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ICAS

SCOTTISH TAXPAYER STATUS AND ONLINE FILING ISSUES

Scottish taxpayer status anomaly for non-resident taxpayers

With Scotland now having a different higher rate band for income tax starting at £43,000 compared to the rest of the UK where it is £45,000, being a Scottish taxpayer now makes a personal difference. With this in mind, it is perhaps worth highlighting an anomaly in HM Revenue & Customs' (HMRC) practices.

HMRC is identifying Scottish taxpayers based on their main address as registered with them. As a broad-brush approach this is unexceptional, but at the edges there are some points for practitioners to watch out for.

Using a Scottish home address

From students to family members working away from home, there is a number of individuals using a Scottish address. Where HMRC have this on file, it will assume that the individual is a Scottish taxpayer. However, a Scottish correspondence address given to HMRC is not conclusive proof of Scottish taxpayer status.

> **EDITORS NOTE**
>
> We apologise for the late delivery of this combined issue of Technical Bulletin, and for any inconvenience caused.

The Basic tests

HMRC technical guidance in the Scottish Taxpayer Technical Guidance Manual at STTG 2000, helpfully set out the basic conditions. An individual is a Scottish taxpayer if:

1. They are a Scottish Parliamentarian; or
2. They have a 'close connection' to Scotland through either:
   - having only a single 'place of residence', which is in Scotland, or
   - where they have more than one 'place of residence', having their 'main place of residence' in Scotland for at least as much of the tax year as it has been in any one other part of the UK.
3. Where no 'close connection' to Scotland or any other part of the UK exists (either through it not being possible to identify any place of residence or a main residence) – [Scottish taxpayer status is determined] through day counting.

The manual goes on to expand these concepts, giving useful guidance from HMRC's viewpoint.

But there is a prior condition. Before we even consider the Scottish taxpayer rules, we must first determine if the taxpayer is UK resident for tax purposes.

Scottish and non-resident

If an individual is non-UK tax resident, they can't be a Scottish taxpayer. We need look no further.

This is where practical HMRC procedures kick in. By default, HMRC assumes that even non-resident taxpayers are Scottish taxpayers if HMRC holds a Scottish address.

The conundrum here was illustrated in a recent Tribunal case (**Theodore David Patrick Laverty [2017] UKFTT 0382 (TC) TC05848**). This case, though it is centred on penalties and missing 64-8s, provides exactly the type of scenario where Scottish taxpayer status could come into play.

Mr Laverty, actually did register an overseas address with HMRC, but given the difficulties he experienced, anyone reading the case might have grave reservations about following suit.

Gone abroad

Mr Laverty, from Glasgow, rented out his house and went to Ho Chi Minh, Vietnam to work. He signed a 64-8, leaving a firm in Belfast in charge of his tax affairs, to ensure that everything ticked along smoothly in his absence.

Returning to penalties

Returning briefly to the UK, Mr Laverty was somewhat surprised to find a £1,700 penalty bill from HMRC for non-filing of tax returns - tax returns which he had never seen, or been notified of by his accountants. HMRC claimed to have sent him tax returns which he had failed to complete.

Delivered by post

The Interpretation Act 1978 usefully says that one can assume that post has arrived, within the expected number of working days, if there is proof of posting and nothing to show the contrary.

HMRC attempted to rely on these provisions to support the penalty notice, saying that post was sent to "*the appellant's correspondence address in Ho Chi Minh City, Vietnam.*" And that "*undelivered correspondence is recorded by HMRC and there are no records to show that any mail was returned undelivered*".

The Tribunal considered reliance on Vietnamese mail to return undelivered post was perhaps a little optimistic.

Missing 64-8

The real snag was that the fall back of intervention by Mr Laverty's accountants had failed, because, claimed HMRC, a 64-8 had never been submitted.

The firm, having attended local Working Together meetings, was aware of problems with HMRC's processing of 64-8s and could say:

"*We have been involved in a Working Together programme with the Inland Revenue over the past few years where we have attended seminars and talks regarding various issues that create problems between the Inland Revenue and agents. The processing of 64-8's has always been a popular topic. We are aware that if a 64-8 is submitted to Longbenton without any attachments (eg CWF1), it is most likely it will never be dealt with if there is no UTR or national insurance number on the form.*"

Importance of Being Earnest

The Tribunal considered that the problems all went back to the alleged non-receipt of the form 64-8, or a later forwarded copy of it, by HMRC. In words reminiscent of Oscar Wilde, it said:

"*If one item of post goes astray that is unfortunate, but if a second item of post is received but the attachment to it, being a copy of the first item, is also not received, that borders on the unbelievable.*"

No case to answer – and a deafening silence

Cancelling the penalties, the Tribunal commented "*the appellant's agent's letter of 27 August 2013 makes a number of points about HMRC's systems for dealing with forms 64-8.*

In the bundle of papers provided to the Tribunal there is no reply to that letter from HMRC. In addition, HMRC's statement of case is silent on the subject.

The Tribunal finds that silence deafening."

Application

It is not uncommon, if an individual goes abroad for an extended period, that they will rent out their UK home while they are away. This gives them a taxable source of UK income while abroad, and HMRC may require returns to be made.

It is also quite possible that they will use a Scottish correspondence address, even if that is a friend's or relative's address – if only to avoid the scenario Mr Laverty encountered.

Given that HMRC may then default to treating the absent taxpayer as a Scottish taxpayer, based on their Scottish address, this may be a scenario to watch. It is perhaps unlikely that there will be many cases where some UK income is sufficient to make a non-resident taxpayer liable for the higher Scottish rate of tax, but it is not impossible.

Conclusion

Recognition of Scottish taxpayers is now more important, and care is needed to rebut HMRC presumptions based on the mere fact of a Scottish correspondence address.

Tailpiece

Mr Laverty's agents used information from Working Together meetings to support their case. The current digital version of Working Together is a newly launched online forum where issues with HMRC systems and processes can be posted, comments made on issues raised by other agents, and responses from HMRC Business units monitored.

All ICAS members in practice are eligible to join. If you would like to be involved, please contact **icas-tax@icas.com**.

2016/17 SELF ASSESSMENT ONLINE FILING EXCLUSIONS: UPDATE

Every year HM Revenue & Customs (HMRC) makes additions to a list of exclusions from online filing for self assessment returns which can be found at: **http://www.sa2000.co.uk/2017-exc-indi.pdf**. This year a significant number of exclusions has been added to the list causing problems for agents who have invested in third party software to enable them to file clients' returns online. Reverting to filing on paper increases the time taken to file and the costs. This seems unacceptable if tax is meant to be going digital.

Personal savings allowance and dividend allowance

The exclusions which have given rise to the biggest issues this year are linked to the personal savings allowance (PSA) and the dividend allowance. The PSA and the dividend allowance provide nil rates of tax on specified amounts of income. However, dividends covered by the dividend allowance still count towards the basic, higher or additional rate bands which can affect the rate of tax paid on dividends received in excess of the allowance. The amount of the PSA depends on the level of adjusted net income - it is £1,000 for basic rate taxpayers, but is reduced to £500 for higher rate taxpayers and nil for additional rate taxpayers.

S25(2) Income Tax Act (ITA) 2007 states '*At steps 2 and 3, deduct the reliefs and allowances in the way which will result in the greatest reduction in the taxpayer's liability to income tax*'. The way that the PSA and dividend allowance operate means that it will be more beneficial for some taxpayers to allocate some of their reliefs and allowances against dividend income before savings income. Unfortunately, HMRC's 2016/17 calculator did not take this properly into account, with the result that the calculations produced for some taxpayers with particular income combinations are incorrect.

HMRC originally decided not to make any alterations to the calculator for this year. It intended to pick up and correct any returns filed online where an incorrect calculation had been produced as a result of the errors in the calculator. The affected scenarios were also added to the exclusions list. Third party software providers did not necessarily adopt the same approach to the relevant exclusions – but many agents found that they could not file online for cases within them.

What has changed and what is the timetable?

Following discussions with professional bodies (including ICAS) and third party software providers, HMRC has now decided to make changes to the 2016/17 calculator in-year to address the errors. Returns filed online after the changes are made should produce the correct calculations.

The changes will address exclusions 48 to 56 and 58 to 59 on the exclusions list. They were implemented in October 2017. HMRC is asking third party software providers to deliver in-year updates to their software to align with HMRC's systems, in order to prevent filing error submissions.

HMRC recognises that agents will be very busy from October, but said that it could not implement the changes more quickly. HMRC intends to maintain the exclusions document for paper returns and claiming reasonable excuse (for late filing) where required.

Where returns have already been filed (online or on paper) before the changes have been made and show an incorrect tax position, HMRC intend to recover them. The recovery will include an SA302 and affected taxpayers will be advised of the correction.

Options for agents

Agents had three options for returns within the relevant exclusions:

- Await the implementation of the fix in October 2017 and then file online; or
- Continue to file online if their current software allows them to do so; or
- File on paper (with a covering letter identifying the exclusion).

If a paper return, which cannot be filed online due to an exclusion, is delivered on or before 31 January of the tax year to which the return relates, HMRC will accept a reasonable excuse for not filing by the normal 31 October deadline for paper returns. An automatically generated penalty will be cancelled if a reasonable excuse claim accompanies the paper return; which can be found at: **https://www.gov.uk/government/publications/self-assessment-reasonable-excuse-for-not-filing-return-online**.

Other exclusions

ICAS raised two other exclusions with HMRC, to request that consideration should be given to fixing these in-year before the main filing period for online returns. ICAS pointed out that this is an important issue for agents who have invested in software on the basis that the system is moving towards 'digital by default' but are now finding that they are faced with incurring additional time and costs filing on paper.

HMRC has supplied replies to both but has regrettably decided not to make in-year corrections for either, although it is considering a 'workaround' for one of them.

Exclusion 60 relates to capital gains where the disposal gives rise to no gain/no loss. The examples given on the list do not mention some common no gain/

no loss scenarios (which could affect more returns) and it is unclear why there is a problem for 2016/17 when there was no issue last year.

HMRC response says:

"The SA108 Capital Gains return page had substantial changes from the previous year to accommodate the changes for Capital Gains.

We thank you for your suggestions for improvements to the examples provided. Space is limited but we will look to incorporate those recommendations.

We are exploring if we can have a workaround for Exclusion 60."

Exclusion 61 relates to farmers' averaging adjustments. ICAS noted that five year averaging claims are time consuming in themselves; having to file on paper (and completing the reasonable excuse form when filing after 31 October) is therefore unhelpful to agents with large numbers of farming clients.

HMRC response says:

"Exclusion 61 affects customers completing the return boxes for averaging adjustment (only for farmers, market gardeners and creators of literary or artistic works) and to decrease tax due because of adjustments to an earlier year.

We appreciate that some agents will have large numbers of farming or other clients and a large percentage may be affected by Exclusion 61 for averaging and that will exaggerate the work involved with producing paper returns.

However, we have no plans to change the Validation which would fix Exclusion 61. The fix would introduce too many risks that we feel are unacceptable. It will however, be fixed for 2017-18."

HMRC went on to say, in response to the general comments about increased costs:

"All Exclusions are important to us and could be created because it has not been possible to change Return boxes, the return box validation or the calculation before 6 April. The two Exclusions 60 and 61 are Validation errors.

As stated in the previous replies we do not intend to make changes to the validation. We apologise for any additional resource and costs attributable to these errors."

TAXATION ASPECTS OF GOODWILL IN PARTNERSHIPS

Many partnerships, particularly professional partnerships, no longer recognise the existence of goodwill. When a partner retires, he does not receive anything in respect of goodwill and a new partner joining does not pay anything in respect of goodwill.

Some partnership agreements provide for payments of goodwill to be made by incoming and to outgoing partners, some of which are recognised within the firm's accounts, while others are paid outwith the accounts.

There is also the issue of what happens to goodwill where a firm buys the business of another and a payment is made in respect of goodwill on this acquisition.

The taxation treatment of goodwill in practice, largely follows HM Revenue & Customs (HMRC) Statement of Practice D12 and is covered in HMRC manuals from CG27000. The full text of SP D12 is covered at CG27170.

The main aspects regarding goodwill within a partnership are:

Disposal of Goodwill by a Partnership

This is subject to capital gains tax with the gain being calculated as normal. The total gain is allocated among partners depending upon their fractional share of the asset surpluses. This will normally be the partners' profit sharing ratio but the partnership agreement may provide for differing profit sharing ratios and capital surplus sharing ratios.

Acquisition of Goodwill by a Partnership

The acquisition cost of goodwill will be allocated between partners in the same manner as a gain on disposal, that is, based on their normal profit sharing ratios or their capital sharing ratios.

Changes in Partnership Sharing Ratios

Where there is a change in profit sharing ratios, some partners' ratios will decrease while others will increase. Where a partner's sharing ratio decreases, he is deemed to have disposed of his interest in the goodwill, potentially giving rise to a capital gain; while a partner whose ratio increases will be deemed to have acquired an additional share in the goodwill. A capital gain will only arise on a partner's sharing ratio decreasing where there has been a revaluation of goodwill in the accounts. Otherwise, where there has been purchased goodwill, the partner will be treated as disposing of the goodwill at the same figure as he acquired it.

Adjustment through the Accounts

Where goodwill is revalued in the accounts, each partners' shares of the revaluation will be credited to his capital or current account. This does not of itself result in a chargeable gain. However, where there is a subsequent reduction in his sharing ratio, he is deemed to dispose of a fractional share of the revaluation surplus. A partner

whose share increases will have a higher base cost for his share of the goodwill.

Payment outside the Accounts

While probably fairly uncommon, a payment can be made between partners, not reflected through the firm accounts, where there is a change in sharing ratios. This will reflect consideration for the disposal of the whole or part of a partner's share of assets, including goodwill, where the latter is not included in the accounts. The receipt by a partner is proceeds for capital gains tax purposes, while the payment by a partner represents a tax base cost.

Where a partner has made a payment outside the accounts, and his sharing ratio subsequently reduces, he will be able to offset part of this against the actual or deemed proceeds which he is deemed to receive.

Where the partner retires, and receives nothing for goodwill, he may be able to claim a capital loss to the extent that he has made a personal payment for a share of goodwill.

Connected Persons

Where no payment is made, in connection with a change of sharing ratio, either through the accounts or outside the accounts, the general position is that a capital gains tax charge will not arise. Where however the transaction is between connected persons, which may be a parent and a child, market value is substituted as deemed consideration unless nothing would have been paid had the parties been at arm's length.

Where a charge to capital gains tax arises, entrepreneur's relief should be available, provided that the conditions are met.

NEGLIGENCE AND ITS LIMITATIONS

Background

On 19 May this year the Mercantile Court, part of the Queen's Bench Division of the High Court, delivered its judgment in **Halsall & Others v Champion Consulting Ltd & Others [2017] EWHC 1079 (QB) (http://www.bailii.org/ew/cases/EWHC/QB/2017/1079.html)**.

The claimants had been partners in a firm of solicitors. They alleged that they had been negligently induced by the defendants (a tax advisory firm and its associated firm of chartered accountants) to invest in two different types of tax mitigation scheme which were later defeated by HM Revenue & Cutsoms (HMRC). The schemes were referred to as the 'charity shell' schemes and the 'Scion' film scheme.

HMRC had pursued enquiries which resulted in the scheme users facing liabilities they had not expected. As a result, they sought to recover their losses from the scheme promoters.

Assurances of success

According to the claimants, the defendants had assured them that the charity shell schemes would work effectively, reduce their tax liability and improve their overall financial position, as well as being able to benefit charities of their choice. They argued that the defendants had been negligent in failing to advise them that there was a significant risk that the schemes would be successfully challenged by HMRC.

They also claimed that the defendants had advised them that the film scheme was robust, with a 75% or 80% prospect of success, that the Scion tax schemes had a history of successful implementation, and that if the film scheme failed, the maximum loss would be the amount of cash invested. In the event, it became apparent that HMRC would deny substantial tax reliefs that had been anticipated. The claimants argued that the advice had been negligent and, as a result, they had suffered loss and damage.

Was there negligence?

On the evidence before her the judge, HHJ Moulder, found that the defendants had advised the claimants to participate in the charity shells, giving them a 100% assurance that their tax liability would be reduced as a result of this investment and that the schemes were not susceptible to a risk of successful challenge by HMRC. The defendants had failed to advise that aspects of the schemes were particularly at risk of challenge. There had been no contributory negligence on the part of the claimants.

Regarding the defendants' assurance that the prospects of success of the Scion film scheme were 75%, the judge concluded that this amounted to a breach of duty, being advice that no reasonably well-informed and competent tax adviser could have given. Again there had been no contributory negligence by the claimants.

Limitation

In England and Wales, the Limitation Act 1980 (LA 1980) s 2 provides that in general "*an action founded on tort shall not be brought after the expiration of six years from the date on which the cause of action accrued*." For this purpose the cause of action accrues at the date on which the wrong is done, even if no-one is aware of it at that time.

In the case of the charity shells, the Court held that this six-year period ran from the date on which the relevant claimant entered into the contract to subscribe for shares in the relevant shell or, at the latest, the date on which the shares in the shell were gifted to charity.

The claim, which was brought on 6 March 2015, fell outside this limitation period.

In the case of claims such as this, for negligence not involving personal injuries, LA 1980 s 14A disapplies s 2 and provides for two alternative periods of limitation – either six years from the date on which the cause of action accrues or, if later, three years from "*the earliest date on which the plaintiff or any person in whom the cause of action was vested before him first had both the knowledge required for bringing an action for damages in respect of the relevant damage and a right to bring such an action.*" Although not relevant in **Halsall v Champion, LA 1980 s 14B** also imposes a separate long-stop time bar on such claims.

The Court found that the claimants had failed to discharge the burden of proof on them that each of their claims in respect of the charity shells was brought within the alternative three-year period offered by **LA 1980 s 14A**.

In relation to the film schemes, the Court concluded that there was no doubt that the primary six-year period had expired. It also held that the claims in respect of these schemes had been brought outside the alternative three-year limitation period and must therefore fail.

The position in Scotland

Had such a case arisen in Scotland, the position would have been different. The Limitation Act 1980 does not apply north of the border. Instead, the relevant statute is the Prescription and Limitation (Scotland) Act 1973 (PLSA 1973).

Most claims in Scots law, including claims for professional negligence or breach of contract, extinguish after a fixed time limit (the 'prescriptive period') – usually five years (PLSA 1973, s 6). In exceptional circumstances this period may be extended, suspended or interrupted. There is also a long-stop prescriptive period which extinguishes any claims after 20 years, regardless of when awareness arose (PLSA 1973, s 7).

It could be risky to try to read across from the judgment in **Halsall v Champion** to the circumstances in which a potential limitation period might apply to any negligence claim arising in Scotland, and specific legal advice should be sought in any particular case.

Lessons to be learnt

The findings of negligence against the defendants in **Halsall v Champion** should act as a wake-up call to practitioners. The fact that the claimants were unsuccessful as a result of the Limitation Act 1980 should be a salutary warning to anyone taking professional advice and finding it wanting.

Tax advisers are already well aware of changed attitudes to tax avoidance. There are stringent requirements for the Disclosure of Tax Avoidance Schemes (DOTAS), and severe sanctions such as Follower Notices and Accelerated Payment Notices.

Even in cases where relatively straightforward tax planning seems unlikely to attract the wrath of HMRC, the risks that clients may seek recompense for unexpected tax liabilities and related costs and losses should not be ignored, but must be actively managed.

Advisers should guard against such risks, and in doing so they should adhere strictly to the published guidance on Professional Conduct in Relation to Taxation (PCRT) (**https://www.icas.com/__data/assets/pdf_file/0007/266056/20161101-Professional-Conduct-in-Relation-to-Taxation-FINAL.pdf**).

A word about engagement letters

Most practitioners rightly regard their engagement letters as crucial in defining their relationships with their clients and setting out the terms and conditions under which they work.

The PCRT states (at paragraph 4.26): "*A member should understand his client's expectations around tax advice or tax planning, and ensure that engagement letters reflect the member's role and responsibilities, including limitations in, or amendments to, that role.*"

Established case law distinguishes between a duty to provide information for the purpose of enabling someone else to decide upon a course of action, and a duty to advise someone as to what course of action he should take. In **Halsall v Champion** the engagement letters did not define the scope of the duty owed to the claimants.

The Court held that, irrespective of whether the defendants were under any contractual duty to provide advice, they did in fact provide advice. The letters did not have the effect of correcting oral assurances that the defendants had given to the claimants at the outset.

Conclusion

HHJ Moulder's judgment runs to 71 pages and is certainly no easy read. However, it contains some instructive messages – both for tax advisers and for those they advise.

IHT, RESIDENCES AND DOWNSIZING

Introduction

The inheritance tax (IHT) nil rate band (NRB) was increased to £325,000 on 6 April 2009 and is unlikely to rise further until 5 April 2021 at the earliest.

Since 9 October 2007, any unused part of a deceased taxpayer's NRB may be added to the NRB of their surviving spouse or civil partner. This 'transferable nil rate band' may be used on the second death, giving the couple an effective NRB which could be as high as £650,000.

New reliefs – a 'residential nil rate band' (RNRB) and a 'downsizing addition' – are available on some deaths from 6 April 2017. These are potentially valuable. They may increase a couple's effective NRB to £850,000 now or up to £1 million by 2020/21. For example, on a death in 2020/21 they might reduce the chargeable estate by as much as £350,000, saving IHT of £140,000.

The way in which the RNRB and downsizing addition are calculated is complicated. HM Revenue & Customs (HMRC) provide detailed guidance and examples in their IHT Manual (**https://www.gov.uk/hmrc-internal-manuals/inheritance-tax-manual/ihtm46000**). For taxpayers, personal representatives and their agents, practical issues regarding record-keeping may raise significant difficulties and are likely to become more problematic as time passes.

Residential nil rate band

In addition to the NRB, a new 'residential nil rate band' (RNRB) may now apply on a death on or after 6 April 2017 when a 'qualifying residential interest' (QRI) is 'closely inherited' – that is, by the deceased's direct lineal descendants. This includes not only their natural children (whether or not adopted by others) but also step-children, adopted children, children they have fostered at any time, and children of which they have been appointed guardian or special guardian.

The QRI is limited to one residential property. If the estate contains more than one such interest, the personal representatives may nominate which property qualifies. The deceased must have occupied this as a residence at some stage, though not necessarily at the date of death.

The RNRB is being phased in, and cannot exceed £100,000 in 2017/18, £125,000 in 2018/19, £150,000 in 2019/20 and £175,000 in 2020/21, rising annually after that in line with the CPI. However, additional RNRB may be due, based on any RNRB unused on earlier death of one or more spouses or civil partners.

On an estate worth more than the 'taper threshold' (currently £2 million) before deducting business or agricultural reliefs or exempt charitable bequests, the RNRB is reduced by £1 for every £2 over this threshold. This produces an effective IHT rate of 60% in the margin.

The downsizing addition

Whether or not RNRB applies, a 'downsizing addition' may be claimed when the deceased has downsized or ceased (for whatever reason) to own a 'qualifying former residential interest' (QFRI) and assets of an equivalent value to that QFRI, up to the maximum RNRB, are closely inherited on their death on or after 6 April 2017.

This downsizing relief seeks to ensure that individuals won't lose the RNRB simply because they choose to downsize to a less valuable property, or because they sell their home for some other reason – perhaps on going into residential care.

The deceased must have owned the QFRI or had an interest in possession in it immediately before the disposal. The disposal must have taken place on or after 8 July 2015, after the nominated dwelling first became their residence, and before they died. A gift subject to a reservation of benefit is not treated as a disposal.

Where more than one downsizing event has occurred, only one can be taken into account, as nominated in the claim. Where the deceased held more than one interest in the same residential property interest, they can be treated as one QFRI if disposed of on the same day.

Entitlement to the reliefs

The RNRB is given automatically if appropriate disclosure is made on the IHT return. The downsizing addition must be claimed within two years from the end of the month in which death occurs or, if later, within three months of the date on which the personal representatives first started to act; in some cases HMRC may allow a late claim.

Record-keeping

After a death, will the personal representatives have sufficient evidence to convince HMRC that the deceased had occupied a particular property as a residence, not necessarily in recent years, so that RNRB can apply? Where the deceased had downsized at any time on or after 8 July 2015, will there be enough evidence to support a claim for the downsizing addition?

While accountants are accustomed to maintaining 'permanent records' regarding the affairs of their ongoing clients, taxpayers often deal with property transactions through a variety of solicitors or other conveyancers over the years. There may be no connection between such advisers and any accountant or lawyer advising on subsequent wills and the eventual winding up of the estate.

Before granting the RNRB, or allowing a claim for the downsizing addition, HMRC may require detailed documentary evidence such as completion statements, evidence of ownership, and confirmation of use as a residence. Will these be available?

Fairness

There are some aspects of the RNRB and the downsizing addition which have been criticised as unfair and do not seem to serve any compelling public interest.

While many taxpayers wish to pass the value of their home to children or grandchildren, others without descendants may have equal need to protect those they leave behind. Why, for example, should a parent leaving their home to a son or daughter suffer less IHT than an unmarried taxpayer of similar means, leaving their home to a sibling who lives with them?

Why should a taxpayer who invests in a valuable home (or has done so in the past) be offered IHT reliefs not available to another taxpayer who has chosen to invest in other assets? For example, why does an individual who has occupied a valuable house deserve a more favourable IHT regime than a person of similar means who has taken care to pursue an ethical investment strategy?

REVIEW OF HMRC TOOLKITS

HM Revenue & Customs (HMRC) currently provide 20 online Agent Toolkits (**https://www.gov.uk/government/collections/tax-agents-toolkits**) which are intended to help agents. They provide guidance on errors HMRC frequently see in returns, and set out steps HMRC believe can be taken to reduce those errors. The toolkits are currently in PDF format.

HMRC suggest several ways agents might want to use the Toolkits:

- as a straightforward checklist
- to complement or check and refresh existing processes
- as a training aid for staff.

They can also be useful for researching particular topics, as they highlight common errors and offer an easy way into relevant HMRC guidance, published in its manuals. They have been developed with the benefit of input from agents and professional bodies, although users should remember that the content is based on HMRC's view of tax law.

Topics range from business profits, directors' loan accounts, and capital allowances, to property rental, trusts and estates, and partial exemption.

HMRC review

HMRC are reviewing the Toolkits and seeking feedback from ICAS and other professional bodies on whether they are meeting agents' needs. We would welcome input from members who use the Toolkits on the following questions:

- Do HMRC Agent Toolkits currently meet your needs?
- Do you feel HMRC Agent Toolkits could be improved? If yes, how?
- What area of HMRC Agent Toolkits currently works well?
- Do you like the PDF format? If the format changed what would you find useful?
- Any other comments regarding HMRC Agent Toolkits?

If there is a reason you don't use the Toolkits, which could be addressed as part of HMRC's review, let us know at: **icas-tax@icas.com.**.

PRACTICE MANAGEMENT COURSES 2018
SAVE THE DATE

Inverness - Wednesday 23 May
Edinburgh - Tuesday 19 June
London - Wednesday 20 June
Glasgow - Tuesday 11 September
Aberdeen - Wednesday 19 September
Bristol - Tuesday 2 October
Dundee - Tuesday 23 October
Birmingham - Tuesday 6 November

TAX EFFICIENT REMUNERATION STRATEGY AND THE NATIONAL MINIMUM WAGE

Many owner/directors of companies receive modest salaries and dividends from their companies as the tax and national insurance cost is lower than receiving a higher salary.

Currently, earnings under £157 per week are not subject to national insurance, so many company directors receive an annual salary of around £8,000.

For a director working 35 hours per week, a salary at this level is substantially below the national minimum wage. Happily, "*the national minimum wage and living wage*", which can be found on gov.uk website at: **https://www.gov.uk/national-minimum-wage/who-gets-the-minimum-wage** confirms, at Section 2 "*who gets the minimum wage*", that company directors are not entitled to the minimum wage.

Matters do not however stop there as the "employment status" document, which can again be found on the gov.uk website at the link below, covers the position of directors and office holders in further detail.

https://www.gov.uk/employment-status/legal-decisions-on-employment-status

At Section 6, the document recognises that directors have different rights and responsibilities from employees, and are classed as office holders for tax and NIC purposes.

Section 7, headed "Office Holder" says that "*a person that has been appointed to a position by a company but does not have a contract or receive regular payment may be an office holder. This is deemed to include registered company directors or secretaries. It is further stated that "Office Holders" are neither employees nor workers. However, it's possible for someone to be an office holder and an employee if they have an employment contract with the same company... that meets the criteria for employees*".

Therefore, if a director has a contract of employment, he may be entitled to the national minimum wage and his tax efficient remuneration strategy may be in breach of this.

So, we have the unequivocal statement that company directors are not subject to the national minimum wage but, by dint of having an employment contract, their employment duties may fall into the national minimum wage definition. Helpfully, a now somewhat old piece of guidance produced by the erstwhile Department of Trade and Industry entitled "A detailed guide to the national minimum wage" stated at paragraph 22:

"*The national minimum wage does not apply to company directors unless they have contracts which makes them "workers". Company directors are classified as "office holders" in common law and can do work, and be paid for it, in that capacity. This is true no matter what sort of work is done, or how it is rewarded, so it is unlikely that a director will have an implied contract which makes him a worker. However, company directors who have employment contracts will need to be paid the national minimum wage. If a company director is unsure whether he has entered into an employment contract with his company he may wish to take legal advice*". Now archived, this could be found on the link below and, the readers more adept at the use of computers than the writer may be able to locate this:

http://www.dti.gov.uk/er/nmw/gtmw.pdf

Summing all of this up, if you are a director of your own company and there is no requirement for a contract of employment for practical purposes, it is probably best not to have one if you wish to pay yourself as tax efficiently as possible.

However, where you are director of a company but not a major shareholder, you may wish the comfort of a contract of employment in case a dispute arises in the future with your employer company.

GETTING RID OF AN UNWANTED HOLDING COMPANY

The owners of many trading companies have interposed a holding company between themselves and the trading company. Thereafter, business premises, surplus cash, and other assets have been transferred to the holding company so that they are protected in event of the failure of the trading company.

Much less common is the situation where there is a trading company, owned by a non-active holding company, which the directors and shareholders view as surplus to requirements. There are, however likely to be tax consequences of doing away with the holding compoany. Before going into these, a simpler solution may be to:

- Hive the trade and assets of the subsidiary up to the holding company and pay any reserves to the holding company by way of dividend. It should be possible to achieve this with no tax cost as the result of capital gains, stamp duty and land and buildings transactions tax reliefs.
- The two companies could swap their names.

- The subsidiary could be struck off.
- A number of contracts with customers and suppliers may have to be changed and perhaps the holding company would have to register for VAT and set up a PAYE scheme.

There is a bit of effort involved in this but it should be achievable unless there are any sensitive contracts which could not be transferred. For example, the subsidiary may have special licences from, for example, the Scottish Environmental Protection Agency, which may not be readily transferrable.

If, for whatever reason, it is not possible to undertake a hiving up, then the following potential tax issues will have to be considered:

1. The shares in the subsidiary could be sold to the individual shareholders. Do they have the available cash to effect the purchase? If the sale is at under value, then they will be subject to income tax on the difference.
2. A capital gain could arise within the holding company unless substantial shareholdings exemption applies. This exemption could very well apply, provided that the subsidiary has been a trading company for at least 12 months. Historically, the holding company had to be a trading company or the holding company of a trading group both prior to the sale and immediately thereafter, but relaxations are included in the 2017 Finance Act to the effect that the holding company does not need to be a trading company or the holding company of a trading group. If substantial shareholding exemption is not available, then there will be a capital gain within the holding company, subject to corporation tax, unless losses are available to offset this.
3. The holding company could then be put into members' voluntary liquidation. This may produce capital gains in the hands of the individual shareholders, taxable at 20% unless the 10% entrepreneurs' rate is available.
4. In the members' voluntary liquidation scenario, as we are likely to be dealing with shares in a close company and shareholders who own at least 5% of the shares, arguably, they will be involved in a similar trade within 2 years of the members voluntary liquidation and there is the possibility that HM Revenue & Customs (HMRC) will invoke the anti-avoidance legislation introduced by s35 Finance Act (FA) 2016 and contained in s396B Income Tax (Trading and Other Income) Act (ITTOI) 2005, and seek to subject the liquidation proceeds to income tax as a distribution. The question is whether avoidance of income tax would be a main purpose in these circumstances? It would indeed be ironic were HMRC to take this view bearing in mind that they are likely to collect capital gains tax from the individual whereas, if nothing was done at all, and the group left intact, no tax would be payable at all.
5. As an alternative to the individual shareholders purchasing the shares in the subsidiary, the shares could be transferred to the individuals by the holding company as a dividend in specie. This will give rise to income tax in the hands of the individuals at rates of up to 38.1%.

Calculations should be prepared covering all the possible outcomes noted above, and a decision can then be made as to whether the tax cost is a price worth paying to be rid of the holding company.

If possible commercially however, the hive up may prove to be the optimum solution.

EMPLOYMENT CORNER

Burden after burden – Relentless Changes to Employment Taxation

Employers and agents could be forgiven for being out of breath when it comes to keeping up with the changes in employment law and taxes – doing so currently requires considerable stamina.

It seems that every Minister has an idea involving employers or employees that they wish to implement at the earliest opportunity to make their mark during their time in power. Yet the unfortunate consequences of this relentless push manifest themselves in the form of bad legislation, further administrative burdens and additional cost for employers, complication and that other thing no-one wants - uncertainty.

It is quite clear that HM Revenue & Customs (HMRC) does not have adequate resources internally to cope with the creation, consultation, and implementation of vast swathes of new legislation, because the way in which this is being handled at the moment is a cause for concern. HMRC is not listening to stake holders who have practical experience of handling live taxation issues, and legislation is being written which in some cases does not make sense – Making Tax Digital is a prime example of this. It will still be going ahead, albeit perhaps with a short delay. HMRC is determined to press ahead despite receiving criticism from employers, agents, and even the House of Lords that it is being brought in too quickly and too severely. We appreciate that HMRC is being pressed to do this by Ministers, but it simply isn't feasible to change things so dramatically without offering employers the necessary support.

One of the things that is often forgotten in the rush is HR. Everything that happens in an employment context has an impact on employees, and HR departments also have to absorb the

changes. A good employment tax practitioner will always consider the employment law side of things and the impacts changes will have. Some of the changes HMRC is making currently clash directly with the HR agenda.

Termination payments

For example, take the legislation drafted for the Finance Bill on the new method of calculating termination payments. ICAS submitted a response to the consultation (**https://www.gov.uk/government/consultations/simplification-of-the-tax-and-national-insurance-treatment-of-termination-payments-consultation-on-draft-legislation**) on termination payments pointing out that the proposed new section 402D of Income Tax (Earnings and Pensions) Act (ITEPA) 2003 would result in disproportionately high tax bills for people whose pay goes down in the period before the 'trigger date', for example, due to short time working, reduced hours, sickness or pregnancy.

Scottish Income Tax

The income tax computation for a Scottish taxpayer with anything other than PAYE earnings just got a whole lot more complicated. Because the Scottish Income Tax rates and bands apply only to non-savings non-dividend income, this results in a computation which has to be done in many parts to work out those parts of the income which still remain taxed at UK rates and those which are taxed at Scottish rates. Some distortions with pensions tax relief, Marriage Allowance, Child care vouchers (Basic Earnings Assessment) have also arisen, so care needs to be taken.

Misalignment of Income Tax and NICs

Now that Scottish ministers have introduced the first divergence in income tax rates since PAYE began, we find ourselves in the opposite position to what the Office of Tax Simplification recommended in its two 2016 reports on Income Tax and NICs alignment. Scottish taxpayers earning between £43,000 and £45,000 (Assuming they are entitled to the personal allowance of £11,500) are now Higher Rate taxpayers unlike their English, Welsh and Northern Irish counterparts, and yet they still pay NICs at the rate of 12% up to £45,000 worth of earnings instead of stopping at £43,000.

Salary Sacrifice

The announcements in the 2017 Spring Budget put paid to many salary sacrifice schemes, and the details of this are still being worked out between employment tax experts and HMRC. Businesses must decide whether they still wish to continue with what they originally offered their employees, or whether to revert back to gross pay. Either way, there will be a NIC cost involved for the employer, and the employees will pay more tax as a result. HR managers will also need to understand the contractual implications inherent in these changes.

Table 1 below shows the timeline for the transition of "salary sacrifice schemes" as we knew them to what are now called "OPRAs" – Optional Remuneration Arrangements.

Table 1

April 2017	April 2018	April 2021
All schemes continue to earliest of next trigger point, or April 2018, unfettered	Existing schemes for Cars, Vans, Fuel, Living Accommodation and School Fees (set up prior to 6 April 2017) can continue to April 2021.	Pensions, Cycle to Work, Child Care and Ultra-low low CO2 Cars (75g/km) continue indefinitely
Prepare for 2018 & 2021 phasing out/ transitional arrangements	All other new & existing schemes must be closed except Pensions, Cycle to Work and Child Care	Schemes for all other Cars, Vans, Fuel, Living Accommodation phased out

Expenses consultation

The Employee Expenses Call for Evidence (**https://www.gov.uk/government/consultations/taxation-of-employee-expenses-call-for-evidence**), closed on 10 July. ICAS submitted a response and we await the Government's proposals in due course.

Employee shareholders

The tax incentives originally conceived by Jo Swinson during the last coalition Government have been shelved and are no longer open to new entrants, as they were found to only being used by companies to reward top executives, rather than be more evenly available across all workers. This ill-conceived idea is yet another example of bad legislation that did not have the desired effect.

As far as HR departments were concerned, the legislation meant issuing revised employment contracts, and the need to make participating employees aware that they were trading their £2,000 of shares for employment rights – something which could have cost them a lot more than £2,000 had they then been unfairly dismissed.

Dynamic Coding

HMRC is carrying out an exercise called "PAYE Refresh" which is an initiative to contemporaneously amend the tax codes of around 6 million PAYE taxpayers. Anyone who receives a P800 reconciliation after the tax year end (ie an under/overpayment notice) will be affected by dynamic coding.

It would appear HMRC now believes it is in a position to put the Real Time Information it has been receiving since

2013 to another good use, in addition to understanding who owes it what on a monthly basis instead of a yearly basis.

However, there are some likely unintended consequences – one of which is that, for the first year of the initiative, it is likely that some employees will pay more tax until the old system of taxing people the year after they receive benefits in kind etc becomes completely real time. Where possible, employees will be re-coded to take account of two years' worth of underpayments, although account will be taken of hardship cases and other mitigating factors.

Employees who access their Personal Tax Accounts, which HMRC recommends for all UK taxpayers, will be able to see, query and amend their tax codes. However, employers should be communicating to their employees that they should not "report" receipt of BIKs using the Personal Tax Account – otherwise, they will be at risk of being charged twice – as the employer has of course primary responsibility for reporting such items on the P11D or via payroll.

Under the dynamic coding regime, potential underpayments are to be replaced with in-year adjustments (IYAs) as soon as HMRC becomes aware of the change, called the "trigger point". HMRC calculates the estimated annual pay of the taxpayer and the tax code results from this. All this information is usually going to be received by HMRC via the FPS return under Real Time Information.

Whilst this sounds like a great plan, potential issues can arise which can skew the figures of estimated pay – such as bonuses (the earlier in the year, the higher the skew risk) due to estimated pay being calculated on a rolling accrual basis. The bonus is a trigger event, but a lower pay figure the following month would not give rise to another trigger event. Therefore, to correct this, the individual may need to access their Personal Tax Account, which they may well not understand, and therefore the employer is likely to receive increased queries as a result. Obviously, this is an issue which HMRC needs to address as a matter of urgency.

PSA (PAYE Settlement Agreement) Simplification Project

HMRC is conducting research which will inform the PSA simplification process and influence HMRC guidance for the coming tax year 2018/19. HMRC is looking to interact with tax professionals or clients who undertake PSA work and wishes to establish a fact pattern around the PSA process, timescales and effectiveness of the current guidance. Anyone who wishes to contribute should contact **john.berry@hmrc.gsi.gov.uk** or **jon.houghton@digital.hmrc.gov.uk**.

EMI penalties for material inaccuracy

On 7 July 2017, HMRC published a UK wide paper which was re-issued in August 2017 with some minor amendments. **www.gov.uk/government/publications/compliance-checks-employee-tax-advantaged-share-schemes-penalty-for-material-inaccuracy-ccfs32**.

The factsheet explains what penalties HMRC may charge employers for material inaccuracies in their annual return of Enterprise Management Incentives.

The main provision is that a penalty of up to £5,000 can be issued where, as the result of a compliance check, HMRC determines that: a material inaccuracy in an EMI return exists; an amended return has not been submitted prior to the discovery; and it can be established the inaccuracy was the result of either carelessness or a deliberate act. For a careless act, a penalty of 0% to 30% can be applied, whereas for a deliberate act, a penalty of 35% to 100% can be applied.

It is therefore important that the employer submits an amended return as soon as it becomes aware that: information was omitted from the return submitted; it becomes aware that the return includes something that should not have been included; or where identifies any other error or inaccuracy in the return.

Penalties can be mitigated by reference to the amount of assistance the employer gives HMRC once a discovery has been made and the level of cooperation in assisting HMRC to resolve the issue and allow access to records. This is referred to as "telling, helping and giving" in HMRC speak – a rather condescending 'dumbed down' term.

Any unresolved cases are referred to the tribunal following the usual process.

HMRC IS SHRINKING ITS REAL ESTATE, BUT AT WHAT COST?

The transformation of HM Revenue & Customs (HMRC) into 13 regional hubs continues, but the National Audit Office casts doubt about the cost savings. The delay to Making Tax Digital for Business threatens the projected additional revenue promised in return for the transformation investment.

During the last financial year, HMRC closed a further 26 offices as it seeks to consolidate into 13 regional hubs spread across city centre locations in the UK.

Currently occupying 145 buildings in 92 towns and cities, HMRC began moving staff into the new Croydon regional hub at 1 Ruskin Square in July, and also signed a 20 year lease for the Edinburgh hub at New Waverley, adjacent to Waverley station.

The Bristol hub at 3 Glass Wharf is currently under construction, whilst Three Snowhill remains the frontrunner for the Birmingham hub and Central Square the favourite site for the Cardiff hub.

The 13 regional hubs are to be based in the following cities:

- Belfast
- Birmingham
- Bristol
- Cardiff
- Croydon
- Edinburgh
- Glasgow
- Leeds
- Liverpool
- London (Stratford)
- Manchester
- Newcastle
- Nottingham

HMRC expects the move to regional hubs to save more than £300m up to 2025 and annual cost savings of more than £90m a year from 2026.

Not so optimistic

However, the National Audit Office (NAO) is not so optimistic. At the beginning of this year, the NAO disclosed that HMRC's original estimate of its estate costs had increased by nearly £600m (22%) since it submitted its business case for the 2015 spending review settlement, more than half of which was due to higher than anticipated running costs for its new buildings.

In its report, alongside HMRC's most recent Annual Accounts, the NAO acknowledges HMRC has recognised its original plan was unrealistic and has taken steps to adjust the scope and timing of the estate programme to keep a tighter rein on cost and delivery risk.

However, the NAO report also refers to the total transformation bill. As part of the 2015 spending review, HMRC received a budget of £1.8bn for its transformation from 2016/17 to 2019/20, in return for committing to efficiencies of £1.9bn by 2019/20 and additional tax revenue of £920m by 2020/21. Much of the additional tax revenue was expected to flow from the introduction of Making Tax Digital for Business, but the delay in rollout until 2020 at the earliest places the target of £920m in serious jeopardy. The NAO report discloses current projections putting the total transformation cost as high as £2.2bn.

TAX CASE

Making good – missing the deadlines

Making good is about benefits in kind. Where an employee has received a benefit in kind, the employee may be given the option by the employer of 'making good' – that is paying the employer a sum of money that covers the value of the benefit, or at least reduces the value of the benefit.

The result is that the benefit in kind is no longer charged, or is reduced. This can be particularly effective where the taxable value of the benefit in kind is based on a scale rate and may exceed the cash value. For example, fuel benefit for vehicles charged at a scale rates where private fuel is made available to the employee, whatever the actual fuel used. Where private mileage is low, the scale charge benefit in kind may cost far more than the private fuel actually used. So it makes sense for the employee to pay the employer a sum of money to cover all private fuel.

This is well and good, but, as with all taxes, there are deadlines. The making good reimbursement to the employer must be made within a fixed time period.

A confusion of dates

The latest 2017 Finance Bill, which became law in the autumn, sets a date of 6 July after the end of the tax year for making good for most benefits in kind from 2017/18 tax year. The date for benefits in kind which are payrolled remains 1 June following the tax year-end.

While this brings much needed clarity, there is still one which got away: s222 Income Tax (Earnings and Pensions) Act (ITEPA) 2003, the charge on 'notional payments' such as those in respect of payments by overseas intermediaries or overseas employers, vouchers, readily convertible assets and employment related securities (s687 – 700 ITEPA 2003). Here the deadline remains as 90 days from the end of the tax year in which the notional payment is made (s222 (1) (c) ITEPA 2003).

A double hit

The usual consequence of missing the deadline for making good is that, for the employee the benefit in kind stands, despite the reimbursement to the employer.

In the case of **Philip Deeks, (Philip Deeks TC05976 [2017] UKFTT 527 (TC))**, the position was more dramatic.

On 20 November 2007, Mr Deeks was awarded 6,924 shares in his employer's company. The shares were subject to restrictions and could not be sold. The restrictions were lifted on 20 November 2008, when the shares were valued at £57,510.13.

Under s222, in its pre-FA 2014 wording, making good was required within 90 days of the relevant transaction date (since 6 April 2014, the time limit is 90 days from the end of the relevant tax year).

This meant that Mr Deeks needed to make good £23,579.15 in income tax and National Insurance by 18 February 2009. In fact, a cheque for £23,579.15 was cleared through Mr Deeks' bank account on 26 March 2009 – just over 5 weeks late.

Burden of proof

Mr Deeks claimed that he had written out the cheque before the 18 February deadline and given it to his employer, but the employer had delayed banking it. The employer claimed that they normally banked cheques within 48 hours. Neither could prove their assertions in regard to this specific cheque.

The Tribunal commented, quoting the **Hilden Park case (Hilden Park LLP v HMRC [2017] UKFTT 217 (TC))**, that the burden of proof lies with HM Revenue & Customs (HMRC) in penalty cases, but with the taxpayer when it comes to displacing tax assessments.

So, in this case, it was up to the taxpayer to show, on the balance of probabilities, that the cheque payment had been made by 18 February 2009. This he couldn't do. In fact, some of the evidence, such as significant payments into his bank account shortly before the £23,579.15 cleared, suggested otherwise.

Tax on top of tax

The taxpayer's argument that this was tax on top of tax, fell on deaf ears. The fact that the £23,579.15 was now included on a P11D did mean that he was paying a tax charge on top of the original bill, and though this was, to a degree, punitive, the Tribunal was not empowered to do anything about it. Judicial Review was the only remedy to the taxpayer if it was considered that HMRC had abused its powers to assess tax.

Conclusion

There is a number of events which can trigger a benefit in kind charge for employees, for example, HMRC would consider payments from an offshore employee benefits trust sufficient to trigger such a charge (see EIM 11811).

But whether it is the one-off release of conditions on employment related securities, or the more routine issue of reimbursement for private fuel, it is important that everyone is aware of the finality of the reimbursement period. Meaning to pay on time is not enough.

With changes in the deadline coming up, it would be a good time to remind employer clients, for the sake of good employee relations, to raise awareness of the issue and the changes.

TAX QUERY

Query: *I have a client who is concerned about a large part of the estate of his wife or his, in particular the matrimonial home, having to be realised in the event of one of them having to go in to a nursing home. His lawyer has suggested that their wills could be amended to include a provision that on the first death, the half share of the matrimonial home belonging to the deceased house should pass into a trust for the benefit of the surviving spouse and children. This seems to be a similar idea to how wills used to be written prior to the transferrable nil rate band. How does this impact on the residence nil rate band that is already £100,000 per spouse and by 6 April 2020 will be £175,000.*

Answer: As the enquirer notes, within three years, a married couple could have the benefit of £1 million of nil rate bands and for many individuals with moderate estates, inheritance tax is not an issue, but the possibility of a spouse having to live in a care home for an extended period at some considerable cost to their estate is of much greater concern.

If the wills of a married couple provide that, on the first death, all assets pass to the surviving spouse, then on the second death, two nil rate bands of £325,000 each will be available unless there have been lifetime gifts within the previous seven years, and two residence nil rate bands will also be available provided that the house passes on the second death to lineal descendants.

HM Revenue & Customs (HMRC) produce a very good guidance note which can be found at: **https://www.gov.uk/government/case-studies/inheritance-tax-residence-nil-rate-band-case-studies**.

The residence nil rate band is not available in respect of lifetime gifts of a house. The type of trust will also have a bearing on matters.

If, on the first death, the half share of the house is transferred to an "interest in possession" trust, this will be an immediate post death interest. The surviving spouse has the life rent of the property, which passes to the children on the second death. The transfer of the half share into the trust is covered by the spouse exemption. On the death of the surviving spouse, the value of the half share held in trust is added to the estate of the second spouse, and inheritance tax is calculated on the total.

On the second death the following nil rate bands will be available:

- The £325,000 nil rate band of the second spouse to die,
- A further £325,000 nil rate band will be transferrable from the first spouse to die, assuming it has not been used against any lifetime gifts in the seven years to the date of death or under the terms of the will of that spouse,
- The residence nil rate band of the second spouse, provided that their interest in the house passes to a lineal descendant,

- A transferrable residence nil rate band of the first spouse to die.

The residence nil rate bands will be available against both the interest in the house belonging to the second spouse to die, and also the value of the half share owned by the trust, provided that the beneficiaries are lineal descendants.

The HMRC guidance referred to above, contains the following example:

Case study 8: how to apply the Residence Nil Rate Band (RNRB) when a home is put into a trust

- Mr H died in the tax year 2017 to 2018. He left a house valued at £350,000 to his wife in a trust for her benefit whilst she's alive.
- His will directed that the house will go to their children on his wife's death.
- Mrs H dies in tax year 2020 to 2021.
- The house, then worth £400,000, passes to the children when she dies.
- A claim is made to transfer any unused RNRB from Mr H's estate. RNRB for Mr H's estate is nil because he left the house to his wife. RNRB available for transfer is 100% because none's been used.
- You work out the RNRB available on Mrs H's estate as shown in Table 1 above.

Table 1

Mrs H's own RNRB	£175,000 (maximum RNRB in tax year 2020 to 2021)
plus transferred RNRB	£175,000 (100% x £175,000)
maximum RNRB for Mrs H's estate	£350,000

As the home passing to Mrs H's children is worth more than the maximum available RNRB of £350,000, Mrs H's estate qualifies for the full £350,000 RNRB.

If the half share of the house passes to a discretionary trust on the first death then this will utilise at least part of the £325,000 nil rate band of the spouse to die. As the half share will not be passing to a lineal descendant, the residence nil rate band will not be available at this stage. It may still be worth considering the use of a discretionary trust if flexibility is required as to the destination of trust assets, or if it is felt that inheritance tax may be an issue on the second death.

VALUE ADDED TAX AND BREXIT

Any article about VAT and Brexit can, in the absence of any concrete plan from the Government, only leave the reader with more questions than answers. Nevertheless, it's still worth giving the whole matter some thought.

On 16 March 2017, the European Union (Notification of Withdrawal) Act 2017 (the Act) became law. This legislation gives effect to the UK's withdrawal from the EU and reflects the principles laid out in the White Paper produced by the Government in the same month.

The Act serves the following purposes: it will repeal the European Communities Act 1972 (ECA) on the day that the UK leaves the European Union (EU); it will end the supremacy of EU law over UK law; and it will also convert EU law, as it stands on Exit Day, into domestic law. Thus applicable EU VAT regulations will remain in effect post Brexit.

For VAT purposes, in the short term, this sounds like a practical solution to an otherwise horrendous legislative mess. Superficially, there is little that needs to be done in terms of VAT in order to separate from the EU. EU legislation has been implemented by the Value Added Tax Act 1994 (VATA 1994) which, will obviously remain in force. VAT will continue as a UK tax.

However, historically, the UK and the EU's VAT history cannot be easily untangled. An immediate problem will be that of existing cases that are in the hands of the Court of Justice of the European Union (CJEU), in respect of past periods. It is worth wondering what view is being taken in the UK tribunals and courts during the two year period between the invocation of Article 50 and Exit Day when a reference to the CJEU is required. Practically, within that time frame, most referrals would not result in any decision or judgment in time for Exit Day. Is it possible that the tribunals and courts will start taking bolder decisions, safe in the knowledge that any misapplication of EU law is unlikely to be subject to an objection. However, there has been no real sign of this in recent months, with courts remaining content to make referrals. Perhaps it is too early to see any change in approach.

Another issue worth considering is the future problem of interpreting VATA 1994 which is now imbued with certain principles of VAT that are strictly European, such as equivalence and effectiveness, and the purposive approach to the construction of legislation, all of which have become the foundations of VAT as we know it.

Perhaps, rather than worry about the pending problems, we should consider the opportunity offered by Brexit for the UK to codify the principles which will govern the UK law of VAT. We could then identify the best elements of VAT law as it stands pre Brexit and ignore less attractive elements. This would allow the UK Government to use VAT more fruitfully, for both political and revenue raising ambitions. VAT after all, is a tax that affects everyone in the UK, more so than any other tax. Indeed, it is the second biggest revenue raiser for

the UK Government. Additional social objectives could be achieved; the scope for zero-rating could be both widened and reduced; additional rates of VAT could be introduced. The world will be our oyster.

At the time of writing, the Prime Minister appears to be saying that the UK will leave the single market and customs union on Exit Day, but with a two year minimum equivalent arrangement to smooth the transition. It is difficult to envisage that membership of either could continue.

One thing that is certain is that when we leave these arrangements, any UK business trading with businesses and customers in other EU member states, will be faced with a different set of rules.

All supplies of goods involving the movement of those goods from the UK to another EU member state will be treated as exports and (most likely) zero-rated. No more Intrastat declarations to worry about.

Supplies of goods from other EU member states into the UK will all become imports, so businesses that don't already have one, should consider applying for a deferment account prior to Exit Day.

The amount of customs duty payable is likely to dramatically increase for many businesses along with the administrative costs associated with importing.

The place of supply rules for services between the UK and other EU member states will simplify and again, no more Intrastat.

This article only scratches the surface of some of the issues at stake with Brexit. There are few certainties apart from the fact that nothing changes until everything changes!

FRC DEFERS DECISION ON UPDATING FRS 102 FOR RECENT CHANGES IN IFRS

The Financial Reporting Council (FRC) recently published a feedback statement summarising respondents' comments to its Consultation Document 'Triennial review of UK and Ireland accounting standards – Approach to changes in International Financial Reporting Standards (IFRS)''. The statement also set out the FRC's revised approach on updating Financial Reporting Standard (FRS) 102 for changes in IFRS.

The Consultation Document was issued in September 2016 and asked for views on whether FRS 102 should be kept up to date with IFRS as IFRS changes, particularly in relation to major new standards that have been issued, and provided an outline timetable for possible changes in relation to financial instruments, revenue and leases. Respondents' feedback showed support for a long term aim of broad consistency with IFRS, but questioned the proposed timetable and suggested more IFRS implementation experience is needed before an assessment of whether and, if so, how and when requirements based on these standards should be considered for incorporation into FRS 102.

The FRC has agreed that further evidence-gathering and analysis needs to be undertaken before any proposals to reflect the principles of the expected loss model of IFRS 9 'Financial Instruments, IFRS 15 'revenue from Contracts with Customers' and IFRS 16 'Leases' in FRS 102 could be made. Therefore, the FRC will not be issuing a triennial review phase 2 exposure draft in 2017.

IFRS 17 'Insurance Contracts' has been issued since this consultation took place. The FRC has previously said that FRS 103 'Insurance Contracts' would be reviewed once the IASB had completed IFRS 17. The FRC still intends to review FRS 103 at a suitable time, but consistently with the approach to other major new IFRS, this is likely to take place once more IFRS implementation experience is available.

At present no target effective date for any changes to FRS 102 or FRS 103 has been set and any detailed proposals will be consulted on in due course.

In addition to the triennial review and any projects to update FRS 102 for major changes in IFRS, the FRC will continue to assess emerging issues as they arise to determine whether action needs to be taken and, if so, in what form and when. When necessary this will continue to include issuing amendments to standards outside regular review cycles.

ACCOUNTING FOR FORWARD CONTRACTS

Many businesses enter into agreements to purchase or sell foreign currencies on a future specified date. This is generally done to hedge against currency fluctuations where an entity is entering into contracts that are denoted in a foreign currency and which will not be settled until a future date.

Under Financial Reporting Standard (FRS) 102 'The Financial Reporting Standard Applicable in the UK and Republic of Ireland', such contracts need to be reflected in the financial statements. Under old UK GAAP, such forward contracts were generally not reflected. Additionally, under the old Statement of Standard Accounting Practice (SSAP) 20 'Accounting for Foreign Currency Contracts', where entities entered into a forward contract to purchase a foreign currency in relation to a related trading transaction, for example the purchase of stock at a future date, the contracted forward rate could be used for accounting purposes.

Under FRS 102 financial instruments are split into basic and other. The accounting requirements of basic financial instruments are dealt with in section 11 and those of other financial instruments in section 12. Section 11 provides guidance on what are, and what are not, basic financial instruments.

Paragraph 11.6 states:

11.6 Examples of financial instruments that do not normally satisfy the conditions in paragraph 11.8, and are therefore within the scope of Section 12, include:

(a) asset-backed securities, such as collateralised mortgage obligations, repurchase agreements and securitised packages of receivables;
(b) options, rights, warrants, futures contracts, ***forward contracts*** *and interest rate swaps that can be settled in cash or by exchanging another financial instrument;*
(c) financial instruments that qualify and are designated as hedging instruments in accordance with the requirements in Section 12; and
(d) commitments to make a loan to another entity and commitments to receive a loan, if the commitment can be settled net in cash.

Therefore, the accounting requirements of forward contracts are contained within section 12 which require:

Initial recognition of financial assets and liabilities

12.6 An entity shall recognise a financial asset or a financial liability only when the entity becomes a party to the contractual provisions of the instrument.

In the case of a forward contract this would be when a legally binding contract is entered into.

Initial measurement

12.7 When a financial asset or financial liability is recognised initially, an entity shall measure it at its fair value, which is normally the transaction price (including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss). If payment for an asset is deferred beyond normal business terms or is financed at a rate of interest that is not a market rate, the entity shall initially measure the asset at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

For a forward contract this would normally be zero.

Subsequent measurement

12.8 At the end of each reporting period, an entity shall measure all financial instruments within the scope of Section 12 at fair value and recognise changes in fair value in profit or loss, except as follows:

(a) investments in equity instruments that are not publicly traded and whose fair value cannot otherwise be measured reliably and contracts linked to such instruments that, if exercised, will result in delivery of such instruments, shall be measured at cost less impairment;
(b) hedging instruments in a designated hedging relationship accounted for in accordance with paragraph 12.23; and
(c) financial instruments that are not permitted by the Small Company Regulations, the Regulations, the Small LLP Regulations or the LLP Regulations to be measured at fair value through profit or loss shall be measured at amortised cost in accordance with paragraphs 11.15 to 11.20.

Hence, such contracts require to be measured at fair value. The entity should compare the forward contract rate with the forward rate at the reporting date. Any difference would be taken to profit and loss account.

Example

Company A which has a year end of 31 December enters into a contract on 30 November 2017 to purchase $200,000 US dollars on 31 January 2018 at a forward rate of $1.28/£1. The spot rate on 30 November 2017 is $1.32/£1. On 31 December 2017, the spot rate and forward rate are $1.27/£1 and $1.31/£1 respectively. The spot rate on 31 January 2018 is $1.30/£1. The accounting

requirements under FRS 102 are as follows:

At Date of Entering into Forward Contract

At this date it is very likely that the fair value of the forward contract is 0 (assuming that the contract has been priced correctly, otherwise there would be a day one gain or loss).

At Year End Date – 31 December 2017

The derivative contract would need to be assessed to see whether a gain or loss is expected.

Amount Payable as per forward contract $200,000/$1.28 = £156,250

Amount Payable as per forward rate as at 31 December 2017 $200,000/$1.31= £152,672

Expected loss on derivative contract = £156,250 - £152,672 = Loss of £3,578

Dr Loss on Derivative – Profit and Loss Account £3,578

Cr Derivative Liability – Balance Sheet £3,578

At Settlement Date – 31 January 2018

Amount payable as per spot rate at 31 January 2018: $200,000/$1.30 = £153,846

Amount payable as per forward rate at 31 December 2017: $200,000/$1.31 = £152,672

Gain on derivative contract = £153,846 - £152,572 = Gain of £1,174

Dr Derivative Liability – Balance Sheet £1,174

Cr Gain on Derivative – Profit and Loss Account £1,174

Thus, an overall loss on the derivative contract of £2,404 (£3,578-£1,174).

This equates to the overall loss ie the company purchased dollars in advance at a pre-agreed rate of $1.28/£1. If it had waited until the actual date of the purchase (31 January 2018) then the spot rate was $1.30/£1. The loss incurred by entering into the forward contract is = $200,000/$1.28 - $200,000/$1.30 = £156,250 - £153,846 = £2,404.

FRS 105 BENEFITS AND DISADVANTAGES

Financial Reporting Standard (FRS) 105 'The Financial Reporting Standard Applicable to the Micro-entities regime' is a stand-alone standard designed specifically for preparing accounts for micro-entities. Micro-entities are companies, limited liability partnerships or qualifying partnerships that satisfy specific criteria. The criteria can be found at section 384A of the Companies Act 2006.

HM Revenue & Customs (HMRC) has also advised that it will accept accounts prepared by unincorporated entities that satisfy the micro-entity financial qualifying conditions under FRS 105 for tax purposes.

In summary, the qualifying conditions (two out of three of which must be satisfied) are:

- Turnover not more than £632,000
- Balance Sheet Total not more than £316,000
- Not more than 10 employees

Additionally, the two-year rule applies ie other than in its first year an entity does not change in size until it fails to meet the size criteria in two consecutive years.

Entities Prohibited from being a micro-entity:

As per section 384B of the Companies Act 2006, the following entities are prohibited from being able to apply the micro-entity provisions:

(a) a company which was at any time within that year a company excluded from the small companies' regime by virtue of section 384 of the Companies Act 2006;
(b) an investment undertaking as defined in Article 2(14) of Directive 2013/34/EU(a) of 26 June 2013 on the annual financial statements etc. of certain types of undertakings,
(c) a financial holding undertaking as defined in Article 2(15) of that Directive,
(d) a credit institution as defined in Article 4 of Directive 2006/48/EC(b) of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, other than one referred to in Article 2 of that Directive,
(e) an insurance undertaking as defined in Article 2(1) of Council Directive 91/674/EEC(c) of 19 December 1991 on the annual accounts of insurance undertakings, or
(f) a charity.

Additionally, the micro-entity provisions cannot be applied by:

(a) a company which is a parent company and which voluntarily prepares group accounts for that year as permitted by section 398 of the Companies Act 2006, or
(b) a company which is not a parent company but its accounts are included in consolidated group accounts for that year.

Micro-entity Regime is Optional

Even where an eligible entity satisfies the micro-entity criteria the application of the micro-entities regime is optional. However, a micro-entity that chooses to prepare its financial statements in accordance with the micro-entities regime is required to apply FRS 105.

Requirements of FRS 105

FRS 105 is based on FRS 102, but its accounting requirements are adapted to satisfy the legal requirements applicable to micro-entities and to reflect the simpler nature and smaller size of micro-entities.

The financial statements of a micro-entity prepared in accordance with FRS 105 that include the micro-entity minimum accounting items are presumed in law to show a true and fair view of the micro-entity's financial position and profit or loss in accordance with the micro-entities regime. FRS 105 permits, but does not require, a micro-entity to include information additional to the micro-entity minimum accounting items in its financial statements. If a micro-entity does include additional information it shall have regard to any requirement of Section 1A Small Entities of FRS 102 that relates to that information.

FRS 105 became applicable for accounting periods beginning on or after 1 January 2016. Earlier application was permitted.

The Small Companies (Micro-Entities' Accounts) Regulations 2013 state that micro-entities are not permitted to apply the Alternative Accounting Rules or the Fair Value Rules as set out in company law. Therefore, micro-entities are only permitted to apply the Historical Cost Accounting Rules. Under limited circumstances FRS 105 requires a micro-entity to estimate the cost of an asset or liability based on its fair value. However, this is done on the basis of providing a best estimate of cost in circumstances where there was no cost incurred eg paragraph A3.9 of FRS 105 states that certain types of assets and liabilities must be measured at fair value at initial recognition, for example inventories acquired through a non-exchange transaction. This does not breach the prohibition against fair value accounting as the use of a fair value is a method of estimating cost at initial recognition.

Simpler Accounts

The use of the historical cost accounting rules for many entities makes the accounting easier, as they will not be required to fair value any assets or liabilities eg derivative contracts that the entity has entered into. Likewise, investment properties, and indeed any other buildings, will be stated at cost. There is also no requirement to account for deferred tax. However, whilst easier to produce, it is argued that the information contained is less useful than that prepared under the requirements of FRS 102. However, that ultimately depends on the type of entity being considered. For many small entities FRS 105 might be a satisfactory accounting standard for their particular transactions.

Additionally, the information required by a set of micro-entity accounts is extremely limited. This is restricted to an income statement, a statement of financial position and a limited number of notes to the accounts and notes included at the foot of the statement of financial position.

The notes required are as follows:

(a) advances, credit and guarantees granted to directors as required by section 413 of the Act (see paragraph 6A.1 in the Appendix to this Section); and
(b) financial commitments, guarantees and contingencies as required by regulation 5A of, and paragraph 57 of Part 3 of Schedule 1 to, the Small Companies Regulations. The total amount of any commitments concerning pensions must be separately disclosed. (Schedule 1, paragraph 57(3)).

FRS 105 expands on the above by providing the following additional information. In relation to (a) above, the details required of an advance or credit are:

(a) its amount;
(b) an indication of the interest rate;
(c) its main conditions;
(d) any amounts repaid;
(e) any amounts written off; and
(f) any amounts waived.

There must also be stated in the notes to the financial statements the totals of amounts stated under (a), (d), (e) and (f).

The details required of a guarantee are:

(a) its main terms;
(b) the amount of the maximum liability that may be incurred by a micro-entity;
(c) any amount paid and any liability incurred by a micro-entity for the purpose of fulfilling the guarantee (including any loss incurred by reason of enforcement of the guarantee).

There must also be stated in the notes to the financial statements the totals of amounts stated under (b) and (c). (Section 413 of the Act)

The total amount of any commitments which are undertaken on behalf of or for the benefit of:

(a) any parent, fellow subsidiary or any subsidiary of a micro-entity; or
(b) any undertaking in which a micro-entity has a participating interest, must be separately stated and those within (a) must also be stated separately from those within (b). (Schedule 1, paragraph 57(4))

The following paragraphs in FRS 105 address these disclosure requirements within the context of specific transactions:

(a) Section 9 Financial Instruments: paragraph 9.28
(b) Section 11 Investments in Joint Ventures: paragraph 11.9
(c) Section 12 Property, Plant and Equipment and Investment Property: paragraph 12.28
(d) Section 13 Intangible Assets other than Goodwill: paragraph 13.17
(e) Section 14 Business Combinations and Goodwill: paragraph 14.3

(f) Section 15 Leases: paragraphs 15.17 and 15.33.
(g) Section 16 Provisions and Contingencies: paragraph 16.19
(h) Section 23 Employee Benefits: paragraph 23.22.
(i) Section 27 Specialised Activities: paragraph 27.5.

An indication of the nature and form of any valuable security given by the micro-entity in respect of commitments, guarantees and contingencies must be given. (Schedule 1, paragraph 57(2))

The following paragraphs in FRS 105 address these disclosure requirements within the context of specific transactions:

(a) Section 9 Financial Instruments: paragraph 9.29.
(b) Section 10 Inventories: paragraph 10.22.
(c) Section 12 Property, Plant and Equipment and Investment Property: paragraph 12.29.
(d) Section 13 Intangible Assets other than Goodwill: paragraph 13.18.
(e) Section 27 Specialised Activities: paragraph 27.6.

In accordance with section 414(3) of the Act, financial statements prepared in accordance with the micro-entity provisions shall, on the statement of financial position and in a prominent position above the signature, contain a statement that the financial statements are prepared in accordance with the micro-entity provisions.

Matters for Consideration

If a business is likely to grow fairly quickly, then consideration should be given as to whether it would be more appropriate to use FRS 102 if the entity is likely to have to apply that standard in any case within a few years. Professional judgement will need to be applied and any tax differences will need to be considered. For those businesses which are unlikely to grow to any extent, then FRS 105 may provide an appropriate accounting framework for their purposes.

In relation to the proposed sale of a business, consideration would also need to be given as to whether accounts produced under this standard are suitable, without amendments, for that purpose.

Consideration also needs to be given as to the usefulness of accounts prepared under this basis when making other decisions.

Filing of Accounts

Micro-entities are exempt from preparing a directors' report. Additionally, they do not need to file the profit and loss account. Therefore, all that must be filed is the balance sheet with the limited notes to the accounts (see above) included at the foot of the balance sheet.

Useful References

The ICAS guide for small and micro-entities can be accessed at: **https://www.icas.com/__data/assets/pdf_file/0006/279942/New-FR-standards-A-Hutchinson-29.11.17.pdf**

The Small Companies (Micro-Entities' Accounts) Regulations 2013 can be viewed at: **http://www.legislation.gov.uk/uksi/2013/3008/pdfs/uksi_20133008_en.pdf**

The Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016 can be viewed at: **http://www.legislation.gov.uk/uksi/2016/575/contents/made**

FRS 105 can be viewed at: **https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-105-The-Financial-Reporting-Standard-applicab.pdf**

Amendments to FRS 105 - Limited Liability Partnerships and Qualifying Partnerships can be viewed at: **https://frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Amendments-to-FRS-105-The-Financial-Reporting-Sta.pdf**

NEW FRC GUIDANCE FOR PENSION AUDITORS POSES CHALLENGES

The Financial Reporting Council (FRC) has been consulting on revised guidance for the auditors of occupational pension schemes in the UK. (**https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2017/April/Proposed-Revisions-to-Practice-Note-15-(Revised)-%E2%80%93.aspx**) Audit Practice Note 15 (PN 15) was last updated in January 2011 and now needs updated to reflect changes to auditing and accounting standards and legal and regulatory developments.

The ICAS Pensions Panel has responded to the consultation draft (**https://www.icas.com/__data/assets/pdf_file/0008/294866/Response-to-the-FRC-on-revised-PN-15-on-the-audit-of-UK-pension-schemes.pdf**) highlighting two key areas where further work is needed to ensure that the revised PN 15 meets the needs of pension scheme auditors.

Supporting the work of pension scheme auditors

ICAS has reservations about the usefulness of draft PN 15 to pension scheme auditors. In our view, the material in the draft is not sufficient to support auditors with a small portfolio of pension scheme audits and it is also unlikely to enhance the audit work of firms with specialist teams of pension auditors.

The status of PN 15 means that auditors must consider and apply the guidance in the Practice Note or, if not, explain how engagement standards have otherwise been complied with.

This requirement does not just set a high bar for auditors, it sets a high bar for the standard of PN 15. With this is mind we are urging the FRC to amend the content of the Practice Note to ensure that it adds value to the audit work undertaken on pension scheme accounts. We have, therefore, several detailed comments on areas for improvement, including:

- Recognising the risk to pension schemes of not complying with new stricter data protection laws, including increased fines for data breaches. The EU's General Data Protection Regulation (GDPR) comes into force in May 2018 and will apply in the UK.
- Circumstances giving rise to a duty to report to The Pensions Regulator on internal control deficiencies identified during an audit.
- Meeting the requirements of ISA (UK) 540 on auditing accounting estimates, including fair value accounting estimates and related disclosures, calling specifically for guidance on the audit of annuity contracts.

The audit of going concern

Conceptually, the going concern assumption is a poor fit for pension scheme accounts which are stewardship accounts primarily intended to record and report on scheme investments, with the trustees having a fiduciary duty towards the beneficiaries of the scheme.

We are concerned that proposals in the Practice Note could lead to auditors issuing qualified "except for" audit opinions as a matter of routine to comply with ISA (UK) 570 on going concern.

The Pensions Statement of Recommended Practice (FRS 102) (the Pensions SORP) does not expect pension scheme accounts to include, in the accounting policies note, a statement that the accounts have been prepared on a going concern basis. Therefore, we are of the view that PN 15 should align with the recommendations of Pensions SORP which directs pension trustees to make statements of fact (rather than of judgement).

We understand it is not the intention of the FRC to issue guidance which could result in "except for" audit opinions being issued as a matter of routine; therefore, we are recommending that the material in the draft Practice Note is reconsidered to avoid any unintended consequences.

A revised edition of PN 15 should be available later this year

ACCOUNTING AND AUDITING QUERIES

Filing Obligations of Medium Sized Companies

Query: *I am a partner in a small firm of chartered accountants and will soon be preparing a set of accounts for a medium-sized company for the year ended 30 April 2017. The accounts will then be audited by another firm of chartered accountants. The client has asked whether they will still be able to file a set of abbreviated accounts with Companies House? I do not believe that the company can file abbreviated accounts but are there any other filing exemptions available to medium-sized companies?*

Answer: For accounting periods commencing on or after 1 January 2016 medium-sized companies are no longer able to file abbreviated accounts with Companies House. This change was enacted by Statutory Instrument (SI) 980/2015 'The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015'. This SI removed regulation 4(3) from 'The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008' which had provided the ability for companies to abbreviate certain of the profit and loss account information filed. There are now no filing exemptions available to medium-sized companies.

In terms of their annual report and accounts for shareholders, medium-sized companies are only entitled to very limited exemptions. These are:

1. Disclosure of non-financial key performance indicators – section 414C(6)

   Within their strategic report this exemption provides the ability for medium-sized companies to exclude an analysis using non-financial KPIs (this exclusion encompasses those relating to environmental and employee matters).

   However, medium companies are not exempt from preparing an analysis using financial KPIs.
2. The exemptions contained in regulation 4(2A) and 4(2B) of the amended 2008 accounting regulations (see below).

   Medium-sized companies: exemptions for Companies Act individual accounts

   (2A) The individual accounts for the year need not comply with paragraph 45 (disclosure with respect to compliance with accounting standards) of Schedule 1 to the ''The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008'.

   (2B) Paragraph 72 of the 'The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008' (related party transactions) applies with the modification that only particulars of transactions which have not been concluded under normal

market conditions with the following must be disclosed:

(a) owners holding a participating interest in the company;
(b) companies in which the company itself has a participating interest; and
(c) the company's directors."

Query: *I am a manager in a small firm of chartered accountants. The firm has a stand-alone Scottish charitable company client and I was wondering whether the charity will require an audit this year. The charity's year end is 30 November 2017. In recent years the charity's income, balance sheet total and number of employees has been well under the Companies Act 2006 small company thresholds and also below 'The Charities Accounts (Scotland) Regulations 2006' audit thresholds (income and balance sheet). It is therefore presently subject to an independent examination (income of around £380,000). However, the charity has recently been advised that it is in line to receive a legacy of over £150,000 in the current year although there is as yet no certainty as to when the legacy might be received.*

If the legacy arrives in this current financial year will the charity require an audit for the year to 30 November 2017 as its income will be over £500,000. If so, and its income in the next financial year drops back down to below £500,000, would an audit still be required for that year, or could the charity revert back to an independent examination?

Answer: For illustration, both the Companies Act 2006 and 'The Charities Accounts (Scotland) Regulations 2006' audit requirements have been set out below. In practice, as the thresholds are significantly stricter in the latter, only these will generally be the determining factor.

Companies Act 2006 Requirements

Provided a stand-alone company is not ineligible, and there are no other applicable requirements, then whether it requires an audit is purely down to it satisfying the qualifying conditions for being classed as a small company as per section 382 of the Companies Act 2006. The two-year rule, as contained in this section, applies in determining whether a company meets the qualifying conditions. Therefore, when assessing whether a company has breached this threshold, consideration needs to be given not just to the year in question, but to earlier years. The wording of this section was revised a couple of years ago but the substance of the rule has not changed. The current wording of section 382 is as follows:

"382 Companies qualifying as small:

A company qualifies as small in relation to its first financial year if the qualifying conditions are met in that year.

(1A) Subject to subsection (2), a company qualifies as small in relation to a subsequent financial year if the qualifying conditions are met in that year.

(2) In relation to a subsequent financial year, where on its balance sheet date a company meets or ceases to meet the qualifying conditions, that affects its qualification as a small company only if it occurs in two consecutive financial years.

(3) The qualifying conditions are met by a company in a year in which it satisfies two or more of the following requirements—

1. *Turnover-Not more than £10.2 million*
2. *Balance sheet total-Not more than 5.1 million*
3. *Number of employees-Not more than 50*

(4) For a period that is a company's financial year but not in fact a year the maximum figures for turnover must be proportionately adjusted.

(5) The balance sheet total means the aggregate of the amounts shown as assets in the company's balance sheet.

(6) The number of employees means the average number of persons employed by the company in the year, determined as follows—

(a) find for each month in the financial year the number of persons employed under contracts of service by the company in that month (whether throughout the month or not),
(b) add together the monthly totals, and
(c) divide by the number of months in the financial year.

(7) This section is subject to section 383 (companies qualifying as small: parent companies)."

'The Charities Accounts (Scotland) Regulations 2006' Requirements

The 2006 Scottish Charities accounting regulations (as amended) state that a charity must be subject to audit by a registered auditor if in any financial year:

- it has gross income of £500,000 or more; or
- the aggregate value of its assets (before deduction of liabilities) at the end of the financial year exceeds £3,260,000; or
- it is required to do so by the constitution of the charity, any other enactment, or on the instruction of its trustees.

For charitable companies, the audit threshold set out in the 2006 Charities accounts regulations will therefore trigger an audit if the charity received the legacy during the year to 30 November 2017, as the income condition is stricter under charity law than under company law. This, of course, is based on the assumption that its other income will remain at a level such that, when added to the legacy, the charity's gross income will be equal or greater than £500,000. The criteria to assess whether an audit is required is based

solely on the relevant figures for the year in question. There is no two-year rule and whether an audit is required is based on the charity's income in the year in question. Therefore, if a charity does have a one-off spike in income which takes it above the £500,000 threshold, eg due to a legacy, then it will require an audit in that one year only.

The way the audit threshold works is therefore potentially very tricky for charities. Once a legacy meets the criteria for recognition in the Charities Statement of Recommended Practice (SORP), it must be recognised as income. If probate was granted on the last date of the financial year, and the other criteria in paragraph 5.31 of the Financial Reporting Standard (FRS) 102 SORP were met, the process of appointing an auditor would need to commence and the appointee would have no opportunity to undertake any work during the financial year under audit.

If the charity were an English Charity then no audit would be required, as the audit threshold is greater at £1m. However, the actual test is applied on the same basis ie it relates solely to the income during the year.

THE CRIMINAL FINANCES ACT 2017 - EVADING THE EVADERS

The Criminal Finances Act 2017 received Royal Assent in April and contains new corporate offences relating to the failure to prevent tax evasion by an associated person. Unlimited fines can be imposed following a conviction. However, if reasonable prevention procedures are put in place, a prosecution is unlikely.

Accountants, lawyers, and other businesses providing financial services such as banks and brokers, are likely to be impacted the most by these new measures, as the Government and HM Revenue & Customs (HMRC) take further steps to clamp down on tax evasion.

The Government believes that relevant bodies – described in the legislation as 'a body corporate or partnership (wherever incorporated or formed)' – should be criminally liable if they fail to prevent those who act for, or on their behalf, from facilitating tax evasion.

Background

The Criminal Finances Act creates two separate but related offences:

1. Failure to prevent facilitation of UK tax evasion offences.
2. Failure to prevent facilitation of foreign tax evasion offences.

Only a 'relevant body' can commit the new offence which, in essence, means companies and partnerships. A relevant body can only commit the new offences if an 'associated person' criminally facilitates a tax evasion offence.

A person is associated with a relevant body if that person is an employee, agent, or other person who performs services for or on behalf of the relevant body. The latter is of particular concern because of the range of people who could be described as an associated person, such as external contractors and subcontractors, as well as temporary workers.

The draft guidance states:

"The question of whether a person is performing services for or on behalf of an organisation is to be determined by reference to all the relevant circumstances and not merely by reference to the nature of the relationship between that person and the organisation. The contractual status or label of a person performing services for or on behalf of the organisation does not matter."

UK tax evasion

The Act states a 'UK tax evasion facilitation offence' means an offence consisting of:

a) being knowingly concerned in, or taking steps with a view to, the fraudulent evasion of tax by another person;
b) aiding, abetting, counselling or procuring the commission of a UK tax evasion offence; or
c) being involved art and part in the commission of an offence consisting of being knowingly concerned in, or taking steps with a view to, the fraudulent evasion of tax.

The UK tax offence will be investigated by HMRC, with prosecutions brought by the Crown Prosecution Service (CPS).

Foreign tax evasion

The Act states a 'foreign tax evasion facilitation offence' means conduct which:

a) amounts to an offence under the law of a foreign country;
b) relates to the commission by another person of a foreign tax evasion offence under that law; and
c) would, if the foreign tax evasion were a UK tax evasion offence, amount to a UK tax evasion facilitation offence.

The foreign tax offence will be investigated by the Serious Fraud Office (SFO) or National Crime Agency, with prosecutions brought by either the SFO or CPS.

Penalties and sanctions

Aside from the negative brand and reputational damage which would inevitably follow a successful conviction, the penalties for such an offence include:

- Unlimited financial penalties; and/or
- Ancillary orders such as confiscation orders or serious crime prevention orders.

Alternatively, a Deferred Prosecution Agreement (DPA) may be reached between a prosecutor and an organisation which could be prosecuted. The DPA allows a prosecution to be suspended for a defined period of time, subject to various conditions being met under the supervision of a judge, who must be convinced the terms are 'fair, reasonable and proportionate'. A DPA would clearly be a more palatable outcome compared to an expensive public trial.

Reasonable prevention

The only defence to these offences is to have a reasonable prevention procedure in place to mitigate any such offences being committed. What constitutes a reasonable procedure will be different for each entity and must be considered in the context of each entity's operations.

The Government has produced six principles to adopt when designing a prevention procedure. These are:

1. Risk assessment;
2. Proportionality;
3. Top level commitment;
4. Due diligence;
5. Communication, including training; and
6. Monitoring and review.

With the new rules now in force, it is important to put in place a prevention procedure now, together with training sessions for staff and any changes required to paperwork, such as contracts or other letters of engagement.

HMRC has increased investment into the Fraud Investigation Service from £186m in 2015/16 to £204m in 2016/17, which suggests it is gearing up for the work it is intending to undertake in this area..

MEDIUM AND LARGE BUSINESSES TO REPORT ON SUPPLIER PAYMENT TERMS

Every year, thousands of businesses experience severe administrative and financial burdens, simply because they are not paid on time. Late payment is a key issue for business, especially smaller businesses, as it can adversely affect their cash flow and jeopardise their ability to trade. In the worst cases, late payment can lead to insolvency.

The Reporting on Payment Practices and Performance Regulations 2017 (**http://www.legislation.gov.uk/uksi/2017/395/introduction/made**) have been introduced which impose a duty on the UK's largest companies and LLPs to report, on a half-yearly basis, on their payment practices, policies and performance for financial years beginning on or after 6 April 2017. The information must be published through an online service provided by the Government, and will be available to the public.

Which businesses must report?

Businesses are required to publish data if, on their last two balance sheet dates (or by reference to the first year only during the second financial period of a new entity), they exceeded two or all of the thresholds for qualifying as a medium-sized company under the Companies Act 2006 (section 465 (3)).

These thresholds are currently:

- £36 million annual turnover
- £18 million balance sheet total
- 250 employees

Special provisions apply in the case of mergers and acquisitions, joint ventures and parent companies/LLPs.

What information requires to be published?

Businesses to which the regulation apply must prepare and publish information about their payment practices and performance in relation to qualifying contracts (see below) for each reporting period in the financial year. The information for each reporting period must reflect the policies and practices which have applied during that period, and the business's performance for that period.

Normally a business will have two reporting periods in each year. These will be the first six months of their accounting period and the second six months of their accounting period. Special provisions apply where a business extends or shortens its accounting period.

For each reporting period, businesses are required to report on the following in relation to qualifying contracts:

Narrative descriptions of:

i. the business' standard payment terms, which must include; the standard contractual length of time for payment of invoices, maximum contractual payment period; any changes to the standard payment terms in the reporting period; and how suppliers have been notified or consulted on these changes
ii. the business' process for resolving disputes related to payment

Statistics on:

i. the average number of days taken to make payments in the reporting period, from the date of receipt of invoice or other notice
ii. the percentage of payments made within the reporting period which

were paid in 30 days or fewer, between 31 and 60 days, and in 61 days or longer

iii. the percentage of payments due within the reporting period which were not paid within agreed terms

Statements (ie a tick box) about:

i. whether suppliers are offered e-invoicing
ii. whether supply chain finance is available to suppliers
iii. whether the business' practices and policies cover deducting sums from payments as a charge for remaining on a supplier's list, and whether they have done this in the reporting period
iv. whether the business is a member of a payment code, and the name of the code

The report must be published on a web-based portal at: **www.gov.uk** within 30 days of the end of the reporting period and approved by a company director or (for LLPs) a designated member.

Which contracts are qualifying contracts?

A qualifying contract is one which satisfies all the following conditions:

a) the contract is between two (or more) businesses
b) the contract has a significant connection with the United Kingdom
c) the contract is for goods, services or intangible property, including intellectual property
d) the contract is not for financial services.

Whether a contract has a significant connection with the UK will depend of the specific circumstances. Business will therefore require to put in place procedures to assess whether each contract falls within the scope of being a qualifying contract.

Penalties for non-compliance

It is a criminal offence by the business, and every director of the company or designated member of an LLP, if the business fails to publish a report, containing the necessary information, within 30 days of the relevant financial period end. It is also a criminal offence to publish a report or information which is misleading, false or deceptive, where they knew or were reckless about it being false or misleading. Any business or individual found guilty of an offence is liable to a fine which is unlimited in England & Wales and a maximum of £5,000 in relation to Scotland and Northern Ireland.

Further information

The Department for Business Energy and Industrial Strategy has issued guidance **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/587465/payment-practices-performance-reporting-requirements.pdf** which provides further information to assist large entities with their responsibilities.

MEMBERS' VOLUNTARY LIQUIDATIONS - TARGETTED ANTI AVOIDANCE RULE

HM Revenue & Customs (HMRC) internal manuals have been updated to provide guidance, including a number of examples, of situations in which HMRC would expect the Targeted Anti-Avoidance Rule (TAAR) to apply. This can be found in the manuals at CTM36305 – CTM36350.

Historically, the gain on a members' voluntary liquidation have potentially been subject to tax as a capital gain. The Government were concerned at "phoenixism" and legislation was introduced with effect from 6 April 2016 which treat liquidation distributions as income distributions where four conditions are met:

- Condition A: The individual receiving the distribution had at least a 5% interest in the company immediately before the winding up
- Condition B: the company was a close company at any point in the two years ending with the start of the winding up
- Condition C: the individual receiving the distribution continues to carry on, or be involved with, the same trade or a trade similar to that of the wound up company at any time within two years from the date of the distribution
- Condition D: it is reasonable to assume that the main purpose, or one of the main purposes of the winding up is the avoidance or reduction of a charge to Income Tax.

An example of the circumstance which concerns the Government is provided at CTM36305:

Mr J is a dance instructor who runs his business through his own company. At the end of each year, instead of paying himself a dividend (which would be liable to Income Tax), Mr J winds up his company and receives the profits as a distribution in a winding up, liable to Capital Gains Tax. He then immediately creates a new company and continues his dance instruction business.

CTM36325 provides a number of examples in connection with Condition C "similar to":

Example 1

Mr G is the sole shareholder in a company that provides a car-washing service. Mr G winds up that company, but continues to provide car-washing services through a partnership with his wife, but now also sells air-fresheners.

Clearly Mr G is carrying on the same trade, or at least a trade very similar to

that carried out by the company, and so Condition C is satisfied.

Example 2

Mrs F is a landscape garden designer and runs her business through a company. Mrs F decides she would like to retire, and so winds up the company. In order to supplement her pension, and because she enjoys it, Mrs F continues to provide routine gardening services to a small group of clients in her local village as a sole-trader.

It is unlikely that Mrs F is carrying on "the same trade" after the winding up as that carried on by the company. However, the provision of gardening services is "similar to" the provision of landscape gardening, and so Condition C is met. (But that does not mean that ITTOIA05/S396B/404A will apply to the distribution, because all the conditions must be met, and it is not likely on these facts that Condition D – the purpose test – will be satisfied.)

Example 3

Mr E is a builder who runs his business through two companies – Company 1 specialises in loft conversions, and Company 2 specialises in extensions. Mr E winds up Company 1, but the trade of Company 2 continues.

As with Example 2, Mr E continues to be involved with a trade that is similar to that of the company that is wound up, and so Condition C is satisfied.

Example 4

Mrs D is a recruitment consultant who runs her business through a company. After three years of training part time, she winds up her company and starts a new company that offers her services as an IT consultant. Some of her new clients are businesses she dealt with in her previous company.

Although Mrs D is still a consultant, the trade has changed significantly and it is unlikely that it would be viewed as the same or similar to that carried on by the wound up company. It does not matter that she continues to deal with some of the same clients because the nature of the service she is providing is different. Even if it were argued that the work was similar consultancy support, it is unlikely that Condition D would be met in any event.

Example 1 gives quite a straightforward circumstance and it would be hard to disagree with the conclusion. Similarly with example 2, which would allow someone to liquidate their company but still to carry on a similar activity on their own account but at a fairly modest level.

Example 3 is slightly more controversial in that Mr E has two construction companies specialising in different aspects of the building trade. He winds one up but continues the other one. The conclusion is that condition C is satisfied, and unless Mr E can show that condition D is not, his liquidation proceeds will be subject to income tax.

CTM36330 also considers condition C and the term "involved with". There are 3 examples.

Example 1

Mrs C is an accountant who runs her business through a company. Her husband is a self-employed lion tamer. Mrs C winds up her company and starts work for a newly-formed company, owned by her husband, which provides accountancy services.

Mrs C continues to be involved with the same trade or activity as the wound-up company was involved with (the provision of accountancy services), even though she is now an employee rather than business owner. She is connected to her husband and so Condition C is met (and so are Conditions A and B). Condition D will still need to be satisfied.

Example 2

Instead of going to work for a newly-formed company, Mrs C, from Example 1, goes to work for her sister's pre-existing accountancy practice, which the sister operates as a sole trader. Mrs C is connected with her sister, and she is continuing to be "involved with" the same or a similar activity, and so Condition C is met.

Example 3

Mr B is a fitness instructor who provides his services through a company. After suffering an injury he winds up his company and starts work as a journalist. Mr B's wife is also a fitness instructor and she offers her services as a sole trader, before and after the winding up of her husband's company. Mr B provides no services to his wife's business at all.

Mr B is not "involved with" a similar trade or activity after the winding up of the first company, even though his wife is.

Example 1 is interesting in that Mrs C winds up her accountancy company and becomes an employee of her husband (a lion tamer!) who sets up a company to provide accounting services. Condition C is met and the same result occurs as in example 2, where Mrs C instead goes to work for her sister who has a pre-existing accountancy practice, by virtue of the fact that she is connected with her sister.

The above examples can be contrasted with example 3 where Mr B winds up his company which provides services as a fitness instructor. He has suffered an injury but his wife, who is also a fitness instructor, continues to provide her services as a sole trader. Mr B is not involved with a similar trade and condition C is not met.

CTM36340 considers condition D. The legislation at Section 396B/404A ITTOIA 2005 states that condition D applies where:

"i*t is reasonable to assume, having regard to all the circumstances, that –*

1. *The main purpose, or one of the main purposes, of the winding up is the avoidance or reduction of a charge to income tax, or*

2. *The winding up forms part of arrangements the main purpose, or one of the main purposes, of which is the avoidance or reduction of a charge to income tax*"

A number of factors are set out to assist in the making of a judgement as to whether condition D applies:

- Whether there is a tax advantage and whether its size is consistent with a decision to wind the company up.
- What extent does the activity prior to winding up resemble the activity carried on by the new company.
- What is the involvement of the individual who received the distribution and to what extent have their working practices changed.
- Are there special circumstances? The example given is of the vendor supplying short term consultancy services to the new owners.
- How much influence did the person receiving the tax advantage have over the arrangements. It may be an individual with a substantial controlling interest decided to liquidate the company while an individual with a small minority interest also received liquidation proceeds. It may be that condition D is satisfied in respect of the major shareholder but not the minor shareholder if both engage in similar activities after the liquidation.
- Is there previous history of similar companies being wound up?
- Were there commercial factors which led to the decision to wind up which were independent of the tax benefits.
- Are there other events which might be taken into account. The example given is where a company sold its trade to a third party leaving just the proceeds of sale.

CTM36345 confirms that share for share exchanges and shares received as part of a demerger will not be caught by the TAAR.

CTM36350 concerns the vexed question of requests for clearance. There is no statutory clearance procedure but the manual states that "although there is a non-statutory clearance procedure… the applicant would not be uncertain about the purpose which is a subjective matter. It follows that a clearance application would not be appropriate unless it is limited to the application of specific rules and legislation where there is genuine uncertainty about their application to a specific proposed transaction".

This is extremely unfortunate and unhelpful as there are many instances where the tax payer has a particular view but he is not at all certain whether HMRC will share that view. As alluded to above, an example would be where the 80% shareholder of a historically very successful company decides to liquidate it. A 25% shareholding is required to block the special resolution but, the other shareholder with only a 20% shareholding, is unable to achieve this. Accordingly, he receives proceeds of £1 million from the liquidation but decides to set up another company to carry on the same type of business. Will he be caught by the TAAR? From the above, you would like to hope not, but he would like to know whether he could start up his new company now at a potential additional tax cost of 28% representing the difference between 38.1% income tax on a distribution against 10% capital gains tax at the entrepreneurs relief rate, or whether he should go on self-imposed garden leave for a 2 year period.

£900,000 after tax is a lot of money in anyone's book, but if our 20% shareholder is relatively young, he may not achieve much of an investment return from this but, instead, wish to continue in the only type of business which he knows. £280,000 is a lot of money at risk if the individual's view is not shared by HMRC, and HMRC are unwilling to tell our man. He either has to take a large risk or click his heels for 2 years.

A most unsatisfactory state of affairs.

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