considered Review Engagements, and the difference between the performance of which under International Standard of Review Engagements (ISRE) 2400 and the ICAS Framework for the Preparation of Accounts. In this article, the second in our series on different types of assurance engagements, we consider International Standards on Related Services (ISRS) 4400, Engagements to Perform Agreed-upon Procedures Regarding Financial Information.

The purpose of ISRS 4400 is to provide the practitioner with guidance when performing an engagement similar to that of an audit, in terms of the work likely to be undertaken but which is only performed on specifically agreed areas. In these engagements, the practitioner does not issue an opinion but rather only their factual findings are reported, which are restricted to specific areas and procedures agreed between the practitioner, the entity and any other third parties. Examples of such engagements include:

- Performing specific audit procedures over a specific item in the financial statements, for example, debtors, creditors, stock;
- Performing specific procedures on the financial statements;
- Performing specific procedures prior to an acquisition.

The outcome is the production of a report by the practitioner to the third party, detailing the practitioner's findings on which the user can base their own conclusions.

Compliance with the International Ethics Standards Boards for Accountants (IESBA) Code is required, although independence is not an explicit requirement.

Terms of the engagement

The terms of the engagement, including the purpose, should be agreed between the practitioner, the entity's management and any third-party recipients of the report. The engagement letter should explicitly state that the engagement does not constitute an audit and consequently, no assurance is provided. The letter should also include details of the nature of the procedures to be undertaken, on which specific areas, and the timing of these procedures. The form of the report, and the extent of distribution of the reported findings beyond the entity and other third parties, should also be agreed with all relevant parties and clearly stated in the letter of engagement.

Performance of the engagement

Sufficient planning should be undertaken by the practitioner to ensure that the engagement is performed in accordance with the terms of the engagement.

Sufficient evidence and documentation should be obtained and produced in order to support the findings produced in the report; what constitutes "sufficient" is clearly a judgement call that will be down to experience and the specific circumstances.

The evidence will be obtained via a variety of processes including inquiry, inspection and observation, re-performance, and third party confirmation.

Reporting on the engagement

At the end of the engagement, the practitioner will issue a report on the findings summarising the purpose, specific procedures and findings from the work undertaken. Sufficient detail should be included in the report as to the information, either financial or non-financial, on which the procedures were performed. A list of the procedures followed should also be attached to the report, and the factual findings should contain:

(a) Title;

(b) Addressee (ordinarily the client who engaged the practitioner to perform the agreed-upon procedures);

(c) Identification of specific financial or non-financial information to which the agreed-upon procedures have been applied;

(d) A statement that the procedures performed were those agreed upon with the recipient;

(e) A statement that the engagement was performed in accordance with the International Standard on Related Services applicable to agreed-upon procedures engagements, or with relevant national standards or practices;

(f) When relevant a statement that the practitioner is not independent of the entity;

(g) Identification of the purpose for which the agreed-upon procedures were performed;

(h) A listing of the specific procedures performed;

(i) A description of the practitioner's factual findings including sufficient details of errors and exceptions found;

(j) Statement that the procedures performed do not constitute either an audit or a review and, as such, no assurance is expressed;

(k) A statement that had the practitioner performed additional procedures, an audit or a review, other matters might have come to light that would have been reported;

(l) A statement that the report is restricted to those parties that have agreed to the procedures to be performed;

(m) A statement (when applicable) that the report relates only to the elements, accounts, items or financial and non-financial information specified and that it does not extend to the entity's financial statements taken as a whole;

(n) Date of the report;

(o) Practitioner's address; and

(p) Practitioner's signature.

When are agreed-upon procedures appropriate?

With a variety of options available, there follows examples of situations when a practitioner might be more likely to enter into an agreed-upon procedures engagement, as opposed to a review engagement or an accounts preparation engagement:

- Confirming the accuracy of earn out calculations;
- Verification of sales order projections as part of a due diligence/acquisition;
- Certification of certain types of grant funding returns;
- Verification of a specific item in the financial statements, for example stock valuation.

Conclusion

The foremost consideration for practitioners when deciding the nature of the engagement to be undertaken will be the type of report required by the entity. If an opinion is required, then an assurance engagement is likely to be the most appropriate. If the entity requires a factual report on findings and has requested the same, then this should be based on agreed procedures performed on specific areas for a prescribed purpose, which means an agreed-upon procedures engagement is likely to be the most appropriate.

FRC AMENDS FRS 101 AND 102 – IMPACT ON ACCOUNTING FOR FINANCIAL INSTRUMENTS

The Financial Reporting Council (FRC) has amended Financial Reporting Standard (FRS) 102 in relation to financial instruments. It is expected that these changes will make the standards easier to use and reduce the cost of compliance. The changes relating to financial instruments are as follows:

- To update the requirements in relation to hedge accounting, making hedge accounting more readily available to entities where it is consistent with their risk management processes.
- To relax the conditions for considering financial instruments as "basic", with the effect that more financial instruments will be measured by reference to cost rather than fair value.

The amendments to FRS 102 in respect of the conditions for classification of financial instruments as "basic". The changes reduce the number of conditions that an instrument must satisfy before it can be classified as basic, and are intended to increase the number of financial instruments that can be measured at amortised cost.. Based on the assumption that an amortised cost valuation of a financial instrument is less costly to determine than a fair value measurement, the expectation is that the amendments will reduce the reporting costs of entities that hold these financial instruments.

Regarding hedge accounting, the belief is that the amendments to the accounting requirements in FRS 102 will have a positive impact on financial reporting as they are intended to make the application of hedge accounting more straightforward for entities. The FRC impact assessment document cites an example of a medium-sized company that has overseas operations where it conducts a number of transactions per year in currencies other than GBP. The company uses forward contracts to manage its exchange rate risk. Up until now, the company has not adopted FRS 23 on *The Effects of Changes in Foreign Exchange Rates* and has instead followed the provisions in Statement of Standard of Accounting Practice 20 *Foreign Currency Translation*. Therefore the company has not implemented hedge accounting due to concerns over the administrative burden, and the cost of doing so. By reducing the administrative burden associated with hedge accounting through the changes to FRS102, the FRC hopes that more companies will consider using hedge accounting.

As a reminder, hedge accounting is optional, therefore entities are expected to perform their own cost-benefit analysis to decide whether or not they wish to apply it.

FRS 101 on *Reduced Disclosure Framework* allows entities to apply International Financial Reporting Standards (IFRS) with exemptions from some disclosures. This standard is intended to increase the number of entities which report under IFRS for group purposes to do likewise in the individual accounts of the parent and subsidiary undertakings. The amendments to FRS 101 are the result of its first annual review by the FRC to ensure that the disclosure exemptions are updated on a timely basis as IFRS develops.

The amendments can be viewed at: **www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Amendments-to-FRS-102-The-Financial-Reporting-Stan.aspx**.

NEW IFRS REVENUE RECOGNITION STANDARD

The International Accounting Standards Board (IASB) has recently issued a new standard on revenue recognition, International Financial Reporting Standard (IFRS) 15 on *Revenue from Contracts with Customers*. This will replace two existing standards for revenue recognition under IFRS: (a) IAS 11 on *Construction Contracts* (and a number of interpretations – see below), and (b) the International Accounting Standard (IAS) 18 on *Revenue*. The effective date for the new standard IFRS 15 is 1 January 2017, although the EU endorsement process means that the application date may be later for EU listed companies.

The main purpose of the new IFRS 15 is to remove inconsistencies and weaknesses in the existing standards, and to improve disclosures about revenue, so it will result in a more coherent and consistent model for reporting revenue. Depending on how specific industries and sectors currently account for revenue, the new standard could result in changes in revenue recognition, particularly in respect of timing differences. While the implementation date may seem far away, companies applying full IFRS will need to start considering how the standard will impact their accounting. For UK GAAP companies, it is worth being aware of this change, as it is likely that ultimately the principles of IFRS 15 will filter down to FRS 102.

Scope

The new IFRS applies to all contracts with customers except for:

(i) Leases within the scope of IAS 17 Leases;
(ii) Financial instruments and other contractual rights or obligations within the scope of IFRS 9 Financial Instruments, IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures;
(iii) Insurance contracts within the scope of IFRS 4 Insurance Contracts; and
(iv) Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

Summary of main features

The new standard requires the use of a single, principles based five-step model to be applied to all contracts with customers. The core principle in that framework is that a company should recognise revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The five steps are:

(i) Identification of the contract with the customer,
(ii) Identification of the performance obligations in the contract,
(iii) Determination of the transaction price,
(iv) Allocation of the transaction price to the performance obligations in the contracts,
(v) Recognition of revenue when (or ongoing as) the entity satisfies a performance obligation.

(i) Identification of the contract with the customer

A contract is an agreement between two or more parties that creates enforceable rights and obligations. A company would apply IFRS 15 to each contract with a customer that has commercial substance and meets other specified criteria. One criterion requires a company to assess whether it is probable that the company will collect the consideration to which it will be entitled in exchange for the promised goods or services. A contract with a customer will be within the scope of IFRS 15 if all the following conditions are met:

- The contract has been approved by the parties to the contract;
- Each party's rights in relation to the goods or services to be transferred can be identified;
- The payment terms for the goods or services to be transferred can be identified;
- The contract has commercial substance; and
- It is probable that the consideration to which the entity is entitled to in exchange for the goods or services will be collected.

Where all of the above criteria are not satisfied, the entity will continue to re-assess the contract going forward to determine whether they are subsequently met, and if so, then from that point, IFRS 15 will apply to the contract.

It will depend on whether certain conditions are met as to whether a contract modification will be accounted for as a separate contract with the customer.

(ii) Identification of the performance obligations in the contract

Performance obligations are promises in a contract to transfer to a customer goods or services that are distinct. At the inception of the contract, the entity is required to assess the goods or services that have been promised to the customer, and identify as a performance obligation:

- A good or service (or bundle of goods or services) that is distinct; or
- A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

A series of distinct goods or services is transferred to the customer in the same pattern if both of the following criteria are met:

- Each distinct good or service in the series that the entity promises

- to transfer consecutively to the customer would be a performance obligation that is satisfied over time; and
- A single method of measuring progress would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

A good or service is distinct if both of the following criteria are met:

- The customer can benefit from the goods or services on its own or in conjunction with other readily available resources; and
- The entity's promise to transfer the goods or services to the customer is separately identifiable from other promises in the contract.

In determining whether a good or service is distinct, a company considers if the customer can benefit from the good or service on its own, or together with other resources that are readily available to the customer. A company also considers whether the company's promise to transfer the good or service is separately identifiable from other promises in the contract. For example, a customer could benefit separately from the supply of building materials and the supply of construction labour. However, those items would not be distinct if the company is providing the materials and construction labour to the customer as part of its promise in the contract to construct a building for the customer. In that case, the company has a single performance obligation to construct a building. The materials and construction labour would not be distinct goods or services because those items are used as inputs to produce the output for which the customer has contracted.

(iii) Determine the transaction price

This is the amount to which an entity expects to be entitled in exchange for the transfer of goods and services. When determining this, an entity will need to consider past business practices.

Where a contract contains elements of variable consideration, the entity will estimate the amount of variable consideration to which it will be entitled under the contract. Consideration of this nature can arise, for example, as a result of discounts etc. It is also present if an entity's right to consideration is contingent on the occurrence of a future event. Due to its uncertainty the amount of variable consideration that can be recognised is limited. In other words, it is only included in the transaction price if, and to the extent that, it is highly probable that its inclusion will not result in a significant revenue reversal in the future when the uncertainty has been subsequently resolved.

In relation to sales or usage-based royalty revenue arising from licences of intellectual property, a more restrictive approach is applied and revenue is only recognised when the underlying sales or usage occur.

(iv) Allocate the transaction price to the performance obligations in the contracts

In situations involving contracts with multiple performance obligations, allocation of the transaction price to the performance obligations in the contract should be by reference to their relative stand alone selling prices. This will require an estimation of the stand alone selling price if this is not directly observable; ie: the entity will need to estimate it. Any overall discount compared to the aggregate of stand alone selling prices is allocated between separate performance obligations on a relative stand alone selling price basis. In certain circumstances, it may be appropriate to allocate such a discount to some but not all of the performance obligations. Where consideration is paid in advance or in arrears, the entity will need to consider whether the contract includes a significant financing arrangement and, if so, adjust for the time value of money. A practical expedient is available where the interval between transfer of the promised goods or services and payment by the customer is expected to be less than 12 months.

(v) Recognise revenue when (or as) the entity satisfies a performance obligation

Revenue is recognised as control is passed, either over time or at a point in time.

Control of an asset is defined as the ability to direct the use of and obtain substantially all of the remaining benefits from the asset. This includes the ability to prevent others from directing the use of and obtaining the benefits from the asset. The benefits related to the asset are the potential cash flows that may be obtained directly or indirectly. These include, but are not limited to:

- Using the asset to produce goods or provide services;
- Using the asset to enhance the value of other assets;
- Using the asset to settle liabilities or to reduce expenses;
- Selling or exchanging the asset;
- Pledging the asset to secure a loan; and
- Holding the asset.

An entity recognises revenue over time if one of the following criteria is met:

- the customer simultaneously receives and consumes all of the benefits provided by the entity as the entity performs;
- the entity's performance creates or enhances an asset that the customer controls as the asset is created; or
- the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

If an entity does not satisfy its performance obligation over time, it satisfies it at a point in time. Revenue will therefore be recognised when control is passed at a certain point in time. Factors that may indicate the point in time has been reached at which control passes include, but are not limited to:

- The entity has a present right to payment for the asset;
- The customer has legal title to the asset;
- The entity has transferred physical possession of the asset;
- The customer has the significant risks and rewards related to the ownership of the asset; and
- The customer has accepted the asset.

Standards/Interpretations to be withdrawn

The following is a list of standards and interpretations that are to be withdrawn following the implementation of the new IFRS 15:

(a) IAS 11 Construction contracts
(b) IAS 18 Revenue
(c) International Financial Reporting Interpretations Committee (IFRIC) 13 Customer Loyalty Programmes
(d) IFRIC 15 Agreements for the Construction of Real Estate
(e) IFRIC 18 Transfers of Assets from Customers
(f) Standards Interpretations Committee (SIC) 31 Revenue - Barter Transactions Involving Advertising Services.

ACCOUNTING AND AUDITING QUERIES

Query: *I am a partner in a medium-sized accountancy practice in the west of Scotland. With the forthcoming introduction of Financial Reporting Standard (FRS) 102 'The Financial Reporting Standard Applicable in the UK and Republic of Ireland', several of my clients have asked whether the new standard will have any impact on their respective revenue recognition policies. Could you please advise whether there are significant differences between the existing UK GAAP revenue recognition requirements as per Application Note G of FRS 5 'Reporting the Substance of Transactions' and the requirements under FRS 102?*

Answer: The requirements on revenue recognition per section 23 'Revenue' of FRS 102 are based on similar principles to those in FRS 5 Application Note G and should not generally result in entities having to change their respective accounting policies for revenue recognition on its adoption. That said, the requirements of FRS 102 are more specific and therefore in some cases they may result in changes of accounting policy. Management should also remember that the adoption of FRS 102 provides them with a good opportunity to review their revenue recognition policies to see whether they are still the most appropriate, and whether disclosures about them are adequate.

Under FRS 102, paragraph 23.10 requires that an entity shall recognise revenue from the sale of goods when all of the following conditions are satisfied:

- The entity has transferred the significant risks and rewards of ownership of the goods to the buyer;
- The entity retains neither involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of revenue can be measured reliably;
- It is probable ("more likely than not") that the economic benefits associated with the transaction will flow to the entity; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

In most cases the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. However, there are various sales-type agreements where this is not the case. Consideration therefore requires to be given to the above criteria to determine the appropriate accounting treatment for particular types of sales. In cases where one of your clients is acting as an agent then its revenue should include only commissions received as part of that arrangement. Whether your client is indeed an agent will depend on their exposure to the risks and rewards associated with sales of the particular goods or services.

It should also be noted that the International Accounting Standards Board issued International Financial Reporting Standard (IFRS) 15 in June (see separate article in this edition). For accounting periods commencing on or after 1 January 2017, IFRS 15 replaces the IFRS revenue recognition standards on which section 23 of FRS 102 is based. However, although it is likely that at some stage in the future the revenue recognition requirements of FRS 102 will be revised based on those in IFRS 15, this is not likely to happen until the FRC's next review of FRS 102, which is due to take place in a couple of years.

Query: *I am the financial controller of a large private company in the east of Scotland. The company's year-end is 31 December. The company is considering installing a new plant facility in central Scotland at a cost of £20 million in the year to 31 December 2015. It is anticipated that if the company goes ahead then a grant equivalent to 10% of the total capital spent will be available via a local government body. I am aware that under existing UK GAAP, given the grant is of a capital nature, it would need to be deferred and amortised to the profit and loss account over the life of the asset. Could you please advise whether this would also be the required treatment under FRS 102 which I am aware will apply to the accounts for the year to 31 December 2015 onwards?*

GOVERNMENT LAUNCHES CYBER ESSENTIALS SCHEME

The subject of cyber security has been hitting the headlines in recent weeks as businesses have been told to make sure that they safeguard themselves and their customers against malware, viruses and a myriad of other programs aimed to steal personal information and client data. In response to this, the Government has launched its cyber essentials scheme and ICAS is delighted to be able to provide free guidance for members on what they should be doing to make sure that their practice is safe.

Information on the scheme can be accessed at: **www.gov.uk/government/publications/cyber-essentials-scheme-overview**.

ICAS guidance can be accessed at: **http://icas.org.uk/cyber-essentials**/.

In addition to this, ICAS has developed an Information Security Framework (ISF), which provides a complete methodology for firms to identify its information assets, and addresses the risks that those assets are exposed to, and how to deploy controls within their business for their safeguard. More information on the ISF can be obtained at: **http://icas.org.uk/isf/**.

Answer: Section 24 of FRS 102 allows the use of two different methods for accounting for such capital grants. These are the performance model and the accruals model respectively. The following illustrates the application of the 2 separate models in your specific circumstances. Please note that potential tax implications are not considered in this answer.

Assumptions

It is assumed that the primary purpose of the grant is a contribution towards the building of the new plant facility and is payable upon completion of the build, and that a separate secondary condition requires the company to employ 10 new staff members, and retain them for a period of 2 years from the date of completion of the plant. It is therefore assumed that the grant is judged to be capital in nature, as the principal terms relate to capital expenditure.

Cost of Plant Facility - £20m

Expected date work will commence - 1 January 2015

Grant available £2m to be paid 6 months after the commencement of work on the facility – assumed 1 July 2015

Expected Date of Completion - 31 December 2015

Employee Criteria – 10 new staff members must be employed and still in their roles two years after the completion date ie as at 31 December 2017

Expected Life of Plant Facility – 50 years (Assumed no need for separate component depreciation)

Amortisation of grant to match ie 2% pa.

Performance Model

Under this model, the grant would be recognised when the performance-related conditions imposed by the grantor are met. If the only condition was completion of the facility, then the full grant would be recognised in the income statement in the year of completion ie 31 December 2015. However, there is an additional employee criterion, which means that the grant cannot be recognised in income until the date at which this criterion is met ie 31 December 2017.

At 1 July 2015 the accounting entry in respect of the grant will be:

Dr Bank £2,000,000; Cr Deferred Income £2,000,000

Being entry to recognise receipt of the capital grant

For the Year Ended 31 December 2017 the accounting entry would be:

Dr Deferred Income £2,000,000; Cr Income Statement £2,000,000

Being the release of the grant to the income statement as the performance conditions have now been satisfied.

Accruals Model

This model is the same as that currently required by Statement of Standard Accounting Practice (SSAP) 4, for companies in relation to capital grants. The grant would be recognised as deferred income on the date of receipt on 1 July 2015 and then amortised over the lifespan of the asset to which it relates.

At 1 July 2015 the accounting entry in respect of the grant will be:

Dr Bank £2,000,000 Cr Deferred Income £2,000,000

Being entry to recognise receipt of the capital grant

For the Year Ended 31 December 2016 the accounting entries will be:

Dr Deferred Income £20,000 Cr Income Statement £20,000

Being the release of the grant to the income statement for the 6-month period.

For the remainder of the asset's lifespan the following journal will be required except for the final year when the above journal for a 6-month period will be necessary.

Dr Deferred Income £40,000 Cr Income Statement £40,000.

PENSIONS AUTO ENROLMENT – ISSUES FOR FIRMS

Pensions auto enrolment has arrived in the UK under a relatively low profile, with a number of staging dates for the bigger employers already having passed. Recent research has suggested that a large proportion of employers still have a very limited understanding of what auto enrolment means for their businesses. There are, therefore, a number of opportunities for accountants, as trusted advisers, to sell their expertise to their clients to help them choose the right scheme for them and comply with the new regime.

There are a number of situations where accountants may be required to provide assistance:

- In the provision of tax advice on the implications of automatic enrolment
- In advising clients on staging dates for their business
- Providing advice to clients in respect of the different types of workforce and who is considered to be an "eligible jobholder"
- Assisting clients who want to ensure that their systems and processes (eg payroll) are able to deal with the auto-enrolment obligations and pensions.

It is important to note that none of the above activities are classified as "regulated" and so a designated professional body (DPB) licence would not be required to provide this sort of advice. In addition, an accountant may also advise a business on what sort of scheme to choose for their business without holding a DPB licence. It is important to note that providing advice to an individual employee would not fall within this exemption and a licence would need to be held. Firms therefore need to be careful that they are not providing the sort of assistance which their lack of a DPB licence makes them ineligible to do.

For more information, including data protection and anti-money laundering implications, ICAS has produced a useful helpsheet on the topic which can be accessed at: **http://icas.org.uk/regulation/news/helpsheets/**.

ICAS "STARTING A BUSINESS" GUIDE – GIVE YOUR CLIENTS A BIT EXTRA

ICAS would encourage its firms to raise awareness of the "Starting a Business" guide, which is a step-by-step guide to financing and starting a new business. For more information and to download the guide visit **http://icas.org.uk/Guide-to-starting-a-business/** (firms are welcome to link from their website to the guide).

We would also be keen to hear from firms who would be interested in "white-labelling" the guide for their own business development purposes. Interested parties should contact **practicesupport@icas.org.uk**.

INSOLVENCY: FOCUS ON FOOTBALL AND LEISURE

European Financial Fair Play

Football activities, both on and off the pitch, are sharply in news focus these days. Despite remarkable revenue growth, numerous well-known clubs have faced an escalation of player costs, unsustainable debts and various forms of financial difficulties, which have led to insolvency proceedings. As a result, the European football governing body – UEFA – has taken action and introduced Financial Fair Play (FFP) regulations. These regulations are designed to encourage clubs to adopt a more economically rational and sustainable approach to their activities. But will these regulations work and what is their impact on financial reporting for football clubs?

The new regulations, effective from 2013/14 tax years onwards, essentially require clubs 'playing in Europe' to report a break-even position, over a rolling period but based on what is termed 'relevant' income and costs.

Recent research carried out with the support of the Scottish Accountancy Trust for Education and Research (SATER) and ICAS has sought to address these questions. Through a series of interviews with finance directors at football clubs, football club auditors, football finance experts and representatives of governing bodies and leagues, the research findings conclude that, while largely supportive of UEFA's objectives, a number of specific concerns exist over the new regulations. In addition, the current financial statements produced by clubs are seen as of minimal or no use, and there is little agreement amongst the interviewees as to whether this perception would change as a result of FFP.

The research report recommends that UEFA should consider three additional aspects:

- The need for more emphasis on cash control measures;
- That sanctions should not be financial in nature; and

- The need to reconsider the risk that sanctioned clubs might suffer some form of double jeopardy.

One specific recommendation is for clubs to disclose their break-even calculations and also to reconcile these calculations to the reported profit or loss in the financial statements. Tied in with wider debates on improving financial reporting and the development of integrated reporting, it has also been suggested that a leading football club participates in an integrated reporting pilot study.

Scottish clubs in distress

Away from Europe, many clubs in the domestic leagues in Scotland continue to struggle financially and are heavily reliant on benefactors. A recent report by a national specialist insolvency firm highlighted that over half of clubs in the top three Scottish divisions are showing signs of financial distress; three of these clubs show critical financial distress signs. Across the UK, over 150 football clubs have gone into administration or liquidation in recent years.

The financial plight of clubs has been exacerbated by the economic downturn with match attendances continuing to decline. The average gate attendance over all four leagues in Scotland was down nearly 6% in the second half of the 2013/14 season.

With many wealthy benefactors unwilling, or unable, to continue to bank roll clubs, there has been an increase in the number of clubs where fan ownership is being pursued as an exit strategy for the traditional club benefactor. Already Stirling Albion, Clyde and East Stirling are in fan ownership and other clubs such as Annan Athletic, Ayr United and Motherwell are taking steps for the fans to gain ownership through Community Interest Companies. The recent administrations of Hearts and Dunfermline Athletic have both resulted in fans taking control of the club.

When a football club enters insolvency proceedings, the issues that an Insolvency Practitioner faces goes far beyond that of any normal insolvency. The range of stakeholders increases with fan groups, politicians and sports governing bodies, all having an important voice in the outcome. Continual trading is essential to preserve the football league licence, which makes the funding of the trade a key matter to be considered. With wage costs often the highest cost associated with a club's activities, there will often be redundancies required, but this also has to be balanced with maintaining sporting competitiveness. Peculiarities around football creditors and sponsorship and TV payments from the league organisations are all particular factors which need to be considered and negotiated. Taking on a football club insolvency is not for the faint hearted!

Financial Fair Play - Implications for football club financial reporting - **http://icas.org.uk/Financial-Fair-Play-Report-Stephen-Morrow/**

Begbies Traynor Red Flag Alert Football Distress Report (May 2014) - **www.begbies-traynorgroup.com/Libraries/Documents/Football_Insolvency_Survey_2014_-_Scotland.sflb.ashx**.

Leisure and retail

Insolvencies within the wider leisure and retail sector have perhaps started to decline from a peak in 2012. Notwithstanding the fact that the pound in the consumers' pockets has been facing ever increasing competing claims, such as from rising energy costs amongst others, coupled with the effect of a general freeze or low level wage increases (under inflation levels), it seems that consumers are perhaps having a bit more confidence in the economy and are willing to spend their money on leisure activities. An alternative theory is that consumers are so fed up with practising austerity in other areas of life that they are not willing to give up what small pleasures they have left!

Recent insolvencies in the leisure sector have however resulted in some challenges and uncertainties for insolvency practitioners. Landlords are often key to successfully re-shaping a distressed retailer's financial prospect, and there has been much dubiety over their rights to rent when a company goes into administration. Historically, administrators would pay landlords rent on a 'pay as you have used' basis as an expense of the administration. However decisions by the courts in the cases of **Goldenacre (2009 EWHC 3389)** and **Luminar Leisure (2012 EWHC 951)** changed that position, such that if a company in administration is using premises on a day on which rent falls due, the company would be liable to pay rent for the whole period covered by that rental payment falling due, (even if the company intends to vacate the premises a few days afterwards). Conversely, if a company goes into administration on the day after rent has fallen due, the company would not be liable to pay any rent at all until the next rent day. As a result of these judgements, where rent is payable in advance, there has been no longer scope for the rent to be apportioned on a daily basis until the recent Court of Appeal decision on Game Group.

Game over?

The position regarding rentals payable by the administrators has changed recently following the Court of Appeal decision in the **GAME Group (2014 EWCA Civ 180)** administration. The Court of Appeal decided:

- Administrators must pay rent for any period during which they use property for the benefit of the administration as an expense of administration (or winding up);
- The rent will accrue from day to day; and
- If the administrator stops using the premises before the next quarter day, the rent for the period of use will be apportioned accordingly.

This recent decision takes matters almost full circle to how the matter was treated pre-Goldenacre and Luminar, and has been broadly welcomed by both landlords and the insolvency profession. The matter may however not be finally settled as it is understood that the right of appeal to the Supreme Court has been granted leaving administrators and landlords with a degree of uncertainty on how to proceed until the matter is finally settled by the Supreme Court.

CA LOGOS

ICAS would like to remind member firms that they should use the CA logo on their websites and letterheads, rather than the ICAS 4-dotted version which was a temporary solution. The firm-specific logo can be accessed at: **http://icas.org.uk/trustedinbusiness/support/**.

MONEY LAUNDERING QUERY

Query: *I have just taken on a new limited company client with three directors who are also the three shareholders, each owning 33% of the issued share capital. Do I need to perform verification procedures on all three directors or is this only a requirement for the principal contact?*

Answer: You are required to verify the identity of all beneficial owners in accordance with section 6 of the Money Laundering Regulations 2007. A beneficial owner within a company situation is defined as either:

- Anyone who ultimately owns or controls more than 25% of the shares or voting rights in that entity; or
- Anyone who exercises control over the management of the entity.

Based on the ownership percentage threshold, therefore, you will need to perform verification for all three directors.

If you were in the situation where one director owned 60% of the shares, and the other two directors each owned 20%, you would need to look at the degree of involvement of the two minority shareholders in the running of the business and make a judgement based on the control the minority directors exercise over the management of the business. If it was apparent that the two minority shareholder directors had very little control in this regard, then an argument could be put forward for not verifying these two individuals. Under these circumstances, however, you would need to ensure that any matters that were considered before coming to such a decision were clearly recorded on the client's file.

TECHNICAL BULLETIN

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