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PENSION CHANGES
Some consequences .... 1
PILOTS TO BE GROUNDED
Changes to trusts up in the air .... 2
THE CHRISTOPHER LUNN & CO SAGA
Son found guilty, father to be retried .... 3
HMRC PENALTIES
Some interesting trends .... 4
RTI FILING PENALTIES AND APPEALS
Changes for employers with 50 or more employees .... 4
HMRC CAMPAIGNS & TASK FORCES
An update .... 5
DIGITAL SERVICES FOR AGENTS
An update .... 5
EMPLOYMENT CORNER
Holiday pay .... 6
Fit for Work Scheme .... 6
HR viewpoint: Stress in the workplace .... 7
TAX CASES
- Whether the supply of Pilates lessons should be exempt from VAT on the grounds that the lessons were educational .... 7
- Whether supplies of catering and entertainment to members of the public should be treated as exempt from VAT as being related closely to the supplies of education .... 7
- Whether the activities of a charity constituted economic activities and therefore whether expenditure on boathouse improvements should be zero rated for VAT .... 8
- Whether an individual was carrying ut a used car trade and therefore was liable to be registered for VAT .... 9
TAX QUERY
- Contributions to referendum campaigns .... 10
AUTO ENROLMENT
Know the workforce .... 11
IMPLEMENTATION OF THE EU AUDIT DIRECTIVE AND REGULATION IN THE UK
Consultation .... 12
FINANCIAL INSTRUMENTS UNDER FRS 102
Accounting and tax implications .... 13
ACCOUNTING & AUDITING QUERIES
- Parent stake in subsidiary increased – revaluation of goodwill under FRS 102 .... 16
- Goodwill amortisation under FRS 102/ FRSSE when useful life cannot be easily estimated .... 16
SMALL BUSINESS ENTERPRISE BILL
Focus on corporate transparency .... 17
SAR REVIEW 20/13
Accountancy sector insights .... 19
MONEY LAUNDERING QUERY .... 20
"GREEN BIOFUEL" TRIAL FOR MONEY LAUNDERING AND BRIBERY
Directors convicted .... 20
ASK RON ABOUT IT .... 21

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# SOME CONSEQUENCES OF PENSION CHANGES

While the proposal to allow individuals to draw funds from their pension arrangements without restriction has been well received, there have also been a number of warnings issued from various interested parties.

What are the potential tax pitfalls of removing restrictions on the individual to draw down on the pension fund that has been built up over one's working life? To name a few:

- Perhaps the most obvious thing to say at the outset is that, where an individual draws a larger sum from his pension fund to invest in another asset, some of his wealth is being moved from an inheritance tax free wrapper into his taxable estate, and may well be subject to inheritance tax as part of his estate.
- It is warned that some individuals might 'blow' a substantial fraction of their entire pension fund on some 'once-in-a lifetime' spending, (for example on luxury goods or a cruise perhaps) resulting in a much reduced pension to fund retirement and possible dependency upon the state; this would not have been the case if they were forced to receive an income over their retirement.
- It is a cynical move by the Government to generate more tax inflow as, apart from the tax-free lump sum component, withdrawals from pension funds will incur an income tax liability.
- This move to withdraw from one's pension fund without restriction could become the next 'mis-selling' scandal in ten years' time when people would feel that they had been badly advised.

If you are asked by your client approaching retirement to shed light on the benefits and drawbacks on drawing down their pensions, beware that this is really the remit of an investment adviser. You can, however, highlight some tax issues that need careful consideration alongside the investment decision to be taken.

The key thing to be aware of from a tax perspective with regard to the drawdown of a lump sum figure concerns the 25%/75% ratio. That is, the first 25% of the lump sum received is treated as tax free and the remaining 75% is treated as if it was income and will be taxed at the standard income tax rates of 20%, 40% and 45% ie the marginal rate of the recipient's income for that tax year.

Assuming that an individual decides to take all that he can out of his pension fund and invest in say, buy-to-let properties, on the basis that he feels that he can obtain better returns than from the underlying investments in his fund, there are various tax matters to consider:

1. *Stamp tax:* Depending on the value of the property or properties purchased, there will be a charge to Stamp Duty Land Tax or Land and Buildings Transaction Tax, depending on

where the property is situated. With progressive rates, this cost will be significant for higher value properties.

2. *Income tax:* The property should generate a reasonable investment return on the basis that the purchase is being effected with monies from the pension scheme, which will reduce or do without any borrowings to fund the purchase of a property. The rent will be subject to income tax in the hands of the individual and he may wish to consider whether he should hold this property, or whether the property should be gifted to his spouse or held jointly. A comparison between the net pension income that is foregone as a result of drawing on the fund needs to be made against the net income that is to be generated from the rentals.

3. *Capital gains tax:* If a property is sold with a gain, then there is likely to be a capital gain on sale, which will reduce the investment return on capital. Apart from the individual's annual exemption, and perhaps that of his spouse if the property is owned jointly, there may be capital losses brought forward from some previous transactions, which they can utilise against any gain. Consideration may be given to making an Enterprise Investment Scheme (EIS) investment to obtain Capital Gains Tax deferral, but EIS investment carries its risks that need to be balanced against any tax advantages that it may confer.

4. *Inheritance tax:* As noted above, whereas a pension fund is not subject to inheritance tax, the assets acquired by an individual who draws substantial funds from his pension fund will be part of his estate for inheritance tax, unless the assets qualify for relief. Buy-to-let properties would be fully exposed. Business or agricultural property relief may be available where the individual has utilised the funds in acquiring qualifying assets.

Everyone will have their own ideas on whether to take some advantage of the opportunity opened up by drawing additional funds from their pension but, particularly in a family situation, there is much to be said for continuing on a prudent basis and perhaps drawing some additional funds when required for a specific purpose such as acquiring a new car. If there is a significant sum remaining within the pension fund then ultimately, this can pass down to the family on death.

The old saying that tax deferred is tax saved is very true. Is there a lot of point in incurring substantial income tax charges in gaining access to a pension fund when it can be left to grow tax free with any tax on the remaining fund being payable at the time of death?

# PILOTS TO BE GROUNDED: CHANGES TO TRUSTS UP IN THE AIR

There are many parts of UK tax legislation which are extremely complex and one of these is the Inheritance Tax (IHT) regime that applies to trusts.

The Autumn Statement announced that, following consultation, one of the proposals regarding trusts would not be pursued, but at paragraph 2.73 of the *Finance Bill 2015*, it is stated that "*the government will introduce new rules to target avoidance through the use of multiple trusts. It will also simplify the calculation of trust rules*".

The stated aim of the original consultation document, published in June 2014, was to reduce complexity and introduce fairness to the IHT rules for trusts.

One of its main proposals was that the IHT nil-rate band should be split between all trusts created by the same settlor. In response to this proposal, most respondents were opposed on the grounds that it would not meet the policy objective of simplification, and would in fact add complexity to the system; and, secondly, that a wide range of trusts would be caught up in the proposed new rules which would create unfairness. The government have listened to these concerns and in the Autumn Statement, there is confirmation at paragraph 2.73 that "*the Government will not introduce a single settlement nil rate band*".

There does seem to be a belief in certain government circles that the sole purpose of trusts is to avoid tax and much of this is fuelled by Employee Benefit Trusts and the like. In very many cases, however, the main purpose of a trust is to protect the interests of vulnerable beneficiaries from others and indeed themselves! A grandparent may, for example, desire to make provision for a minor grandchild but perhaps does not trust the parent to look after the child's interests and so settles assets in trust for the benefit of the grandchild, and to be looked after by trustees. Reading between the lines, it was perhaps considered that there was a tax advantage where a settlor set up several trusts as each trust would, in effect, have its own nil rate band.

This is, however, no different from a donor gifting assets to several different individuals. In fact, it is more difficult as generally, gifts into a trust are chargeable lifetime transfers, and if the donor settles more than his nil-rate band into a trust, there is an immediate charge at the lifetime rate. This effectively discourages donors from

gifting more than their nil-rate band into trust during a period of seven years. The Autumn Statement and the subsequent "*Summary of Responses on Inheritance Tax: A fairer way of calculating trust charges*" which was issued in December indicated, however, that "*an area of tax avoidance within the use of multiple trusts, known as pilot trusts*" will be tackled.

A pilot trust is one of a number of trusts set up in an individual's lifetime, often on consecutive days, with a small amount of cash. Trusts are thereby created and, as they have been set up on different days, they are not treated as related trusts. Were trusts to be related trusts then there would only be one nil rate band allocated among them.

On the death of the individual, bequests could be made to each pilot trust and each would have its own nil rate band.

There is an advantage in having several non-related trusts, rather than one large trust, as multiple nil-rate bands are available with the pilot trusts arrangement. The proposed rules, when enacted will have to have some mechanism for identifying what is a series of pilot trusts, and what is not. At present, this will be entirely obvious, but when the legislation is enacted, practitioners will no doubt be looking for ways around the legislation.

# THE CHRISTOPHER LUNN & CO SAGA – SON FOUND GUILTY, FATHER TO BE RETRIED

The removal of Agent status by HMRC and subsequent fraud charges levied against Christopher Lunn & Co (CLAC) partner Denis Christopher Lunn (DCL - father) and his son Christopher Jonathan Lunn (CJL) first appeared in the headlines back in 2010. Since then, the case against the Lunns has been making its passage through the courts and the latest twist was that DCL is to be retried in 2015.

During the majority of this time, reporting restrictions have been in place which means that very little information has been in the public domain in relation to this very interesting case of the unqualified tax agent who was suspected of deliberately inflating expenses in his clients' tax returns.

By way of an overview for those unfamiliar with the case:

- CLAC had its agent status withdrawn in November 2010 by HM Revenue & Customs (HMRC) due to concerns that it was manipulating figures found in its clients' annual accounts.
- This was subsequently reinstated on appeal in February 2011 after it was decided that HMRC had not followed correct procedures when removing the agent status.
- HMRC again removed agent status in July 2011.
- DCL was charged with 6 criminal counts of cheating the public revenue, and the case was heard in October 2013.
- He was found not guilty on 2 of these counts in March 2014 and a retrial scheduled for September 2015 on the remaining 4 charges.
- The two charges which he was acquitted of relate to: capital gains tax treatments of companies without Extra Statutory Concession 16 clearance and phoenixing; and backdating the use of limited companies by clients (in order to reduce tax liabilities).

At the same time, CJL was also being prosecuted under the fraud act for misrepresentation. He has been found guilty of 6 counts of cheating the public revenue. One of the counts relates to him sending false invoices to HMRC to cover up an increase in the amount charged for accountancy fees on behalf of CLAC's clients.

It was discovered that clients were given a low-cost bill for accountancy services (a tax deductible expense), but these amounts were increased when their accounts were submitted to HMRC. The firms' clients therefore paid less tax than they owed, with their accountancy fees inflated to such an extent (sometimes into thousands of pounds) that the tax benefit was often equal to the true cost of the accountancy service.

Another of the charges related to allegations that CJL had lied to HMRC about a client's source of income. His version of events was that the client had earned income through a limited company whereas the reality of the situation was that the income had been generated in the personal capacity of the client. He was convicted of these six counts and sentenced to 9 months imprisonment, suspended for 12 months, and ordered to carry out 250 hours of unpaid work. It seems like quite a lenient sentence. The hearing of DCL, who was the owner of the now defunct practice, is likely to be far more revealing with heavier sentences a possibility.

Some of Lunn's clients have been prosecuted separately in relation to their tax affairs. One, Harriet Sheard (**TC 04027**), was a self-employed camera operator. She originally provided her services through self-employment and then transferred her business to a limited company on the recommendation of CLAC. She seems pretty atypical of a CLAC client, with her case exposing the following activities:

- Income being taken through the limited company before the company was active;

- Over-statement of certain expense items (such as “use of home as office”);
- Accountancy fees that were based on a provision that far exceeded what was actually billed.

In the case of Sheard, her defence was that she had left everything in the hands of her accountants so expected everything to be dealt with in a professional manner. Unfortunately, this did not wash with the tribunal and she was penalised for her carelessness.

# HMRC PENALTIES – SOME INTERESTING TRENDS

The latest publication from the Office for Tax Simplification has shed some light on the current penalties regime, particularly in relation to the split of penalties for deliberate errors. The data obtained, for tax years from 2010/11 through to 2013/14, show that there has been a steady rise in the proportion of cases relating to penalties being classified as deliberate (up from 5.92% in 2010/11 to 36.19% in 2013/14). For full details see Table 1.

**Table 1**

| Year | Total penalties levied | Of which deliberate | % deliberate |
|---|---|---|---|
| 2010/11 | 7,859 | 465 | 5.92 |
| 2011/12 | 14,191 | 1,045 | 7.36 |
| 2012/13 | 9,504 | 2,332 | 24.54 |
| 2013/14 | 15,135 | 5,477 | 36.19 |

The data in Table 1 is really quite astonishing. HM Revenue & Customs comment that the reason for the increase in the proportion of these penalties which are deliberate is as a result of their staff gaining a better understanding of “*the use of the penalties and the difference between prompted and unprompted disclosures*”. Our understanding may be slightly different – it would appear to be more likely that the thresholds are being interpreted differently and the result of this is heavier penalties for individuals and businesses with inaccuracies in their returns.

Practitioners are reminded of the 4 types of penalties which may apply:

1. Error but with reasonable care taken
2. Careless error due to failure to take reasonable care
3. Deliberate but not concealed
4. Deliberate and concealed

Given that the penalties for deliberate concealment can be up to 100% of the tax due (and potentially involve criminal action in the most serious of cases), practitioners should be aware of the risks that this could pose to certain types of clients.

# RTI FILING PENALTIES AND APPEALS – CHANGES FOR EMPLOYERS WITH 50 OR MORE EMPLOYEES

Filing penalties began on 6 October 2014 for employers with 50 or more employees. Employers who have incurred these penalties will start to receive quarterly penalty notices from the beginning of February 2015. Agents will not be sent copies of these notices. HM Revenue & Customs have stated that the notices will have a prominent message instructing employers who are represented to show their agent the letter immediately. This first letter in February will set out all the filing penalties incurred for quarter 3 of 2014/15 (tax months 7, 8 and 9).

All penalties on the letter will be given a unique identification reference so that employers can easily identify the penalty, should they want to appeal.

More information, including how to appeal these penalties, can be accessed at: **www.gov.uk/government/uploads/system/uploads/attachment_data/file/389240/bulletin51-december2014.pdf**.

# HM Revenue & Customs Website Moves to .GOV.uk

The HM Revenue & Customs (HMRC) website has moved from its previous location at: **www.hmrc.gov.uk** to **www.gov.uk/government/organisations/hm-revenue-customs**. Visitors to the old web address will be automatically redirected to this new address.

A full alphabetical list of HMRC services available can be accessed at: **www.gov.uk/government/organisations/hm-revenue-customs/services-information**.

# HMRC CAMPAIGNS AND TASKFORCES – AN UPDATE

HM Revenue & Customs' (HMRC) campaigns and taskforces remain a key feature of their efforts to clampdown on unpaid tax. In the past two years, the number of taskforces has declined markedly compared to 2011/12 when new sector targets were announced almost on a monthly basis. Campaigns continue to be rolled out regularly with some success in encouraging individuals to come forward and "get their matters in order".

Current "live" campaigns include:

- Let property: **www.gov.uk/let-property-campaign**
- Second incomes: **www.gov.uk/secondincomes**
- Credit card sales: **www.gov.uk/creditcardsales**
- Solicitors tax: **www.gov.uk/solicitors-tax-campaign**

These campaigns have varying deadlines for making disclosures and timescales for paying over any tax that is due. Practitioners with clients who may be considering making a disclosure under any of them should visit the individual campaign page to ensure that they have the correct information at the outset.

The most recent taskforces concern over-claimed VAT in the Nottingham, Birmingham, Coventry, Stoke and Wolverhampton areas, and property tax evaders in the South West and South Wales.

There are a number of criminal investigations underway as a result of taskforce and campaign activity and so far eight people have been convicted of cheating the public revenue. Sentences totalling 10 years have so far been handed down and £593,000 recovered from individuals.

The total tax recovered by task forces and campaigns since the start of their implementation in 2007 stands at £988million (as of 30 October 2014).

### Latest HMRC taskforce – Horse box owners targeted

The latest (rather narrow, it would seem) sector of the taxpayer population selected for more detailed investigation appears to be the owners of horse boxes.

HMRC appear to have reason to believe that a large number of farms and rural businesses have acquired horse boxes and lorries through their business, only for them to be used predominantly by the individual in a personal capacity with no personal use declaration being made (and therefore no tax on the benefit-in-kind being paid), or for the entire expense of owning the asset being run through the business.

Practitioners with farming and/or rural clients should be aware of this initiative and make sure that relevant clients are informed of this strand of HMRC activity.

# DIGITAL SERVICES FOR AGENTS – AN UPDATE

### Agent Online Self-Serve (AOSS)

HM Revenue & Customs' (HMRC) digital agent strategy is progressing and the Agent Online Self-Serve (AOSS) project has completed its first stage of assessment, which involved it passing a list of 26 tests to complete the Government Digital Services Assessment. The next stage will be "private beta" which involves agent testing with a small number of agents.

HMRC is looking for volunteers based in the UK with between 20 and 200 employer PAYE clients who hold authorisation to act on their behalf (via the Government gateway). Those who wish to volunteer may register their interest by emailing **diane.ross@hmrc.gsi.gov.uk**.

Once this testing has been completed, a prototype will be available to view on the GOV.UK website.

### Guidance for agents

All of HMRC's guidance has now moved to GOV.UK and so anyone trying to access the HMRC homepage will be redirected to the homepage which sits on GOV.UK. The address of this page is **https://www.gov.uk/government/organisations/hm-revenue-customs**.

### News for agents

Since the move to GOV.UK, the way that HMRC's "latest news" is viewed has changed. Agents can sign up for the latest news by signing up for HMRC's feed at: **www.gov.uk/government/latest?departments%5B%5D=hm-revenue-customs**.

Feeds are available on the following subjects:

Self-assessment: **www.gov.uk/personal-tax/self-assessment/latest**

PAYE for employers: **www.gov.uk/business-tax/paye/latest**

VAT: **www.gov.uk/business-tax/vat/latest**

HMRC is also working on a feed for tax agents which will be available at some point in the future.

# EMPLOYMENT CORNER

## Holiday Pay

The issue of holiday pay was burning fiercely last year and seems set to continue into 2015. Employers must now consider whether or not to include elements such as pro-rated overtime and commission in holiday pay if the employee would be financially disadvantaged by not receiving them.

### Why does this affect tax advisers and auditors?

The 'irregular' nature of holiday pay that has resulted from pro-rated overtime and commission can be prone to incorrect treatments for PAYE/NIC. The errors engendered from dealing with holiday pay of this nature would in turn lead to incorrect Employer P35 Returns and penalties from HM Revenue & Customs (HMRC). Furthermore, there are the knock-on effects for the accounts as a result of incorrect payroll costs, leading to errors in corporation tax returns and computations of corporation tax liabilites. It is important therefore that employers understand these implications and make every effort to understand their obligations.

### Background

Under the Working Time Regulations 1998, the concept of 5.6 weeks of holiday pay was made official. For non-salaried employees and employees with variable pay, employers were expected to calculate holiday pay based on the last twelve weeks' earnings, utilising the definition of "pay" set down in the Employment Rights Act 1996. This essentially meant calculating the normal working hours and paying holiday pay accordingly.

However, in recent years, two cases set the issue on conflicting paths in terms of how holiday pay should be calculated.

In **Bamsey & Others v Albon Engineering & Manufacturing plc [2004] ICR 1083**, the Court of Appeal decided overtime did not count towards holiday pay unless it is both compulsory and guaranteed. However in **British Airways plc v Williams and Others [2012] UKSC 43 SC**, the UK Supreme Court referred a number of matters to the Court of Justice of the European Union (CJEU), who, decided holiday pay should instead correspond to "normal remuneration".

Looking at this judgement in more detail, the courts have defined that "normal remuneration" should comprise any elements of pay which are "intrinsically linked" to the performance of tasks. Even though some of these may only be earned periodically, together they form the normal remuneration of the employee.

### Current position

Two further cases have also influenced the position regarding holiday pay, and they are **Lock v British Gas Trading Ltd and Others [2014] CJEU C-539/12 Ad** and **BEAR Scotland Ltd v Fulton and Baxter [2014] UKEATS/0047/13**. The Lock case is concerned with commission-based pay structures and it rules that an employee who is unable to earn commission because he is on holiday which he is obliged to take is at a financial disadvantage. The Employment Appeal Tribunal (EAT) judges on the BEAR case held that holiday pay should include "non-guaranteed overtime" (ie if you are offered it, you have to work it). However, the calculation of overtime only applies to the first 20 days of holiday pay (obiter) as this falls in line with EU holiday pay directives. It is worth noting that the judgement from the BEAR case, being an EAT decision is binding on employment tribunals and therefore creates potential liability for employers as a result.

It almost goes without saying that employers now need to consider all elements of pay, entitlements and allowances (for example, shift premiums, on-call, standby, travelling time, etc) to decide whether they need to be included in the holiday pay calculation for an employee.

### Back pay?

Claims for back pay are not actionable if more than three months have elapsed since the relevant periods of qualifying holiday pay that have been incorrectly calculated. It should be noted that from 1 July 2015 claims will be restricted to two years, with a transitional phase between 8 January 2015 and 30 June 2015.

Further concerns may arise with the inclusion of holiday pay in contracts of employment, which may give rise to breach of contract claims by employees if existing contracts do not comply with the new rules.

## Fit for Work Scheme

The Fit for Work Scheme was launched in December 2014 and concerns employees with over 4 weeks' sickness absence. A special occupational health service has been set up by the Government to support employees in getting back into the workplace as soon as possible. Here are the key points which employers, auditors and tax professionals need to know about:

- The service, which includes a medical assessment, is provided free of charge.
- If the employer wishes to pay for any further related treatments to get the employee back to work, such as private physiotherapy or sports injury therapy, he can pay up to £500 of treatment without incurring a benefit-in-kind charge.
- Further detailed advice can be sought from the Fit for Work Scotland website at: **www.FitforWorkScotland.scot** and advice line (0800 019 2211).

### HR viewpoint: Chronic stress dominates a third of UK working life

According to a recent survey undertaken by Star Consultancy, over one-third of employees in the UK spend one-third of their time at work feeling stressed.

The research concluded that an average staff member feels anxious, stressed and worried about an aspect of their work 35% of the time. More than two-thirds of those questioned said this level of stress reduces motivation, productivity, and self-confidence, and 62% cited it as the main reason they do not always perform at their best. Worryingly, more than one in 10 (14%) admitted that they feel stressed or anxious at work every day, and a third of workers knew of at least two people at work who take anti-depressants.

Two-thirds of workers attributed stress to work pressures and deadlines, yet only 6% of these workers had actually mentioned their problem to a manager. With 7% of respondents reporting that they have taken up to five days off work because of stress, anxiety or depression, researchers said that this was a "call to arms for employers".

The findings highlight the need for both employers and employees to understand the nature of stress and for bosses to put state of mind first to ensure a healthy, high-performing workforce. Scientific evidence suggests that it is in fact a person's own mindset and attitude which leads to stress at work rather than the work itself, which is not yet widely recognised.

The issues of motivation, employee engagement and clear communication have never been more important to ensure that employees are as productive as possible and absenteeism and presenteeism are reduced, thereby reducing cost and increasing competitive advantage. Practitioners may wish to mention this to their clients and assist them in monitoring these costs.

## TAX CASES

### Christine Joy Hocking v Commissioners for HM Revenue & Customs [2014] UKFTT 1034 (TC)

***Point at issue:*** Whether the supply of Pilates lessons should be exempt from VAT on the grounds that the lessons were educational.

***Background:*** After retiring from her career as a dancer in 1987, Christine Hocking launched her business, Pilates Body Awareness. The subject of the appeal concerns output VAT that Miss Hocking had charged for attendance at Pilates classes that she subsequently discovered could be exempt under the "private tuition" exemption. Her request to reclaim the VAT charged was rejected and she appealed to the First-Tier Tribunal (FTT).

***Argument:*** Miss Hocking argued that her classes, which were based on a syllabus developed entirely by herself, were educational in nature. Unlike traditional sports, such as tennis, which develop concentration and physical skills like hand-eye coordination, Miss Hocking submitted that Pilates is more demanding in that it requires an understanding of the living, moving body. She argued therefore that her classes contained a significant educational element as well as the physical aspect of the training. Apart from providing private classes, Miss Hocking also delivered training to a number of students in schools as part of their key stage 4 and GCSE Physical Education.

The key to whether or not the Pilates lessons fell to be exempt depends on that subject being "commonly or ordinarily" taught in schools and universities. Determining what is "ordinarily" is not straightforward.

Unfortunately for Miss Hocking, the evidence presented to the tribunal demonstrated that, to the extent that Pilates is taught in schools or in universities, as part of a syllabus of physical education or dance, such teaching is uncommon.

***Judgement:*** Accordingly, although the FTT found Miss hocking's supplies of tuition to be educational in nature, "*they do not in our judgement at the present time cover school or university education, and so cannot fall within the exemption at Item 2, Group 6 of VATA*".

The appeal was therefore dismissed.

### Revenue & Customs Commissioners v Brockenhurst College [2014] UKUT 0046 (TC)

***Point at issue:*** Whether supplies of catering and entertainment to members of the public should be treated as exempt from VAT as being closely related to the supplies of education.

***Background:*** Brockenhurst College, which is a college of further education, offers various courses to its students, including catering and drama qualifications. As part of the catering course and in order to gain real-world experience, students work in the college kitchen and its adjoining restaurant, which is open to paying members of the public who typically pay 80% of the cost of the meal to dine at the restaurant. As part of the drama course, the students stage productions which are also open to members of the public who pay a small charge to attend.

Initially, the College accounted for output tax on supplies at the restaurant but subsequently submitted a repayment claim on the basis that it should have treated the supplies as exempt. HM Revenue & Customs (HMRC) rejected the claim on the basis that the supplies

were standard rated supplies of catering. The College appealed, contending that they should be treated as exempt supplies of vocational training. The FTT accepted this contention and allowed the College's appeal, finding that "*the operation of the college restaurant was an integral part of the provision of educational and vocational training. It is required as part of the examination body requirement and as part of the course and curriculum*". The Commissioners duly appealed and the case was heard at the Upper Tribunal (UT).

***Argument:*** The Principal VAT Directive (2006/112/EC) is the correct legislation to which we must refer in this case. Article 132 part 1(i) of the directive states that:

"*… member states shall exempt the following transactions….the provision of children's or young people's education, school or university education, vocational training or retraining, including the supply of services and of goods closely related thereto, by bodies governed by public law having such as their aim or by other organisations recognised by the Member* State concerned as having similar objects".

The exemptions found in Article 132 have been implemented into case law by s31 of the Value Added Tax Act (VATA) 1994, which provides that a supply of services is an exempt supply if it is of a description for the service being specified in schedule 9 VATA. Items 1 and 4 of subsection 6 of the directive covers "education" and includes "*the supply of any goods or services (other than examination services) which are closely related to a supply of a description falling within item 1 (the principal supply) by or to the eligible body making the principal supply provided:*

*(a) the goods or services are for the direct use of the pupil, student or trainee (as the case may be) receiving the principal supply; and*

*(b) where the supply is to the eligible body making the principal supply, it is made by another eligible body*".

[Where item 1(a) relates to the provision by an eligible body of education and 1(c) the provision of vocational training.]

HMRC appealed against the decision from the FTT on the basis that there is an error of interpretation of the relevant law contained in the Directive. They contended that the supplies in question were not closely related to the principal supplies of education that the College makes to its students, who are involved in the restaurant and the concerts and performances, nor are these supplies of catering and entertainment performance for the "direct use" of those students, as required by item 4. Rather, it is the third-party customers who eat at the restaurant and enjoy the benefit from this facility and the performances provided; ie the customers at the restaurant and the performance are the direct users and consumers of the services in question, not the students.

The College contended that the requirement that the goods or services must be for the direct use of the students do not limit the application of the exemption. "Direct use", it believed, could simply be satisfied by virtue of the students obtaining a benefit from the provision of the services. In this case, this is the experience of working in the catering environment.

The key piece of legislation which prevented the Revenue from overturning the appeal was that under EU law, which stated that there was no requirement that the goods or services be consumed by the student.

***Decision:*** The Revenue's appeal was therefore dismissed.

### Commissioners for HM Revenue & Customs v Longridge on the Thames [2014] UKUT 0504 (TCC)

**Point at issue:** Whether the activities carried out by a charity constituted economic activities and therefore whether expenditure on improvements to a boathouse should fall to be zero-rated for VAT.

***Background:*** Longridge on the Thames (Longridge) operates as an outward bound centre situated on the River Thames from a facility which was previously owned by a local Scout group who had to pass on the operation as a result of not having the financial means to maintain the facility. The site was then transferred to a local charitable trust, Longridge, which assumed the responsibility for the use of facilities on the site, which included the boating facilities, a camping area, games field, ropes course, climbing wall, Jacob's ladder, the waterfront landing stage, and storage facilities provided by buildings for storing craft and equipment for the various water-based activities provided.

On taking charge of the site in 2005, it became apparent that a significant overhaul of the facilities was required. At the heart of this overhaul was the erection of a training centre at the site. This training centre included toilets, showers and changing rooms on the ground floor with meeting room facilities on the upper floor. It is the VAT on the cost of this construction (£135,000) that is the subject of the dispute. In November 2011, HMRC stated that the supplies ought not to be zero rated and Longridge appealed to the FTT **([2013] UKFTT 158 (TC))**, who found in favour of the appellant, confirming that by far the greater part of its activities were "*directly by way of carrying out its charitable objectives*". It is this decision which HMRC then appealed to the Upper Tribunal.

**The facts:** Longridge operated as a registered charity with the object of promoting, amongst other things "*the development of young people in achieving their full physical, intellectual, social and spiritual potential as individuals, as responsible citizens and as members of their local, national and international communities*".

The cost of building the training centre was met entirely by donations and grants rather than out of charges made to customers (the main donor was Sport England). Both the lower and upper floors of the centre were used for Longridge's activities.

The provision of the facilities at the site is not only for the benefit of young people, but also extends to users through booking of facilities by groups of adults and corporations. For this reason, it operates a tiered system of pricing with the corporate and adult groups paying something more akin to a market rate for the use of the facilities, compared to the young people whose use is heavily subsidised. For disadvantaged or disabled groups, this fee is often waived completely. During the period from 1 January 2012 to 25 November 2012, 94.5% of those people using its facilities were young people and of the remaining 5.5% who weren't, only around 23% of these paid the full price.

An analysis of the costs and revenues from these activities during the 2010/11 accounts showed:

Subsidised activities: costs £655,498, revenues £580,883
Non-subsidised activities: costs £53,476, revenues £61,998

***Argument:*** This case hinges on whether or not Longridge was engaging in an economic activity in its provision of activities. The reason behind this is that section 30 of the VAT Act 1994 (VATA) provides for certain supplies by a taxable person to be taxable at the zero rate. Group 5 of Schedule 8 VATA confirms that one of these activities at which zero rating is applicable is "*a building.... intended for use solely for...a relevant charitable purpose*".

HMRC's principal argument was that the FTT had erred in law by focusing on the prices charged by Longridge and the fact that, because the prices charged do not cover the costs of the services rendered, that it could not be classified as an economic activity; i.e. it does not have to be profit making to be carrying on an economic activity. They referred to case **C246-08 Commission of the European Communities v Finland (2009) ECR I-10605** as a recent example demonstrating the principle that an activity may be an economic activity despite it not returning a profit. This case concerned the zero rating of the provision of legal aid in Finland when the facility was extended to persons who would normally fall out of the income eligibility criteria for receiving a free service, albeit with them paying a proportion of the fees (so not completely free). Although classified as an economic activity, the wide scope of the European definition of economic activity means that it is not something which the appellant was able to use to convince the UT:

"*an activity is thus, as a general rule, categorised as economic where it is permanent and is carried out in return for remuneration which is received by the person carrying out the activity*".

In rejecting the Finland argument, Judge Rose stated that "*their method of calculation and their relationship to costs is impermissible because it offends against the principle that activities can be economic even if they are not pursued for profit. On the contrary, the Finland case indicates that the test to be applied is a more nuanced one than HMRC urged upon me here*".

***Decision:*** The FTT's decision was therefore upheld.

***Commentary:*** This case hinges on the concept of "economic activity" and the fact that an exemption exists for supplies that are provided in a charitable context. HMRC's attempt to use the example of the system for legal aid provision in Finland as an explanation for how an economic activity does not necessarily have to be profit-making is a curious one and, given the differences in the two cases, definitely seemed hopeful on their part.

The full case details can be obtained at: **www.tribunals.gov.uk/financeandtax/Documents/decisions/HMRC-v-Longridge.pdf**.

### Matthew John McCallister v HM Revenue & Customs [2014] UKFTT 875 (TC03991)

***Point at issue:*** Whether an individual was carrying out a used car trade and therefore was liable to be registered for VAT.

***Background:*** This case concerns an appeal by Mr McCallister (MM) against an assessment made against him by the Commissioners of HM Revenue & Customs for an amount of £128,834 of VAT and a late registration penalty amounting to £26,869.

The crux of the case concerns whether or not MM was involved in the trade of used cars and therefore whether he ought to have registered under the VAT margin scheme.

During the period in question, from December 2002 until February 2010, MM was unemployed and received state benefits. As his mother's cousin worked at Inter City Motor Auctions (ICA), MM would spend a lot of his time there, it forming the main part of his social life and he also helped out from time to time by moving cars. He stated that he would buy two cars a year perhaps, for around £300 to £400, with the funding provided by his mother. These cars would generally be sold for scrap for a couple of hundred pounds.

HMRC obtained information surrounding an account which was in the name of a Mr M McCallister. The account purported to show sales in the region of £6.5m over the period in question. The account was registered to an address at 1 Gibson Street, Glasgow, G31. MM confirmed that he resided at Flat 2/2, 213 Broadfauld Street, Glasgow, G32 8PS. Upon further investigation it became apparent that 1 Gibson street did not exist and

that 3 Gibson Street was the first odd numerical address (as per postal records).

MM explained that the extent of his involvement at the auction site was limited to moving cars, buying the odd car for himself, and helping friends and family source cars.

***Argument:*** HMRC's argument hinged on the fact that there was an account with MM's name on it and this account had seen significant purchasing activities. They estimated, based on the profile of figures, that there would have been transactions in the region of £6.5m and that VAT was due on this. They did not, however, have any evidence to tie MM to this account other than his name being on it. HMRC had obtained access to the bank statements of MM (he held only one account) but these were returned and not requested again.

MM argued that his attendance at the auction site was purely on a social basis. At one point during correspondence with HMRC, Mr Mullen, a family friend of MM who provided some assistance at the start of the investigation, stated that MM had a learning disability and was supported by his mother, who had at a point in the past had a significant win on the national lottery.

MM mentioned some irregularities that had come to his attention whilst he had been at the auction site, including car parking tickets for cars that did not belong to him and a police investigation against a Mr Kennedy where the police asked MM about cars that he had supposedly bought. When MM explained that he had not bought these cars, the police went to the auction site and found that the cheque for the vehicle purchase did indeed relate to a Mr Kennedy.

HMRC relied solely on the printouts obtained from ICA and had not carried out any further investigations into the buying and selling of any of ICA's other customers. Neither did they obtain any information around how MM set up his account with ICA, which is unusual as this would require some form of photographic identification and would have tied MM more closely to the account. MM's argument throughout was that other people were using his account or that he was buying cars on behalf of family and friends for which he received no remuneration. He stated further that controls at ICA were weak (a case involving embezzlement in the past was mentioned).

***Decision:*** In making their decision, the tribunal make the point that it is up to MM to prove to them that the facts which support his case are more likely than not to be true. The tribunal believed MM and his evidence and concluded that, based on the delivery of his evidence, "*he would not have had the administrative and business skills to carry out an activity of trading which over the period of eight years had an estimated turnover of £6.5m*".

***Discussion:*** This is a very curious case where HMRC have gone after the individual based on the VAT angle rather than the income tax angle. Presumably their lack of evidence with regard to linking MM to the proposed used car business persuaded them that going for the VAT angle was a safer option. It does seem here, however, that something unusual was going on and it gives us some insight into the workings of the hidden economy. The fact that HMRC did not obtain any evidence in relation to MM's lifestyle was perhaps an oversight on their part.

The full case transcript can be accessed at: **www.bailii.org/cgi-bin/markup.cgi?doc=/uk/cases/UKFTT/TC/2014/TC03991.html&query=tc03991&method=boolean**.

# TAX QUERY

## Contributions to referendum campaigns

***Query:*** *What is the tax treatment of payments made by trading companies to the "Yes" and "Better Together" campaigns during the Scottish independence referendum? Contributions to either were not payments directly to a political party so these are not disallowed on that basis but what is the corporation tax treatment of these contributions?*

***Answer:*** As you will be aware, contributions to political campaigns are disallowed under principles established by case law, and in order to be deductible for corporation tax the taxpayer has to be able to demonstrate that expenditure is wholly and exclusively incurred for the purposes of its trade (section 54 Corporation Tax Act (CTA) 2009). To support a case for a deduction a taxpayer would need to be able to make a case that:

- The referendum campaign was not a political campaign; and
- The purpose of the donation to the campaign was in connection with the trade.

It is debatable whether the referendum campaign was not a political campaign for tax purposes, and companies may need to be prepared for a challenge from HM Revenue & Customs (HMRC) on this issue.

Where expenditure is not in the form of a donation to a political party and is expenditure representing consideration for goods or services which are bought with some political or quasi-political purpose in mind, the expenditure may be deductible in line with the decision from **Morgan v Tate and Lyle Ltd [1955] (35 TC 367)**. In this case, it was held that money spent on a propaganda campaign against the nationalisation of the sugar industry was money laid out wholly and exclusively for the purposes of the trade and was deductible. The HMRC guidance

can be found in Business Income Manual (BIM) 35570.

The other case of relevance is **Boarland v Kramat Pulai Ltd [1953] (35 TC 1)**. This case concerned a tax deduction claimed for expenditure incurred on printing and circulating a pamphlet in which the Chairman attacked the policy and acts of the UK Government of the time. In Boarland, the circumstances were distinguished from Morgan and the expenditure was held not to have been incurred wholly and exclusively in connection with the trade. The HMRC guidance on their understanding of the case law is in BIM37035.

These cases suggest that the critical test when considering the tax treatment of an item of expenditure is the precise nature and purpose of the expenditure in relation to benefit or further the trade carried on by the taxpayer. This is ultimately a question of fact for determination by the Tribunal or Courts. It is important to establish the company's intentions, and board minutes, external and internal communications on the expenditure can serve to provide contemporaneous evidence of the position. The disclosure of the expenditure in the accounts should also be considered, as this will be a factor to be taken into account in establishing the facts and determining the tax position, but is not necessarily determinative.

Once all this information has been gathered together, the company will be able to assess whether it can satisfy the "wholly and exclusively" test in section 54 CTA 2009.

# AUTO ENROLMENT - KNOW THE WORKFORCE

Under Pensions legislation, employers need to assess their staff to determine if they are eligible for automatic enrolment (AE). It is essential to do this in order to comply with AE duties. This is an area where employers may request assistance from their accountants, especially if the accountant is already providing a payroll bureau service.

### Initial checks: How long would a full assessment take?

It is important that accountants do not make assumptions about their clients' workforce for the purposes of AE. Assessing staff can take some time depending on the size of the business and complexity of the workforce. The very first and important task is to establish the staging date, preferably using the Pension Regulator's (TPR's) staging date tool on the website. Once the staging date is established, the next key step is to do a 'quick check' to ascertain how long a full assessment is likely to take and ensure all the information held about staff is accurate.

TPR recommends starting to assess workers several months before the staging date to avoid the risk of non-compliance. While 'several' suggests more than two but not many, it is important to note that it is months rather than weeks to carry out a full assessment, and that time requirement has to be scheduled to ensure that the assessment is completed by the staging date.

TPR's staging date tool can be accessed at: **www.thepensionsregulator.gov.uk/employers/tools/staging-date.aspx**.

### Who is a worker?

What accountants will need to do for AE will depend on whether the employee is someone the legislation classifies as a 'worker'.

At first glance, accountants may assume that only employees who are paid through the PAYE system are considered workers. However, the definition of worker under the legislation is widely drawn and it is important not to exclude workers inadvertently from the process as this contravenes AE duties.

When determining who is a worker, employers and accountants should be aware that:

- A contractual employment relationship does not have to be in writing. To fall within the scope of 'worker' the contract can be verbal and the terms implied rather than explicitly stated.
- Temporary and part-time staff will fall into the category of a worker. In addition, depending on the contractual terms, workers may be those on zero-hour contracts and secondees.
- Another category of worker is a 'personal services provider'. Typically, these workers may appear to be self-employed. However, in certain circumstances they are actually classified as a worker. If an employer expects the particular person to perform the specific work, and/or if the person cannot sub-contract or send a substitute (unless it is due to sickness), or if the person is not undertaking the work as part of his/her own business, then the employer may need to classify the 'personal services' provider as a worker.
- In making the judgement as to whether an individual is undertaking the work as part of his/her own business, the employer should consider factors including whether the employer controls the hours worked, whether tools or facilities are provided, whether employee benefits are provided and whether the employer is financially responsible for faulty work.

Detailed guidance on how to classify a worker can be accessed at: **www.tpr.gov.uk/docs/detailed-guidance-1.pdf**.

### Show your working

When carrying out the assessment, accountants and their clients should exercise 'reasonable judgment' in

defining workers. The rationale for the decision should be documented to demonstrate the underlying reasons for inclusion or exclusion of a person from the 'worker' category for AE purposes. Should there be any reasons to suspect non-compliance through a failure to classify staff correctly at a later stage, written evidence of how these decisions were reached at the time may be required by the regulator.

### Types of worker

The types of worker for which the employer will have AE duties are split into two categories, jobholders and entitled workers. Jobholders are further split into two categories.

- *Eligible jobholders:* these are workers who are eligible for AE and are over 22 in age, who ordinarily work in the UK, and earn above the earnings threshold currently set by the Department for Work and Pensions at £10,000 per annum.
- *Non-eligible jobholders:* these are workers who are not eligible for AE but can choose to opt in. They are aged between 16 and 21, or between state pension age and 74, and are ordinarily working in the UK, and earn above the earnings threshold of £5,772 per annum. Essentially, they are workers who either meet the £10,000 per year threshold but not the age requirements, or who meet the age requirements but not the £10,000 earnings threshold.

Entitled workers are those workers who are entitled to join a pension scheme and are between 16 and 74, who ordinarily work in the UK but who earn below the earnings threshold of £5,772 per annum. They are 'entitled' because they have a right to join a pension scheme but do not need to be automatically enrolled.

It should be noted that although the thresholds are quoted in annual terms, the assessment will always use a pro-rata value based on whether the worker is paid weekly, monthly or fortnightly. This means that their total earnings in a year are not relevant and they only have to earn over the threshold in one pay period to trigger AE. Detailed guidance is available at: **www.thepensionsregulator.gov.uk/docs/detailed-guidance-1.pdf**.

It should also be noted that the categorisation of 'worker' covers workers wholly or ordinarily working in the UK. For certain employments, this may require further investigation to understand the exact scope of these terms in relation to the employment.

Detailed guidance on assessing the workforce is available at: **www.tpr.gov.uk/docs/detailed-guidance-3.pdf**.

### Ongoing duties

It is critical that the employers keep track of their workforce to ensure compliance with their AE duties. Workers must be assessed regularly as their contracts, hours, pay and conditions may change. Regular data cleansing and update of all staff records will help ensure workers are assessed correctly and will avoid the risk of non-compliance.

Further detailed guidance on assessing workers is available on the TPR website at: **www.tpr.gov.uk/employers/know-your-workforce**.

# CONSULTATION ON THE IMPLEMENTATION OF THE EU AUDIT DIRECTIVE AND REGULATION IN THE UK

### Introduction

Just before the end of 2014, the Department for Business, Innovation and Skills (BIS) issued its much anticipated consultation on the reform of the audit market following the publication of the new European legislation, the recommendations from the Competition and Markets Authority (CMA) and other regulatory changes. At the same time, the Financial Reporting Council (FRC) issued its own consultation on options for amending its framework of auditing and ethical standards for auditors to give effect to the requirements of the EU Audit Directive and Regulation.

### Background

In May 2014, the new Audit Directive and Audit Regulation were published in the EU Official Journal. The Directive establishes requirements for the audit of annual financial statements and builds on the existing EU Audit Directive. The Regulation specifically establishes further requirements in relation to the audit of Public Interest Entities. The new requirements come into effect on 17 June 2016 and many of the provisions are likely to apply to financial years starting on or after that date.

### BIS Consultation

The BIS consultation is seeking views on the implementation of the Audit Directive and Audit Regulation in the UK in its Discussion Document '*Auditor Regulation – Discussion document on the implications of the EU and wider reforms – December 2014*'.

BIS is keen to receive opinions on the following key areas, among others:

- Whether the current definition of a public interest entity (PIE) should be expanded beyond the EU minimum of banks, listed companies, building societies and insurers.
- The future regulatory framework and the respective responsibilities of the FRC and Recognised Supervisory Bodies (RSBs).

- The proposed restrictions and cap on the provision of non-audit services by auditors to PIE audit clients.
- The proposal to extend the maximum duration of the audit engagement with a PIE to 20 years subject to a retender process after a maximum of 10 years.
- Alignment of the increase in the small company audit exemption thresholds with the increase in the small company thresholds for financial reporting purposes. This would result in the turnover and balance sheet total criteria for audit exemption purposes being increased from £6.5 million and £3.26 million to £10.2 million and £5.1 million respectively.

Many of the articles in both the Audit Directive and Audit Regulation relate to matters covered in the FRC's auditing standards and ethical standards for auditors. Where there are Member State options, both BIS and the FRC believe that if they impact upon the FRC's standards, the responsibility for development and revision of the relevant audit or ethical standard should fall to the FRC. BIS is therefore seeking views on whether the FRC should be given this responsibility.

The BIS Consultation is open until 19 March 2015 and can be accessed at: **www.gov.uk/government/consultations/auditor-regulation-effects-of-the-eu-and-wider-reforms**.

### FRC consultation

The FRC's consultation document seeks stakeholder views on the member state options allowed under the EU's legislation. In some respects, the UK's current requirements go beyond those of the legislation. In those cases, and where the member state options allow, the FRC is seeking views on whether or not to retain current provisions, to extend them further, or to align them with the new legislation, in particular:

- **Entities not covered by the definition of a PIE** - The EU definition of a PIE is different to the current requirements of the FRC's auditing and ethical standards;
- **Non-audit services** - The Regulation prohibits the provision of certain non-audit services by auditors of PIEs through a 'black list' and places a cap on permitted services. The FRC is consulting on how to apply the cap and the list most effectively in the UK; and
- **The geographic extent of application** - Under the Regulation, the prohibitions on non-audit services to PIEs or their controlled entities within Europe, apply to auditors and their network firms. The consultation seeks views on whether these prohibitions should apply in relation to all audited group entities, irrespective of their location.

The FRC will consult on specific changes to its standards during 2015, taking into account responses received to this initial consultation. The closing date for this consultation is 20 March 2015. The consultation document can be found at: **www.frc.org.uk/News-and-Events/FRC-Press/Press/2014/December/FRC-consults-on-EU-Audit-Directive-and-Regulation.aspx**.

# FINANCIAL INSTRUMENTS UNDER FRS 102 – ACCOUNTING AND TAX IMPLICATIONS

The start date for new UK GAAP, in the form of FRS 100, 101 and 102, has finally arrived, with the first sets of accounts under new GAAP to be filed for years ending on or after 31 December 2015. For many organisations, the transition to Financial Reporting Standard (FRS) 102 is likely to involve one of the key areas that are due to change, and this key area is the treatment of financial instruments. In this article we set out some of the main accounting changes to financial instruments, as well as the potential tax implications of the new accounting requirements.

For the very many UK bodies, corporate or incorporate, which do not currently apply FRS 26 '*Financial Instruments: Recognition and Measuremen*t' and the fair-value accounting rules under the Companies Act, this area of accounting involving financial instruments does not feature much in the preparation of their financial statements. Just because this area of accounting is not a current feature, there may be an oversight that FRS 102 will not affect how financial instruments are to be treated either in the future. However, the definition of financial instruments under FRS 102 is more wide-ranging, so everyone applying FRS 102 will need to consider what financial instruments they have (both on and off balance sheet) and determine how they will be accounted for.

### Definition of financial instruments

FRS 102 defines a financial instrument as 'a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity'. The standard contains two sections – basic financial instruments (section 11) and other financial instrument issues (section 12). It is expected that section 11 will apply to all entities, while section 12 will also apply where more complex financial instruments are held. Additionally, certain items that do satisfy the definition of a financial instrument, such as a lease, are specifically scoped out of these sections because they are covered by a separate stand-alone section (20) in the standard.

### 'Basic' Financial Instruments under section 11

Section 11 states that financial instruments that usually meet the definition of 'basic' include:

(a) cash;
(b) demand and fixed-term deposits when the entity is the depositor, eg bank accounts;
(c) commercial paper and commercial bills held;
(d) accounts, notes and loans receivable and payable;
(e) bonds and similar debt instruments;
(f) investments in non-convertible preference shares and non-puttable ordinary and preference shares; and
(g) commitments to receive a loan and commitments to make a loan to another entity that meet certain conditions.

In the following section, we set out some common 'basic' financial instruments that a company might hold, and look at how the accounting will change under FRS 102.

### Bank loan

As we reported in issue 128 of Technical Bulletin, the FRC issued an amendment to FRS 102 in August 2014, which clarified and expanded which types of debt instrument (eg bank loans) will fall to be treated as basic. The guidelines on this are very specific and rules-based; therefore companies will need to make a very careful analysis of the terms and conditions of any loan arrangements they have in order to ensure these commitments are classified appropriately.

Debt instruments that fall to be treated as 'basic' are measured initially at the transaction price (including transaction costs), and then at amortised cost using the effective interest rate method. The amortised cost is calculated as the net of the following:

(a) the amount at which the financial asset or financial liability is measured at initial recognition;
(b) minus any repayments of the principal;
(c) plus or minus the cumulative amortisation using the effective interest method of any difference between the amount at initial recognition and the maturity amount;
(d) minus, in the case of a financial asset, any reduction (directly or through the use of an allowance account) for impairment or uncollectability.

**Table 1**

On 1 January 20X0, an entity receives a loan of CU1,000, incurring administration costs of CU50. Interest of CU40 is payable annually, in arrears, over the next five years (31 December 20X0 to 31 December 20X4). The total loan amount repayable at 31 December 20X4 is CU 1,100.

| Year | Carrying amount at beginning of period | Interest expense at 6.9583%* | Cash outflow | Carrying amount at end of period |
|---|---|---|---|---|
| | CU | CU | CU | CU |
| 20X0 | 950.00 | 66.11 | (40.00) | 976.11 |
| 20X1 | 976.11 | 67.92 | (40.00) | 1,004.03 |
| 20X2 | 1,004.03 | 69.86 | (40.00) | 1,033.89 |
| 20X3 | 1,033.89 | 71.94 | (40.00) | 1,065.83 |
| 20X4 | 1,065.83 | 74.16 | (40.00) | 1,100,00 |
| | | | (1,100.00) | 0 |

* The effective interest rate of 6.9583 per cent is the rate that discounts the expected cash flows on the bond to the initial carrying amount:

40/(1.069583)1 + 40/(1.069583)2 + 40/(1.069583)3 + 40/(1.069583)4 + 1,140/(1.069583)5 = 950

The example shown in Table 1 above illustrates how amortised cost is calculated on a 5-year loan.

### Interest-free inter-company loan

Inter-company loans are a common financial instrument for group companies, and these loans are likely to be advanced interest-free between members of a group. Under the old UK GAAP (for those not applying FRS 26), this type of arrangement could be recognised at the value of the consideration received. However, this is not permitted under FRS 102 because such a loan is considered a financing transaction. FRS 102 states:

'*A financing transaction may take place in connection with the sale of goods or services, for example, if payment is deferred beyond normal business terms or is financed at a rate of interest that is not a market rate.*'

If an arrangement represents a financing transaction, the financial asset or liability should initially be measured at the present value of the future payments, discounted at a market rate of interest for a similar debt instrument. It is subsequently measured at amortised cost as above.

A common feature of inter-company loans is that there may be no formal repayment terms, or they are considered to be repayable on demand. If this is the case, it is unclear what period the initial measurement should be discounted over. In determining this, it will be necessary to consider how quickly the loan could be repaid if required. Relevant considerations include: does the borrower have the resources available

to repay the loan? And if not, how long would it take to make the repayment? A further consideration is the overall substance of the arrangement as well as the contractual terms; if there is no intent or ability to repay, then it may be appropriate to treat as a capital contribution instead of a loan.

**Example of initial measurement:**

A parent company grants an interest-free loan of CU100 to its subsidiary on 1 January 20X0. The loan is repayable on 31 December 20X0. The market rate for a similar loan is 10%, therefore the loan is initially measured at 100/1.1 = CU90.9. The balancing figure of CU9.1 would be treated as a capital contribution, and recognised directly in equity by the subsidiary.

### Investment in shares

Under the old UK GAAP (excluding FRS 26), investments in shares are either measured at cost, or at a valuation under the alternative accounting rules. Under FRS 102, investments in non-convertible preference shares and non-puttable ordinary and preference shares are treated as basic, but must be measured at fair value through profit or loss, if they are traded publicly or their fair value can otherwise be measured reliably. An entity should use the following hierarchy to estimate the fair value of the shares (FRS 102 11.27):

(a) The best evidence of fair value is a quoted price for an identical asset in an active market. Quoted in an active market in this context means quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted price is usually the current bid price.

(b) When quoted prices are unavailable, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place. If the entity can demonstrate that the last transaction price is not a good estimate of fair value (eg because it reflects the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted.

(c) If the market for the asset is not active and recent transactions of an identical asset on their own are not a good estimate of fair value, an entity estimates the fair value by using a valuation technique. The objective of using a valuation technique is to estimate what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

As the changes in fair value are recognised in profit or loss, rather than via reserves as a balance-sheet entry, this could introduce greater volatility into a company's reported results. Companies will need to ensure that they are able to access valuations for their investments at the initial transition date to FRS 102 in order to prepare their opening balance sheet.

On occasion if the shares in question are not listed and their respective fair value cannot be determined reliably, then they should be reflected at their transaction price, and this should include any directly related purchase costs eg commission costs.

### 'Other' Financial Instruments under section 12

Section 11 of FRS 102 is intended to encompass all of the most common types of financial instruments that a straightforward business will deal with. However, it does not necessarily follow that this type of 'straightforward' business will never have to consider the relevance of section 12 for 'Other Financial Instruments.' Common derivatives like interest rate swaps and foreign currency forward contracts are examples of some fairly commonplace financial instruments that fall outwith the scope for 'basic' financial instruments under section 11.

As with investments in shares which come under section 11 for 'basic' financial instruments, companies need to ensure that they identify all derivatives and other financial instruments and ensure that they obtain valuations for these at the transition date.

### Potential tax impact

With the accounting treatment of financial instruments changing, it is likely that many companies will also see a change in the impact of these assets and liabilities in tax terms. When the UK introduced full IFRS for the group accounts of listed companies back in 2005, some changes were made to the relevant tax legislation to take account of the new accounting. As FRS 102 is a more IFRS based model than current UK GAAP, it is likely the changes to tax legislation will also be relevant to those adopting FRS 102.

For tax purposes, most financial instruments under FRS 102 will be treated as:

- Loan relationships (Part 5 Corporation Tax Act (CTA) 2009)
- Non-lending money debts (treated as loan relationships under Chapter 2 of Part 6 CTA 2009); or
- Derivatives (Part 7 CTA 2009)

The biggest impact in tax terms will relate to financial instruments measured at fair value – either through P&L or other comprehensive income – these are likely to be brought into account for tax purposes. The tax treatment is a departure from the normal principle of looking only at the profit and loss impact, and ensures that items taken to reserves are brought into account.

Some specific financial instruments will entail specific tax treatments; eg for loans between connected companies, profits must be calculated on the basis of amortised cost.

On transition to FRS 102, entities will restate their opening balance sheet, and therefore sections 315 to 319 CTA 2009 will apply for tax purposes. These calculate the transitional adjustments by comparing the opening accounting value in the current accounting period with the closing accounting value for the previous accounting period. When International Accounting Standards were required for certain listed entites in 2005, the Government introduced Change of Accounting Practice Regulations which allowed the transitional adjustments on the adoption of IAS or FRS 26 to be deferred. The regulations apply to most transitional adjustments arising in respect of loan relationships or derivative contracts from changes in accounting practice. Therefore they are likely to be applicable for first-time adoption of FRS 102, and in most cases will have the effect of spreading the transitional adjustments across ten years.

### Further information

HM Revenue & Customs has published two overview papers on the tax implications of new UK GAAP – on FRS 101 and FRS 102. These are available to download from: **https://www.gov.uk/government/publications/accounting-standards-the-uk-tax-implications-of-new-uk-gaap**.

## ACCOUNTING AND AUDITING QUERIES

***Query:*** *I am the financial controller at a large private company which is a parent undertaking with a number of subsidiary undertakings. Currently, consideration is being given to increasing the parent's stake in one of its subsidiaries from 60% to 75%. I am aware that the requirements under current UK GAAP normally require for the assets and liabilities of the subsidiary undertaking in question to be revalued to fair value and any goodwill arising on the increase in the stake held to be calculated. Could you please explain whether the accounting required for an increase in ownership of a subsidiary under new UK GAAP, ie Financial Reporting Standard (FRS) 102, is the same?*

***Answer:*** In such circumstances, the accounting under FRS 102 is not the same as that required by FRS 2. Paragraph 51 of FRS 2, requires that "*The identifiable assets and liabilities of that subsidiary undertaking **should be revalued to fair value and goodwill arising on the increase in interest should be calculated by reference to those fair values**. This revaluation is not required if the difference between net fair values and carrying amounts of the assets and liabilities attributable to the increase in stake is not material*."

In contrast, however, paragraph 9.19C of FRS 102 requires that "*The identifiable assets and liabilities and a provision for contingent liabilities of the subsidiary **shall not be revalued to fair value and no additional goodwill shall be recognised at the date the controlling interest is increased***." The transaction shall be accounted for as a transaction between equity holders. An entity shall treat changes in a parent's controlling interest in a subsidiary that do not result in a loss of control as transactions with equity holders in their capacity as equity holders. Accordingly, the carrying amount of the non-controlling interest shall be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. Any difference between the amount by which the non-controlling interest is so adjusted and the fair value of the consideration paid or received, if any, shall be recognised directly in equity and attributed to equity holders of the parent. An entity shall not recognise a gain or loss on these changes. Also, an entity shall not recognise any change in the carrying amounts of assets (including goodwill) or liabilities as a result of such transactions.

***Query:*** *I am a partner in a medium sized firm of chartered accountants in England. A number of my company clients have been expressing concern about the requirement contained in paragraph 19.23 of FRS 102 and similarly in paragraph 6.13 of the Financial Reporting Standard for Smaller Entities (effective January 2015) which relates to the period over which goodwill should be amortised in situations where an entity is unable to make a reliable estimate of its useful life. The wording of the specific paragraphs in both standards restrict this period in such circumstances to a maximum of 5 years.*

*Is there any possibility that a change will be made to this requirement, as currently the FRSSE (effective 2008) allows goodwill to be amortised over a period of up to 20 years. FRS 10 likewise makes an assumption that goodwill will be amortised over a period not exceeding 20 years although it allows this assumption to be rebutted if certain specific criteria are met.*

***Answer:*** Firstly, this maximum period requirement only applies where an entity is unable to make a reliable estimate of the useful life of the goodwill in question. The current requirements in FRS 10 and in the FRSSE (effective 2008) both implicitly require an assessment of the economic life of goodwill to be undertaken. Therefore, in relation to the transition process to adopting FRS 102 there should be a basis for retaining an entity's existing policy for amortising goodwill purchased prior to the date of transition. Please note that this is contingent on a proper assessment having taken place.

### Purchased goodwill which relates to post-transition-date transactions

The 2013 EU Accounting Directive requires that in circumstances where the useful economic life of goodwill or an intangible asset cannot be reliably estimated, then it should be amortised over a period not shorter than 5 years

and not more than 10 years. The Department for Business, Innovation and Skills (BIS) intends the UK regulations to enact this EU legislation early in 2015. The requirements of the EU Accounting Directive will apply to accounting periods commencing on or after 1 January 2016 but early adoption is expected to be allowed. The FRC will need to make amending changes to FRS 102 which will reflect this requirement for goodwill.

Therefore, in circumstances where an entity cannot make a reliable estimate of the useful life of goodwill, it will be required to amortise this over a period not exceeding 10 years but also not less than 5 years.

Additionally, a longer period can be used where a reliable estimate can be determined. Factors to be considered when assessing the useful economic life of goodwill include the following:

- Expected changes in products, markets or technology;
- Expected future levels of competition, demand; and
- Existence of market entry barriers.

Please note that this list is not exhaustive and is provided merely to highlight some factors for consideration in determining whether a longer time period other than those stipulated in FRS102 should be adopted for the amortisation of goodwill.

# SMALL BUSINESS ENTERPRISE BILL – FOCUS ON CORPORATE TRANSPARENCY

The Small Business Enterprise (SBE) bill was presented in June 2014 and is currently at the committee stage of the House of Lords. The objective of the Bill is to help foster a business environment in the UK that is supportive to small businesses and start-ups, and to provide them with an opportunity to compete, obtain finance, grow, innovate, export and create jobs.

One of the key features introduced by the Bill concerns a requirement for greater corporate transparency so that the owners of businesses are readily identifiable.

Schedule 3 of the Bill requires companies to keep a register of persons of significant control. This register must contain details of all persons with more than 25% of a company's shares or voting rights, or who otherwise exercise control over the company and its management, and will require to be filed at Companies House. Ownership details of LLPs will also require to be held on the register.

### Key features of the Bill

- A publicly accessible register of company beneficial ownership is to be held at Companies House.
- The register will contain information on individuals who ultimately own or control more than 25% of a company's shares or voting rights, or who otherwise exercise control over the company and its management.
- Equivalent ownership details of LLPs are also to be included on the register.
- The register will cover private and public companies and LLPs, but not companies which already comply with disclosure rules under the *Financial Conduct Authority's Disclosure and Transparency Rules*.
- Structures containing corporate directors are to be prohibited, but with specific exemptions for large groups of companies, (see below for further explanation).
- Bearer shares will be abolished and existing bearer shares are to be converted to registered shares.
- The regime for disqualifying directors will be expanded, with "unfitness" being determined by a broader and more generic provision.
- Courts will be able to take overseas misconduct into account when deciding whether to disqualify a director, and sectoral regulation and director disqualification will be better integrated.

### What will be contained in the register of company beneficial ownership?

The new register will contain information on individuals who ultimately own or control more than 25% of a company's shares, or who otherwise exercise control over the company or its management (ie all beneficial owners). It will include where a person's interest is held jointly with another individual, or as a result of various shareholdings in the company, such that they can control more than 25% of the company's shares or voting rights. In this situation, joint ownership is defined as the individual ownership of an asset by two or more individuals.

The existing definition of beneficial ownership, as applied in anti-money laundering legislation, will be used as the basis for the statutory definition of "beneficial ownership" for the purposes of this new register.

Where a qualifying beneficial interest in a company is held through a trust, the trustees or any other natural persons exercising effective control over the trust will be required to be disclosed as the beneficial owner of the company. In the majority of cases, that will only require the trustees to be registered, but in some cases may be another person such as the beneficiary or settlor.

### What companies are covered by this new regime?

UK "bodies corporate" that have an existing obligation to register information on their members at Companies House will be within this new regime. This will therefore include private limited companies, companies limited by

guarantee, public companies and limited liability partnerships.

Companies that already have to comply with the *Financial Conduct Authority's Disclosure and Transparency Rules*, ie Main Market and Alternative Investment Market companies, or which have securities listed on a regulated market subject to equivalent disclosure requirements, will be exempted.

The position with respect to Scottish limited partnerships is currently being discussed and it is not yet clear whether or not they will require to be included within this regime.

Wholly-owned subsidiaries of companies that maintain a register of beneficial ownership (or which are exempt from the need to do so) will only need to provide information about their parent company, rather than about their parent company's beneficial ownership.

### Who will have the obligation to identify and obtain information on beneficial ownership?

The obligation will fall on both companies and individuals. Companies will be required to identify their significant beneficial owners. As well as this, where the company knows or has "reasonable cause" to believe that there is any other significant beneficial owner, the company shall also be required to obtain the relevant information on that individual. Individuals with a qualifying beneficial interest in the company will be required to disclose this to the company.

### What will the register contain?

The register will contain the beneficial owners':

- Full name and date of birth;
- Nationality, and country or state of residence;
- Residential address and service address;
- The date on which the beneficial interest in the company was acquired; and
- Details of the beneficial interest and how it is held.

### Whose job will it be to maintain the register?

Companies are to be required to maintain their own register. They will have to update the register if a change to their beneficial ownership has occurred. Beneficial owners will be required to inform the company of any changes to the information recorded in the register.

All of the information held by the company will be provided by the company to Companies House, where it will be publicly accessible with the exception of residential addresses and full dates of birth.

There will be measures to protect beneficial owners' full information from public disclosure in exceptional circumstances.

Companies will be required to provide an initial statement of beneficial ownership on incorporation, and will then be required to confirm that the information held at Companies House is correct at least once every twelve months and to detail all changes that have occurred in-year.

### The position on corporate directorships

The Government has decided to prohibit the use of corporate directors. (At the moment, a company can have a corporate director provided that at least one of its directors is a natural person.) The inclusion of LLPs within this prohibition is still being considered.

Most companies will not be able to appoint a corporate director, although a company will be able to continue to use or appoint a new corporate director if the situation falls within one of these suggested exemptions:

- Group structures including large listed companies;
- Group structures including large private companies; or
- Charities.

Clarification will be required on how "group" or "large" in this context are to be defined,.

The new prohibition will apply not just to new director appointments, but also to existing corporate directors. So it seems that existing corporate directors outside the suggested exemptions will need to be removed, and here the Government suggests that a one-year period for companies to become compliant should be sufficient.

These changes require primary legislation to amend the Companies Act 2006, which the Government intends to bring forward "as soon as Parliamentary time allows".

### What about bearer shares?

The creation of new bearer shares (ie "share warrants to bearer", as defined in sections 122 and 779 of the Companies Act 2006) will be prohibited. There will be a nine-month period following the policy coming into force during which bearer shareholders can surrender their bearer share warrants and convert them to registered shares (irrespective of any contrary provisions in the company's articles).

### Directors' disqualification regime updated

The Government considers that the existing directors' disqualification regime (as set out in the Company Directors Disqualification Act (CDDA) 1986) needs updating.

So it is proposing that Schedule 1 of the CDDA, which sets out matters determining directors' unfitness, should be replaced with a new provision setting out factors which will be considered in determining unfitness, including the materiality of the conduct, the culpability of the individual and the impact of their behaviour. The court or the Insolvency Service will be required to take these factors into account in considering whether or not, and for how long, a person should be disqualified.

The law will be amended to require courts to take any overseas misconduct into account when deciding whether or not to disqualify a director in the UK.

The courts will also be required to consider breaches of sectoral regulation in disqualifying a director.

The time period for instituting disqualification proceedings under section 6 of the CDDA will be increased from two to three years of the earliest insolvency event.

### Further reading

Details of the Act can be obtained on the Parliament website at: **http://services.parliament.uk/bills/2014-15/smallbusinessenterpriseandemployment.html**.

# SUSPICIOUS ACTIVITY REPORT REVIEW 2013/14 – ACCOUNTANCY SECTOR INSIGHTS

The National Crime Agency (NCA) has released its Suspicious Activity Report (SARS) review of 2013/14 focusing on the activities of the Accountancy Sector. A number of interesting findings applicable to practitioners are evident, mainly focusing on the level of reporting and the quality of reports submitted to the NCA.

### General trends

- There is a downward trend in the number of accountancy SARS despite an increase in the overall level of SARS being reported. See Table 1 below.
- Total SARS submissions were up 12% on the previous year whereas accountancy SARS fell by 9%.
- Of all accountancy SARS, 4% were consent related.
- In terms of reporting trends within the sector, there seems to be an increase when a new accounting year begins. Given that work trends tend to be condensed around January tax return deadlines and December year ends, this manifests itself in lower SAR reporting in the first few months of the year, once year ends have been completed.

### SAR quality

- A SAR quality review highlighted that 46% of SARS were below the standard expected. This is mainly due to a very short description of the reason for the suspicion, giving end-users very little in the way of information. If these SARS had been consent SARS, under the new closure process which was introduced from 1 October 2014, these would have been closed due to insufficient information. As a reminder, “consent” allows reporters a defence against a money laundering offence by seeking the consent of the NCA to undertake an activity which the reporter suspects may constitute one of the three money laundering offences (per sections 327-329 of Proceeds of Crime Act 2002).
- A reminder to reporters – they need to address the following:
  1. Who?
  2. What?
  3. Where?
  4. When?
  5. Why?
  6. How?
- There was only 1 consent request from an ICAS firm during 2013/14.
- There are still issues around the understanding of what “consent” actually means. Out of the 1,154 submissions from all sectors that were reviewed by the UK Financial Intelligence Unit (UKFIU), 14 were from the accountancy sector. Of these, 9 were ultimately processed as consent requests and 5 were closed as they did not meet the s.338 (authorised disclosure) criteria.
- Since 1 October 2014, consent requests that miss out the reason for suspicion or fail to identify the nature of the criminal property will be closed without any further engagement.
- A review of consent standards was conducted between October and November 2014 and found that the accountancy sector was the second most likely sector to have consent requests closed due to one or more of the required elements being absent for a consent SAR to be properly considered.

**Table 1**

| | All sectors | Excl banking | Accountancy | Accountancy % |
|---|---|---|---|---|
| 2012/13 | 316,527 | 65,191 | 5,428 | 8 |
| 2013/14 | 354,186 | 67,879 | 4,930 | 7 |

### Three examples of suspicious activity reports requiring some improvement

These three examples give an insight into some of the more common types of SARS which the NCA receive. In all three instances, the information provided is woefully inadequate.

1. *“Information has come to our attention that the main subject has been convicted of a drug trafficking offence”*

   Missing information:

   - How and when did the information come to the attention of the firm?
   - In what capacity is the firm involved?
   - Are there any further suspicions or irregularities aside from the conviction?

- What is the suspicion?
- Is the suspicion in relation to money laundering or terrorist financing?

2. *"My client has told me that he is not declaring all of his income"*

Missing information:

- When did the client advise this?
- What is his declared income?
- Did he disclose what amount of earnings he is not disclosing and why?
- Can further content of any discussions that have taken place be detailed?
- Is there any suspicion that the subject is attempting to launder funds for criminal gain?

3. *"We are Mr Jones' accountants and noticed the issue on preparing the accounts"*

Missing information:

- What is the issue that you have become aware of and when did it occur?
- Have there been discussions with the client over the issue?
- Have there been any irregularities in the past?
- Is there a business involved?
- Is there a suspicion that money laundering is occurring?
- Are there grounds for suspecting any links to terrorist financing?

More details on reporting a SAR can be obtained at: **www.nationalcrimeagency.gov.uk/publications/116-submitting-a-sar-within-the-regulated-sector/file**.

# MONEY LAUNDERING QUERY

***Query:*** *We are a medium-sized firm with a number of clients for whom reports are submitted to the Money Laundering Reporting Officer (MLRO) each year. The MLRO deals with these reports appropriately and the process is completely confidential. A number of these reports are in relation to audit clients where the issue has been discovered during the current year fieldwork. Our procedures dictate that a point forward be raised where an error or misstatement as a result of suspected fraud is found.*

*We document our formal consideration of risk at the planning and completion stage of all assignments, so there will be a general awareness of the risks associated with each client. However, what is the correct approach to take in circumstances such as these for the following accounting year? Should we mention specifically in the audit risk assessment/planning approach the prior year issue?*

***Answer:*** The fact that a point forward was made on the prior-year file means that you will need to consider this during your planning of the current year audit. Of course it is unlikely that you would know whether or not the issue was the subject of a suspicious activity report (SAR) to the MLRO or whether it was deemed necessary for a SAR to be filed with the National Crime Agency.

How you approach this from a planning perspective will depend on how much you know about the situation. If you are the audit partner and know that a report was filed with the NCA, then this may mean that you wish to address the issue in the planning more specifically but you must be very careful that your approach does not result in the client being tipped off (remember that under section 333 of the Proceeds of Crime Act 2002, a person commits an offence if they make a disclosure that is likely to prejudice a money laundering investigation).

You would be wise therefore to err on the side of caution in this regard and approach in a more general manner. Either way, you are right in thinking that the issue should be mentioned in the audit planning but how you address it during the fieldwork will need some care.

# DIRECTORS CONVICTED IN "GREEN BIOFUEL" TRIAL FOR MONEY LAUNDERING AND BRIBERY

Three men have been convicted in relation to the Serious Fraud Office's (SFO) investigation into Sustainable Growth Group (SGG), including subsidiaries Sustainable AgroEnergy Plc (SAE) and Sustainable Wealth (UK) Investments Ltd (SWI). Two of these men have also been convicted of offences under the Bribery Act 2010, the first conviction to be secured by the SFO since the law came into force in July 2011, and one of only a few successful prosecutions under the new law by all agencies.

The defendants were found guilty of conspiring to sell and promote SAE investment products based on "green biofuel" Jatropha tree plantations in Cambodia. The green biofuel products were sold to UK investors who invested primarily via self-invested pension plans (SIPPS). The Court found that investors had been deliberately misled into believing that SAE owned land in Cambodia; that the land was planted with Jatropha trees; and that there was an insurance policy in place to protect investors if the crops failed.

The three men convicted were:

Gary Lloyd West, former Director and Chief Commercial Officer of SAE

James Brunel Whale, former Director, CEO and Director of SGG

Stuart John Stone, Director of SJ Stone Ltd, a sales agent of unregulated pension and investment products

This is arguably the first major bribery conviction under the new 2010 Act. Readers of Technical Bulletin may remember the case of legal clerk Munir Patel who was the first person to be charged under the new law for receiving £500 bribes to remove motoring offences from court records.

Mr West, apart from being convicted for fraud (false representation, fraudulent trading and providing false information), was also convicted on two counts of bribery contrary to s2(2) of the Bribery Act 2010 (offences relating to being bribed) – "*requesting, agreeing to receiving or accepting a financial or other advantage intending that, in consequence, a relevant function or activity should be performed improperly*".

Similarly, Mr Stone was convicted of conspiring to furnish false information, and was found guilty of two counts of bribery contrary to s1(1) and s1(2) of the Bribery Act 2010 (offences of bribing another person) – "*offers, promises or gives a financial advantage to another person with the intention of inducing that person to either perform improperly a relevant function or activity or to reward a person for the improper performance of such a function or activity*".

Mr Whale was convicted of conspiracy to commit fraud, conspiring to furnish false information, fraudulent trading and a Bribery Act 2010 offence.

This case is the first involving the section 2 offence of requesting or accepting a bribe as an improper inducement and demonstrates the SFO's ability to police the Act, as well as showing that the offences under the Act can be used successfully to prosecute those who set up elaborate frauds to conceal their wrongdoings.

# ASK RON ABOUT IT

***Query:*** *We have been running the same computers in our office for 3 years now and have noticed a definite dip in overall performance over the last 12 months in particular. This is both when using network applications such as Microsoft office and our accounts preparation software but also when using the internet. When we put the system in I was told that it was a relatively high specification. Do you have any suggestions as to why this might be the case or what we might be able to do to remedy it? I understand that technology moves on at a pace these days so would welcome some expert input.*

***Answer:*** You are absolutely correct, technology is ever evolving! No matter how fast or shiny computers might be when they were new, they all seem to get slower over time. The computer you bought three years ago might not run as quickly after you install a dozen programs, most of which will be receiving regular updates which will increase the load that is placed on the machine, not to mention Windows and anti-virus updates which improve the security of your machine at the cost of performance. The slowdown might happen so gradually that you hardly notice it, until one day you are trying to open a program or file and wonder what has happened to your shiny new computer!

***Take note:*** *Before you make any changes to your workstations or server, it is imperative that you have an adequate (and tested) backup system for all vital information. Always be sure to save a copy of your important files to the server that is being backed up, no matter what method you use for the original storage. Then, if your hard disk ever fails, you won't lose your data.*

## Windows performance troubleshooting and housekeeping tips

The first thing that you can try is the Performance troubleshooter, which can automatically find and fix problems. The Performance troubleshooter checks issues that might slow down your computer's performance, such as how many users are currently logged on to the computer and whether multiple programs are running at the same time.

*Open the Performance troubleshooter by clicking the Start button, and then clicking Control Panel. In the search box, type troubleshooter, and then click Troubleshooting. Under System and Security, click Check for performance issues.*

Two simple housekeeping tips that are often overlooked and should be encouraged as a routine are: (1) shut down your PC at the end of the day, and (2) restart your server once a month. These routines are a good way to clear out the memory and ensure that any errant processes and services that have been running get shut down. Restarting closes all the software running on your PC—not only the programs you see running on the taskbar, but also dozens of services that might have been started by various programs and never stopped. Restarting can fix mysterious performance problems when the exact cause is hard to pinpoint.

Also, try uninstalling old programs from the Control Panel. You may find programs that you no longer use or did not even know you had, because installing one program sometimes causes another one to be installed, such as a browser toolbar. Removing what you don't need is a great way to keep your machine running smoothly.

If you try these tips and your computers are still too slow, you might need new PCs, server or some hardware upgrades, such as a new hard disk, or more memory.

### Security

If your computer is running slowly, it is possible that it has been infected with a virus or spyware. This is not as common as the other problems, but it is something to consider. Before you worry too much, check your PC using anti-spyware and anti-virus programs.

A common symptom of a virus is a much slower-than-normal computer performance. Other signs include unexpected messages that pop up on your PC, programs that start automatically, or the sound of your hard disk constantly working.

Spyware is a type of program that is installed, usually without your knowledge, to watch your activity on the Internet. You can check for spyware with Windows Defender or other anti-spyware programs.

The best way to deal with viruses is to prevent them in the first place. A firewall of any description is a must for any user connecting to the internet. Always run anti-virus software and keep it up to date. Even if you take such precautions, however, it is possible for your PC to become infected. For a truly effective platform, a dedicated hardware firewall with deep packet inspection (a form of computer network filtering that examines the data part (and possibly also the header) of a "packet" as it passes an inspection point, searching for protocol non-compliance, viruses, spam, intrusions, or defined criteria) provides the best all-round solution and goes a long way to securing networks from the more sophisticated and damaging internet threats. Firewall requirements for PC's and Mac's are different and you should seek advice regarding the most appropriate type depending upon the operating system.

### Hard disk

It is worth checking the available hard disk space on your server and workstations. If your hard drive is full the machine will be very slow and it is also a sign that there is more data on the PC that it can cope with. To view the amount of free space on your hard disk:

*Click the Start button, and then click Computer.*

*Click the hard disk you want to check. The total size and available free space appear in the details pane at the bottom of the folder window.*

If you need to free up disk space, here are some things you can do:

- Run Disk Cleanup. This tool removes temporary files, empties the Recycle Bin, and removes a variety of system files and other items that you no longer need.
- Delete all but the most recent restore point. System Restore uses restore points to return your system files to the state they were in at an earlier point in time. If your computer is running normally, you can save disk space by deleting the earlier restore points.

### RAM

Over time the space and memory available for new tasks becomes smaller, so it is worthwhile reviewing the available storage and memory capacity on your workstations and server.

Random access memory (RAM) is temporary storage space that your computer uses to run Windows and other programs. RAM is a general indication of performance that is measured either in megabytes (MB) or gigabytes (GB): the larger the number, the faster some programs will run. RAM is not used for storage when your computer is turned off. It is different from disk space, which is the amount of storage space available on your computer's hard disk. When your computer runs low on memory and needs more memory space immediately, modern operating systems use hard disk space to supplement system RAM through a procedure called paging. Too much paging degrades overall system performance.

No discussion of how to make your computers run faster would be complete without mentioning that you should consider adding more RAM. If a computer running Windows 7 seems too slow, it could be because the PC no longer has enough RAM. The most effective way to speed up operating performance is to add more. Windows 7 can run on a PC with 1 gigabyte (GB) of RAM, but it runs better with 2 GB or for optimal performance, boost that to 3 GB or more. It is recommended that Windows Server 2008 runs with 2 GB RAM or greater. Here is the maximum RAM for 32-bit systems: 4 GB (Standard) or 64 GB (Enterprise and Datacenter) and 64-bit systems: 32 GB (Standard) or 1 TB (Enterprise and Datacenter) or 2 TB (Itanium-Based Systems).

*Open System by clicking the Start button, right-clicking Computer, and then clicking Properties.*

*In the System section, next to Installed memory (RAM), you can see the amount of RAM your computer has.*

### Internet

It is vital to secure your Wi-Fi. If your Wi-Fi is not password protected, anyone can use it meaning that people might be logging onto your network without you knowing, causing speeds to drop as a result, and security threats.

Most Internet services focus on download speed, but depending on your business type, guaranteed upload speed can be critical. Upload speed is the rate at which your Internet connection sends data up-stream to the Internet.

Upload speeds will be essential to your business if you share large data files or host data at a head office, for example.

You may think your connection is slow but it may be the fastest connection you

can get. The most accurate way to test the line speed is to go to this address and follow the instructions: **http://speedtest.btwholesale.com**.

## Networking

When the traffic load grows on your network, how do you steer around congestion and reduce collisions? By switching. Effective switching is essential to handle the growing network traffic coming from video and other bandwidth-intensive applications, more user devices, and more packets headed to servers and storage in the cloud.

When you begin using cloud services you are pushing out much more traffic to the internet than you had before. Any small or medium sized business can use LAN switching to sustain the speeds and availability that users need, and a speed of 1 Gigabit is preferred. If your files or applications which run on the server are running slowly it may be that your switch is only capable of a 100 megabit connection which is 10 times slower than it could be. To find out what speed a PC is connected at, just double-click the icon for your network connection in the Control Panel.

## Summary

There are many areas to review before you need open the cheque book! Hopefully this answer has provided you with some guidance on what improvements could be made to your current setup to optimise computer performance. Many thanks for your question and I wish you well for a prosperous 2015.

Email any further questions for Ron to: **practicesupport@icas.org.uk** with "Ron IT" in the subject header.

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