Technical Bulletin

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Tax treatment of life insurance policies – getting the details right

Our members in practice are likely to encounter various permutations of life insurance policies, with the tax treatment varying depending on the nature of the policy and who receives the proceeds in the event of a claim. Here's a reminder of the various tax issues to be aware of when advising clients.

Key person insurance

Most businesses will have directors or employees who would be considered to be a 'key person' and the day-to-day operation of the business would be majorly impacted by the death of such a key person or their long term absence from work due to accident, injury or critical illness. Key person insurance would normally be in the form of a fixed payment to cover significant liabilities of the business or an ongoing payment to support the business on the death of the key person or during their absence due to accident, injury or critical illness.

HMRC outlines the tax treatment in its manual BIM45525. Given the nature of the insurance, there should be no employment tax considerations as the proceeds are paid directly to the business in the event of a claim.

Initial treatment of premiums for key person insurance

Where the sole purpose of the key person insurance is to make good the loss of trading income from the long

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term absence from work of the key person, the premium should be deductible from the taxable profits of the business. To ensure this treatment, policies which cover the death of the key person must be term insurance covering against the risk that an insured key person dies within the term, otherwise the premium will be disallowable.

In other cases, such as where the insurance is to cover a liability, the premiums will not be allowable as a deduction from the trading profits of the business.

Tax treatment in the event of a claim

When a claim is made under a key person insurance policy, the tax position will be in line with Section 103 CTA 2009 (companies) or Section 106 ITTOIA 2005 (unincorporated businesses). The general position is that where tax relief has been obtained on the initial premiums that the proceeds on a claim will be taxable as part of the trading profit of the business. But there would presumably be costs to offset against the insurance receipts, such as the costs of the replacement staff covering the absence of the key person.

Where the initial premiums are not deductible, the general position would be that the receipt of the insurance proceeds are not taxable as part of the trading profits of the business. It should however be noted that the tax treatment of a particular insurance receipt is completely separate from the deductibility of expenditure on the initial premiums.

So, by disallowing the cost of insurance premiums which meet the criteria for being deductible from the trading profits of the business, this would not in itself alter the future treatment of any potential claim. HMRC manual BIM45525 explains that "no assurance can be given that any future receipt will be excluded from trading income even though the premiums are not allowable" and cites the cases of Simpson v John Reynolds & Co (Insurances) Ltd [1975] 49 TC 693 and McGowan v Brown & Cousins [1977] 52 TC 8).

Relevant life policies

Many employers will provide some form of death in service benefit to their employees. Unlike key person insurance (where the proceeds are paid to the business), the proceeds would be payable to the employee (or as otherwise directed). This would normally be in the form of a relevant life policy which qualifies for specific tax treatment.

As explained in HMRC's manual BIM46140, the cost of the premium for relevant life policies are deductible from the taxable profits of the business. HMRC manual EIM15045 explains the income tax treatment for the employee – the employer financed retirement benefits scheme (EFRBS) rules do not apply in the case of a relevant life policy, which mean that the payment of the premiums are not a benefit in kind assessable on the employee.

As such, the ability to obtain tax relief for the employer without giving a benefit in kind for the employee can make this an attractive part of an employee's remuneration package.

Other life insurance policies

In some cases, the directors of companies which are owner managed businesses will have taken out some form of life insurance cover in their own name as individuals rather than in the name of the company. This can complicate matters if the premiums are paid by the company, as this makes it more difficult to argue that the above rules apply.

Importance of getting advice

Whilst our members will be working with clients who have both key person insurance and relevant life policies and can advise on the tax treatment, as an insurance product it is advisable for the client to consult an independent financial advisor.

Proposed changes to HMRC's data collection powers

Draft legislation announced on legislation day ('L-day') 2023 will provide the Commissioners of HMRC with additional powers to require information from employers, as well as additional information in self-assessment tax returns of individuals, partnerships, and trusts.

In her written statement on 18 July 2023, Victoria Atkins (Financial Secretary to the Treasury) argued that this would improve the quality of the data collected by HMRC, provide better outcomes for taxpayers and businesses, improve compliance, and result in a more resilient tax system.

The draft legislation follows an HMRC consultation on improving the data it collects from its customers in July 2022. Along with other professional bodies, ICAS provided feedback to the consultation and the government responded on tax administration and maintenance day 2023.

Following the consultation, the draft legislation extends the scope of section 8 of the Taxes Management Act (TMA) 1970 (for individuals and trustees) and section 12AA of TMA 1970 (for partnerships), allowing the Commissioners of HMRC to introduce regulations. These regulations can require the provision of information that the Commissioners consider relevant for the purpose of the collection and management of income tax, corporation tax and capital gains tax. Failure to comply with any regulations introduced under the above sections will result in a fixed rate penalty of £60.

The draft legislation also introduces new powers under the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 which may require additional information from employers as part of a PAYE return. As above, this is limited to any such information that the Commissioners consider relevant for the purpose of the collection and management of income tax, corporation tax and capital gains tax.

Changes to TMA 1970 and ITEPA 2003 will take effect from the 2025/26 tax year onwards. HMRC has not released draft regulations at this stage but has given an indication as to how the new powers will initially be used.

Additional information from employers

HMRC has advised that it will require employers to provide additional information on the hours worked by employees in real time information (RTI) submissions. Employers are currently required to select a banding of their employee's working hours in RTI full payment submissions, HMRC currently uses this to corroborate universal credit claims.

Instead of the current approach, the proposal is for an exact number to be required of either the contractual hours worked (where working hours are reasonably stable) or actual hours worked by hourly paid employees.

In our response to the consultation, we highlighted the logistical concerns of data being held in different business departments (most commonly human resources and payroll) and in a number of different systems. However, the government has argued that employers are already required to keep records of the hours their employees work to satisfy minimum wage legislation and, in some cases, display this information on payslips. Only time will tell how this change will impact on employers.

Additional information from self-employed taxpayers

At present, there is a box in the SA103 pages of the self-assessment income tax return for taxpayers to enter the dates the business started and ceased trading. Similar boxes can be found on the SA800 for partnerships and the SA901 for trusts.

Completion of these boxes is currently optional. HMRC proposes for this to be mandatory from the 2025/26 tax year onwards. The dates should normally be fairly easy to obtain, and in our feedback to the consultation we felt that this should not create significant problems to taxpayers or their agents in most cases.

Additional information from shareholders in companies that are owner managed businesses

HMRC has indicated that, from the 2025/26 tax year onwards, it will require shareholders in companies that are owner managed businesses to separately disclose their dividend income from their other dividend income, as well as their percentage shareholding in the company. We understand this is likely to be on the

SA102 employment tax pages, which would suggest that the information would only be required by directors, in line with our feedback to the consultation.

The definition of an owner managed business for this purpose is still to be confirmed, but we expect it to be similar to the existing legislation for close companies. Section 439 CTA 2010 defines a close company as one controlled by its directors or by five or fewer participators.

How HMRC will use the information on dividend income may become clearer in due course. However, we understand that HMRC will use the additional information on owner managed businesses to monitor overall tax compliance and it will also enable the government to have a better understanding of how the owner managed sector operates when considering future tax and business support measures.

Additional information forms now required for R&D claims

From 8 August 2023, all companies making research and development (R&D) tax relief claims must complete an additional information form (AIF) to accompany the claim. This applies to claims for both research and development expenditure credit (RDEC) and SME schemes.

Between 8 August and 3 September 2023, almost half the R&D relief claims received by HMRC did not have an accompanying AIF, which means they are invalid.

HMRC is writing to companies and authorised agents where an R&D relief claim has been submitted without the AIF, explaining that the claim is invalid, and that the corporation tax (CT) return will be corrected to remove the claim.

Additional information forms

HMRC has provided guidance on who can submit the AIF (accessed from the guidance page) and the additional information required, which includes details of qualifying expenditure and contact details for the main R&D contact at the company and any agent involved in the claim.

It is important to note that the requirement for an AIF applies to all claims made on or after 8 August, irrespective of the accounting period to which the claim relates.

What happens when claims are rejected because the AIF has not been completed?

Provided that the company is in time to amend the CT return, it can still make a valid claim to R&D relief by amending the return to reinstate the R&D claim and completing the AIF at the same time.

Completing CT returns – Box 657

When completing the CT return which includes an R&D claim, the company should put an ‘X’ in Box 657 to indicate that the AIF has been submitted. However, there is a known problem affecting some claims to RDEC.

HMRC notes that some customers are unable to complete both boxes 655 and 657 on the CT600 and may get the error message, “Error 9283 — Box 655 can only be completed if at least one of the boxes 670 or 680 is greater than 0 (zero).”

Where this error arises HMRC guidance states, “…do not make entries in boxes 655 and 657. You must still submit the additional information form to make a valid R&D expenditure credit claim.”

HMRC plan to update the service in April 2024 to fix this issue. Until then, HMRC advises affected companies to use the white space on the CT return to explain that an R&D claim is being made and that the AIF has been completed.

Claim notifications

The AIF is not the only new requirement for R&D tax relief claims introduced in 2023. For accounting periods starting on or after 1 April 2023, some companies need to notify HMRC that they will be making a claim for R&D tax relief in advance of making the claim. The ‘claim notification’ must be submitted via an online form no later than six months after the end of the period of account.

HMRC’s guidance sets out which companies need to notify, submission deadlines, who can submit the claim notification and the information required to complete the form. The claim notification form can be accessed from the guidance.

Cosmetic medical sector – HMRC identifies new target

It has come to our attention that HMRC has recently formed a specialist project team to target the rapidly growing cosmetic medical sector. The focus of attention is whether treatments such as Botox, fillers, teeth veneers, or facial chemical peels, qualify for medical exemption from VAT. HMRC's position is that the treatments should be treated as standard rated.

This view has been supported by a recent decision at the First-tier Tribunal (FtT), involving Illuminate Skin Clinics Ltd (TC/2019/05352). In that case, there was an extensive reference to two other leading cases, SkinRich and Mainpay. Illuminate had made a claim for VAT credit, which HMRC had denied.

Background

The supply of medical care, when delivered by professionals registered with their appropriate statutory body, is exempt from VAT, if the provision of the care takes place in a hospital or other state-regulated institution. The medical care itself should be concerned with diagnosing, treating, and, in so far as possible, curing diseases or health disorders.

The decision

Dr Sophie Shotter, the Director of Illuminate, is a qualified doctor, registered with the General Medical Council. After deciding to focus on 'aesthetic medicine,' she began treating clients in 2012, as a sole trader, from her own home and three beauty salons. In 2014, she established Illuminate and continued to deliver a range of facial and skin treatments, from clinic premises which were registered with the Care Quality Commission. The Tribunal accepted Dr Shotter as a skilled professional but concluded that the services offered were not exempt within the proper meaning and effect of the relevant VAT legislation.

The Tribunal drew attention to the following:

- Clients were making use of the Appellant's services because they wanted to. There was no diagnosis of a health disorder, no careful investigation of symptoms or analysis of a client's medical history, and no referrals from a doctor or other medical professional.
- As no diagnoses had been conducted at the starting point for medical care, 'treatment' in the sense captured by the exemption, was not being undertaken in response to a disease or other medical disorder.

Summary

This was a complex ruling which raised important issues. Primarily this centred on the significance of detailed and contemporaneous records, which Illuminate did not have, in order to evidence the medical assessment necessary to qualify for the medically exempt VAT treatment.

HMRC: requests for securities if tax not paid

Although not an everyday occurrence, HMRC can ask for a financial security if it believes a business may be at risk of not paying its taxes, whether that be Corporation Tax, VAT, PAYE or National Insurance Contributions.

The security demanded can be in the form of a payment directly into a nominated HMRC bank account or a performance bond from an approved financial institution. HMRC will not accept security in the form of an asset, such as a high value car or cryptocurrency. Most importantly, it is a criminal offence not to give a security to HMRC when it asks for it.

Why does HMRC ask for a security?

There are two primary factors HMRC considers before seeking a security:

1. Whether those in control of the business are connected to a previous business failure, which resulted in a loss of tax.
2. Whether there is reason to believe the business will fail to comply with its tax obligations.

How does HMRC ask for a security?

HMRC will issue a Notice of Requirement (NoR) to a business stating that a security is required. Sometimes

HMRC will issue a warning letter before a NoR is issued. However, if HMRC believes a warning letter might increase the risk of tax not being paid, a NoR may be sent or delivered in person, without any warning at all.

What does a NoR contain?

A NoR explains:

- HMRC's legislative power to require a security.
- The amount of the security.
- The date on which the security is to be given, which is usually 30 days after the day the NoR has been received.
- How long HMRC can keep the security for.
- The names of all the people connected with the business who have been given a NoR requiring them to give security jointly and severally.
- How the security has been calculated.
- The means by which the security should be given.
- The right of appeal.

What are the appeal rules?

An appeal must be made in writing to HMRC within 30 days of the date of the NoR. HMRC will then try to settle the matter by agreement. If that is unachievable, then HMRC will offer a review by a different HMRC officer. If agreement can still not be reached, there remains the opportunity to take the appeal to a Tax Tribunal.

If a warning letter has been received before the issue of a NoR, then representations should be made to HMRC immediately, before a NoR is issued.

What happens if the security is not paid?

It is a criminal offence not to pay a security shown on a NoR and HMRC may seek a prosecution, punishable by fine in addition to any compensation awarded by the court.

Specified Adult Childcare Credits

Given that families all have different arrangements for childcare, HMRC introduced a special Class 3 National Insurance credit known as Specified Adult Childcare Credits (SACC) in April 2011. This applies where an 'eligible family member' looks after a child under 12, as it is recognised that the family member may be looking after the child when the child's parent(s) are working.

In many cases, this will typically be where a grandparent looks after their grandchildren. But it could also include a parent who does not live with the child, a great-grandparent, a great-great-grandparent, brother or sister (including half-brother, half-sister, step-brother, step-sister and an adopted brother or an adopted sister), aunt or uncle.

SACC essentially transfers the National Insurance credit that the Child Benefit claimant would receive for entitlement to state benefits to the eligible family member. It could help reduce potential gaps in the National Insurance record of the family member looking after the child. They should receive a Class 3 National Insurance credit for each week or part week they provided care for the child.

As this is based on the Child Benefit claim, there is only one credit available, regardless how many children are on the Child Benefit claim. So, if two grandparents look after their daughter's two children, there would only be one credit and it would need to be decided which grandparent received SACC. But if those same two grandparents look after their daughter's child and their son's child, it is likely that they could both claim SACC assuming that both children are included on two separate Child Benefit claims.

There is a particular interaction with the High Income Child Benefit Charge (HICBC) rules, where one of the taxpayers in the household has an adjusted net income of more than £50,000. In some cases, parents affected by HICBC have not claimed Child Benefit because of the expected need to repay all or part of the Child Benefit received. It is considered best practice for the household to still claim Child Benefit and elect to not receive payments, in order to preserve entitlement to state benefits. But in many cases, parents affected by HICBC will simply not bother claiming Child Benefit. That decision is not without its potential consequences.

Where the parents do not claim Child Benefit and rely on a family member to look after their child, this would impact on the ability for them to transfer the National Insurance credit under SACC. It can be difficult to rectify matters, as it is normally only possible for Child Benefit claims to be backdated by three months.

CJRS: Innocent errors brought forward at tribunals

Written by Markel Tax, ICAS Evolve Partner

Based on the speed and complexity of the Coronavirus Job Retention Scheme (CJRS) rules and ever-changing guidance, innocent errors were bound to slip through. So why have HMRC taken CJRS cases to tribunal based on apparent minor technical breaches?

In the vast majority of cases, tax tribunals are primarily concerned with the merits of each party's technical arguments under common law, and as such, have no duty to consider fairness or equity in relation to appeals against HMRC decisions.

Issues of fairness or discretion are more aligned with public law, which can be considered should a judicial review application be made. As this can be a costly and daunting process, the majority of taxpayers and their advisers will restrict their appeals that cannot be resolved directly with HMRC to the tax tribunal process.

Never has the above been more appropriate than in the raft of recent decisions concerning the Coronavirus Job Retention Scheme (CJRS).

Due to the nature of the circumstances which we all found ourselves in back in early 2020, the government and HMRC were required to introduce a scheme which would process claims quickly.

Whilst there is no doubt that the scheme was predominantly a success and provided much needed support to millions, the speed at which it was introduced and the complexity of the rules and ever-changing guidance meant that numerous errors were made. Whilst HMRC's guidance said that they would not actively look for innocent errors, there have been a number of cases taken to tribunal based on what appear to be minor technical breaches.

Whilst these issues may be considered to be minor, the tribunal has been consistent with its messaging: we have sympathy with the employers, but we do not have any jurisdiction that would allow us to deviate from the legislation.

In Glo-Ball Group Ltd [2023] UKFTT 435 (TC), HMRC had identified that posts had been made onto the company's Facebook account by workers who had been furloughed, and as such, sought to reclaim the amounts that had been claimed in relation to those workers. This was despite those posts being made whilst the workers were at home, and the fact that the company's primary activity of providing children's parties had ceased due to the pandemic. The judge had sympathy with the employer, commenting that: "What business would not wish to maintain its reputation during this difficult period so that once the situation returned to normal, the business could start to generate income?" However, they still found that these posts constituted work, and upheld HMRC's assessments as a result.

In Luca Delivery Ltd [2023] UKFTT 278 (TC), the director had notified his accountant in November 2019 that his wife was to become an employee of the company with a salary of £5,000 per annum, which she began to receive in December 2019. The company even paid their accountant for processing her salary via the payroll, but due to a misunderstanding this was not done until June 2020. As a result, she did not appear within the RTI returns submitted by 19 March 2020, and was therefore considered not to be eligible for furlough. Again, the judge had sympathy with the employer, stating that whilst they may have a claim against their accountants for their failure, the tribunal had no jurisdiction to direct that HMRC could not recover the overpayments, and HMRC's assessments were again upheld.

A similar decision occurred in Carlick Contract Furniture Ltd [2022] UKFTT 220 (TC). Two workers started employment on 24 February 2020, however as this was just after the cut-off date for the February payroll, their pay for both February and March was not processed until the March payroll run, with that RTI return submitted to HMRC on 25 March 2020. As there was a requirement for employees to be included in an RTI return submitted to HMRC on or before 19 March 2020, the employees were again considered not to be eligible. Whilst the tribunal came to the only decision it could in upholding HMRC's assessments, it again expressed sympathy with the employer.

Lastly, in both Oral Healthcare Ltd [2023] UKFTT 357 (TC) & Raystra Healthcare Ltd [2023] UKFTT 496 (TC), the tribunal found that whilst they had sympathy for the employers, IT system errors which led to employees either not being included within the relevant RTI returns or RTI returns not being submitted to HMRC did not allow them to deviate from the legislation as there was no 'reasonable excuse' provision or an equivalent. In both cases, HMRC's assessments were upheld.

The above shows that until the normal time limit can no longer be utilised by HMRC, it is likely that cases involving what appear to be relatively innocent errors will be brought before the tribunal. After that, grounds for appeal concerning the speed and complexity of the scheme, as well as every-changing guidance will likely feature more heavily in appeal proceedings as arguments concerning behaviour and reasonable excuse can then be relied upon.

HMRC's list of named tax avoidance schemes, promoters, enablers and suppliers

In 2021 HMRC ran a consultation 'Clamping down on promoters of tax avoidance' which proposed a package of measures to tackle promoters of tax avoidance schemes.

The consultation highlighted that promoters of avoidance schemes often use advertising and marketing material that focuses on the promised tax benefits of the scheme – but is usually silent about the risks and what will happen if HMRC makes a successful challenge. This can leave taxpayers who have entered these schemes with significant tax bills.

The consultation set out the powers HMRC already had to publish information about schemes. However, HMRC's Spotlights, which highlight schemes that HMRC is considering and has concerns about, do not include scheme or promoter names. Spotlights can be published soon after HMRC identifies the scheme – but it could take much longer for names of promoters and enablers to be published under the DOTAS and POTAS regimes.

Publishing names of promoters and schemes as soon as possible

We supported the proposals in the consultation (subject to safeguards) to allow HMRC to be more transparent at an earlier stage about schemes and promoters it was looking into. Members of professional bodies subject to PCRT are required to advise clients on material uncertainty in the law (including where HMRC takes a different view); therefore, knowing that HMRC was making enquiries into a scheme would be relevant.

Feedback from our members indicated that it would be helpful to know, as soon as possible, that HMRC is actively enquiring into particular schemes and promoters. The client may not have been given accurate information and may have been led to believe that HMRC has 'approved' the scheme in some way. It would be useful for advisers to be able to point clients to a published statement that HMRC has concerns about a particular scheme and is enquiring into it.

After the consultation, the Finance Act 2022 included the legislation to expand HMRC's powers to publish details of promoters and avoidance schemes at an earlier stage.

List of named tax avoidance schemes, promoters, enablers and suppliers

The list is published on GOV.UK and is regularly updated. Under the Finance Act 2022 HMRC can publish:

- Name of scheme.
- Description of scheme.
- Details of persons suspected of promoting the scheme, or of being a connected person.
- Any other information HMRC considers relevant to publish about these schemes to inform taxpayers about the risks associated with the scheme and protect public revenue.

The details can be published at an early stage when HMRC may have limited information, but has a suspicion that a scheme involves tax avoidance. The published information must be amended or withdrawn if it turns out to be incorrect or misleading in a significant respect.

HMRC also publishes other information about avoidance schemes, including a list of schemes subject to a 'stop notice' under the POTAS regime and the Spotlights.

EMI share option scheme in a company owned by an employee ownership trust

Regardless of the ownership of a company it is important to incentivise and motivate key employees, and this is no different where a company is owned by an employee ownership trust. It is possible to have an Enterprise Management Incentive (EMI) scheme in such a company.

Care must however be taken where a company has a small number of employees and it is proposed to grant options of 5% or more of the share capital of a company owned by an employee ownership trust.

Section 236J TCGA 1992 covers the all-employee benefit requirement of the employee ownership trust legislation. An "excluded participator" is not an eligible employee.

An excluded participator is a participator who is beneficially entitled to, or has rights to acquire, 5% or more of the ordinary share capital, and anyone connected with such a person.

One of the requirements of the employee ownership trust reliefs is the limited participation requirement. Condition D, contained in section 236N, is that at no time in the period beginning with the disposal and ending on 5 April following did the participator fraction exceed 2/5.

The participator fraction is calculated as:

- The number of employees who are 5% participators, together with the number who are employees or directors and connected with another employee or director who is a 5% participator, divided by the total number of employees of the company or group.

Not meeting the 2/5 requirement will deny the availability of the capital gains tax relief to the vendor shareholders. If subsequently there is a disqualifying event then section 236P can result in a capital gains tax charge in the trust based on the difference between the market value of its shares and the seller's original base cost. If the trust has not disposed of its shares, then it may not have funds to pay this charge.

One of the disqualifying events is that the participator fraction exceeds 2/5. As noted above, the fraction is basically the number of employees who are participators divided by the total number of employees.

In companies with few employees, but a number of EMI option holders, then rights to acquire 5% or more could result in a capital gains tax charge. Such circumstance may be rare in practice but the granting of EMI options, and indeed other share options could result in significant and unexpected tax liability.

Splitting the company

It is quite common for the shareholders of a company or group to want to either separate divisions of a company, into two or more separate companies which they continue to own or, in other instances, for individual shareholders to go their separate ways each with part of the business in their own company.

At its simplest, shareholders could purchase a division or group company but they would generally require to have the necessary funding to be able to affect this.

The reasons for such a split may be:

1. Shareholders wishing to separate a property business from the main trading business in a single company. This situation often arises where shareholders are getting older and feel that they could continue to operate a property rental business but would wish to retire from the trading company and dispose of its shares.
2. An offer is received to acquire a trading company but the purchaser may not want or have the funds available to finance the acquisition of the property division.
3. The second or third generation of a family property business may wish to go their own ways with their own property business, rather than be minority shareholders along with other relations, in a larger property company.

The answer may be to carry out a demerger.

Depending on the circumstances, this may be possible without giving rise to income tax, capital gains tax, corporation tax, stamp duty, land tax or land and buildings transactions tax liabilities.

Where two trading divisions of a company are to be separated, or two (or more) trading companies are to be separated, then a statutory demerger falling within section 1091 CTA 2010 may be possible. However, a statutory demerger is not possible unless we are dealing with trading divisions or trading companies. A statutory demerger is not possible where an investment business or company is to be demerged. Similarly, HMRC clearance will not be given where it is proposed to dispose of one of the companies after the demerger.

It is possible for a demerger to be carried out where there is either an investment business or a proposal to dispose of one of the demerged businesses, under the provisions of section 110 of the Insolvency Act 1986. Many companies do not however like to be associated with a group member being liquidated as, a section 110 reconstruction involves the liquidation of a parent company, often formed for the purpose.

Again, advance clearances are normally sought from HMRC when adopting the section 110 route.

The more common procedure is now a capital reduction demerger.

In simple terms, a parent company reduces its share capital and transfers these shares in one or more subsidiaries to a company owned by some, or all, of the shareholders of the original company.

Where the objective is simply to separate two businesses, with the shareholdings in the original company being mirrored in the shareholdings of the new company, it should be possible to achieve the separation with HMRC advance clearance.

At its simplest, this is likely to involve:

1. Formation of a new holding company “Holdco” which will issue its shares to shareholders pro rata to their holdings in the existing company. This should also result in a sufficient share capital to allow Holdco to reduce its capital in step 4 below.
2. One of the businesses is hived up to Holdco, often by way of distribution in specie.
3. The shareholders form another new company “Newco”.
4. Holdco reduces its share capital by an amount equivalent to the remaining value of the existing company, which it transfers to Newco (Debit share capital and credit investment in subsidiary).
5. In consideration for the transfer of the existing company, Newco issues its own share to the individual shareholders of Holdco.

However, where, for example, two siblings, A and B wish to split a property portfolio and each go their separate way with their own property company then, A will form Newco. The reduction of Holdco’s share capital apply to the shares held by A, and Newco will issue further shares to A. At the very least, there is likely to be a stamp duty cost.

HMRC clearances will generally be sought under section 138 TCGA 1992, section 139(5) TCGA 1992, section 701 ITA 2007 and section 748 CTA 2010.

The demerger must be carried out for commercial reasons and it is necessary for businesses to be demerged and not merely ‘separation of an asset’ from the business.

Immediately post transaction, exemption from stamp duty under section 77 FA 1986 and perhaps also under section 75 FA 1986 should be sought from HMRC, if available.

Clients should be warned that there will be a lot of legal documentation to be signed, as part of the process.

Cyber security actions

Written by David Fleming, Chief Technology Officer at Mitigo

Millions of cyberattacks take place every year and many thousands of businesses, including accountancy firms, are seriously damaged as a result.

The advancements in, and availability of attack technology and the use of AI (Artificial Intelligence) means that criminals can now discover and evaluate weak points in every business, whatever the sector, regardless of the size. For firms to effectively plan a defence against the attacks they must first understand where their vulnerabilities lie.

Cyber security vulnerabilities in 2023

A successful attack can make money for the criminals in several ways. They may trick a human (staff/customer/supplier) into sending money to a fraudulent bank account. Or they may steal something valuable, such as sensitive confidential proprietary or client information, in order to blackmail you into paying a ransom for its return. That confidential information may still then be used to attack you or your clients or extort money from them. Ransoms are also frequently paid in order to regain business functionality, after criminals have encrypted data and systems.

The criminals first find a way into your business through the gaps in your defences (these are known as vulnerabilities). Mitigo assess hundreds of businesses a year and set out below are the areas we are currently finding provide most opportunity for the criminals.

Remote working

Staff working away from the office provide many attack opportunities. Have you specifically reviewed your remote working set-up from a cyber security perspective?

Have a look at our video for some pointers on how well you've set-up your remote working.

Email platforms

Thousands of email accounts are hijacked weekly and exploited by criminals. There are two common areas that these criminals often exploit:

1. Authentication methods – just relying on username and passwords is not enough. Typically, over 20% of untrained staff fall for the simulated phishing email attacks that we run for clients. This is how usernames and passwords are stolen.
2. Spoofing controls – fraudsters can fake your email address. This is called spoofing. There are three domain records (SPF, DKIM and DMARC) that need to be properly configured by your technical support to stop this.

Software patching

Having an effective patching regime is critical to your cyber resilience. Security patches are released by suppliers which in turn notify everyone (including criminals) of newly discovered software flaws.

Staff digital behaviour

Most successful attacks rely on human error at some stage, which is why staff training combined with proper governance is so important. Three key areas to consider are:

1. Passwords: How disciplined are you? Do staff use strong passwords, and do they know how dangerous it is to use work emails and passwords for non-work purposes? And do you really know if the rules you set are being enforced?
2. Information transfer: Are you really in control of the way data is transferred and stored? To keep your data secure, avoid transferring information via G-drives, Drop Boxes, and on WeTransfer.
3. Speed and trust: How quick are staff to trust and press links on their mobile phones? Might your staff fall for the criminals' ever more sophisticated tricks?

Cloud services

At its worst, cloud can mean loss of control and lack of risk visibility. Have a look at our video for some pointers on how well you've set-up your cloud services.

Supply chain weaknesses

Third parties who provide services to your organisation are often one of the weakest links in your cyber security. Most commentators are predicting a growth in supply chain attacks this year. This article from the NCSC provides a good explanation of the risks involved.

Cyber security action plan

When considering the steps to set out in your cyber security action plan, there are a few key areas to consider which can help secure your business from cyberattacks.

1. Cyber security vulnerability assessment

You must start by identifying your biggest risks and the vulnerabilities that need closing.

The list of common vulnerabilities mentioned above is a good starting point for this process. Consider how well each of those areas has been set up. Do you have evidence that cyber security has been properly considered? Make sure you review where your valuable information is kept and the way your payments process operates, as these are common targets.

You may have heard of cyber security buzzwords like penetration testing, vulnerability assessments, and network security scanning which will all help you assess your vulnerability to attack. A good starting point would be to use Mitigo's cyber security assessment tool which allows you to understand areas of your firm which may be most vulnerable to attack.

2. Cyber security policy

Define how the business will work to reduce risk, for example, explain to employees what acceptable personal use of a work device is.

We recommend that you define your policy in key areas. Examples include - digital usage and behaviour, passwords and access management, and information storage and transfer. Then make sure all staff are aware of the rules and what is expected of them.

You must have a defined policy in place for software patching, back-up testing and virus protection to include clarity on actions and responsibilities. It is then important that you find a way of measuring compliance.

This may sound onerous, but it is absolutely necessary, and it is an expectation of regulators and the Information Commissioner's Office (ICO).

3. Vulnerability closure, strong controls, and alerts

Once you have completed the steps above, you need to make sure you close the vulnerabilities identified, that technical policies are implemented and that the right system controls are set up to protect you. It is essential that someone suitably qualified advises on how properly to configure your software and hardware from a security perspective.

The work here obviously depends on how your business operates, but here are just 3 examples of what we look for during our assessments.

1. Anti-virus software:

Is it on every device; is it being kept up to date; can it be locally switched off; has it been 'loosened' too much and is someone centrally viewing the critical alerts?

2. Windows network patching:

Are Windows patches being deployed on time to laptops, PCs and servers? How long can a laptop go without a critical patch being deployed?

4. Email account login failures:

If you are on Office365 someone should be alerted to suspicious login attempts and you should be configuring the controls to restrict who has access to your systems.

5. Cyber security training

Make sure that regular training keeps staff alert to the risks. It's time to invest in some good cyber security training and we believe that getting simulated attacks done frequently will improve your cyber security culture.

6. Incident response training

Yes, the worst does sometimes happen. In most cases fast, pre-planned emergency response arrangements can massively reduce the impact on your business. Start by getting the key people in a room and discuss how you would go about dealing with a ransomware attack. Write down your plan, communicate it and practise it.

Regulation news

ICAS launches new AML monitoring regime

Find out what the new AML monitoring regime means for you and your firm including:

- Why have we changed the regime?
- What are the main changes?
- How often will a firm be reviewed?
- How are firms reviewed?
- What are the benefits of this?

Read the full article and access our FAQ document to find out more.

Changes to ICAS' Public Practice Regulations

Council recently approved several changes to the Public Practice Regulations which should be reviewed by all practice firms since they take effect from 2 September 2023.

The changes relate to:

- Alternates
- Use of the description 'Chartered Accountants' by firms
- Holding out as a principal

Read more about what this means for you and your firm.

Guidance for audit firms: ISQM (UK) 1 – a reminder

International Standard on Quality Management (UK) 1 (ISQM (UK) 1) replaced International Standard on Quality Control (UK) 1 (ISQC (UK) 1) effective from 15 December 2022.

A reminder of the key requirements, the implications for monitoring visits, what the monitoring team are finding on visits and a reminder of the resources available can be found here.

What should I do if my client leaves?

When a client tells you they are moving to a new accountant, it can come as a surprise.

Read our five steps you should take to ensure you meet your professional and ethical obligations.

ICAS vision for excellence in regulation

ICAS have launched a new ICAS Regulation Strategy setting out the new vision for regulation.

Find out more about what the regulatory function does and why it is essential for protecting and promoting trust in the accountancy profession.

The future of insolvency regulation

ICAS supports the UK governments decision not to create a single regulator for the insolvency profession.

Read more of the responses from Robert Mudge, Executive Director, Regulation and David Menzies, Director of Practice at ICAS.

Tax advice: Professional standards and conduct

Find out more about the ongoing work to improve standards in the tax advice market, what Professional Conduct in Relation to Taxation (PCRT) means and what the updated standards mean for CAs.

New Suspicious Activity Reporting Portal

The new National Crime Agency (NCA) Suspicious Activity Reporting Portal is now open to all reporting organisations.

Any ICAS AML supervised firm can now register and immediately begin submitting SARs. Once registered, the SAR Portal will become the sole route by which you should submit reports.

It is recommended that registration is completed as soon as possible as the current SARs Online System will be decommissioned later this year.

For further guidance visit the NCA website.

Engaging positively with a complaint?

Even the most diligent CAs can find themselves on the receiving end of a complaint.

How you manage a complaint to ICAS can have a significant impact on the outcome – read our useful pointers here.

HMRC and Companies House updates

Changes to VAT on sales of second-hand cars in Northern Ireland

The way VAT-registered businesses account for VAT on used motor vehicles which they buy in Great Britain (GB) and move to Northern Ireland (NI) for resale, has changed. HMRC has contacted impacted businesses to remind them about the action they may need to take before 31 October 2023.

VAT margin scheme

If businesses have second-hand motor vehicles in stock that they bought in GB and moved to NI before 1 May 2023, they can continue to use the VAT margin scheme if those vehicles are sold by 31 October 2023. If they are sold after 31 October 2023, the business will have to account for VAT on the full selling price of the vehicles.

Second-hand motor vehicle payment scheme

The new second-hand motor vehicle payment scheme was introduced on 1 May 2023. If businesses bought second-hand vehicles in GB and moved them to NI on or after 1 May 2023 for resale, they may be eligible for a VAT-related payment under the new scheme. This scheme has replaced the VAT margin scheme in such cases. Although VAT will be charged on the full selling price of the vehicle when it is sold, this payment will ensure that businesses selling in NI will pay the same net amount of VAT as if they had continued access to the VAT margin scheme for these vehicles.

Chartered Accountants Ireland are ‘discussing the impact of this deadline with HMRC’.

Reporting rules for digital platforms

New rules are being introduced that will require digital platform operators in the UK to collect and verify information about users selling goods or services on their platforms. Digital platform operators will have to report this information to HMRC. HMRC will use the information to help sellers get their taxes right and identify, and tackle, non-compliance.

Digital platform operators will also have to provide sellers with a copy of the information they sent to HMRC. This will help sellers to get their taxes right.

Digital platform operators must start collecting information from 1 January 2024. The first reports are due by 31 January 2025.

It is anticipated to impact digital platforms which facilitate the provision of taxi and private hire services, food delivery services, freelance work and the letting of short-term accommodation.

Overlap Relief – preparing for the new tax year basis

On 11 September 2023, HMRC is launching an online form for submitting requests for details about overlap relief. This will provide an easier way to submit requests and make sure that these are dealt with separately from general post.

HMRC will be publishing additional accompanying guidance on overlap relief and changes to the rules for the new tax year basis. The guidance on changes to reporting income from self employment and partnerships is available on GOV.UK.

Taxpayers with an accounting date other than 31 March or 5 April who are affected by the move to the new tax year basis may need to find out the details of their overlap relief. They’ll need to do this ahead of submitting returns for the 2023 to 2024 transitional year.

Overlap relief information can only be provided if these figures are recorded in HMRC systems, taken from information submitted by taxpayers as part of previous tax returns. If this information has not been submitted in tax returns, HMRC will not be able to provide it. However, in these circumstances, it may be possible to provide historic profit figures, to allow overlap relief to be recalculated.

Further information on overlap relief and basis period reform is provided in the Business Income Manual and HMRC is also running a series of webinars for agents (under ‘Live webinars’) about the new tax year basis.

Removal of functionality to copy across existing VAT clients to agent services account

When using their agent services account (ASA), agents can copy over existing client relationships for VAT and Income Tax Self Assessment (ITSA) customers from their old Government Gateway ID.

HMRC will be removing the functionality to copy across existing VAT clients to ASA from October this year. Ensure that your existing VAT clients are copied across to your ASA before this date.

Once this functionality is removed you can authorise VAT clients using the digital handshake authorisation route available in your ASA.

The copy functionality will remain for ITSA customers.

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