CAPS TECHNICAL BULLETIN

ISSUE No 133
AUGUST 2015

SOME SUMMER BUDGET SURPRISES

The 2015 Summer Budget was a mixture of proposals which had been pre-announced mixed in with a number of surprise announcements.

Among the good tidings are the reduction in the main corporation tax rate to 19% with effect from 1 April 2017, and then to 18% with effect from 1 April 2020. The rates are simply stated, though it will not be as simple to compute a company's chargeable profits to tax. These complexities, however, are nothing new and are to be coped with.

The Chancellor has listened and the annual investment allowance will be set at £200,000 from 1 January 2016. Unless he later changes his mind, the annual investment allowance will remain at this level for a number of years, which should give business the certainty to plan, and not push them towards purchasing plant and equipment earlier or later than commercial sense would otherwise dictate.

Dividend Tax Allowance

For a number of years now, it has been beneficial, from a tax point of view, for company owner/managers to remunerate themselves by way of dividends rather than salary. Many have worried that national insurance may be applied to close company dividends. Instead, the Chancellor has proposed that the notional tax credit attaching to dividends be abolished from 6 April 2016, and in place of the notional tax credit, there will be a dividend tax allowance of £5,000 per annum. This will certainly help higher-rate taxpayers who receive modest dividends from companies that will be covered by the dividend tax allowance. However, above this threshold, basic-rate taxpayers will suffer income tax at 7.5% on their dividends, higher-rate taxpayers will suffer tax at 32.5% on what will become a net dividend but without deduction of a notional tax credit. At present, a higher-rate taxpayer suffers income tax at an effective rate of 25% on the dividend received. As for an additional rate taxpayer, there will be a similar increase from what is currently borne on his dividend income which is taxed at an effective rate of 30.55% on the net dividend, to an effective rate of 38.1% once the dividend tax allowance is introduced and taken into account. This is quite a clever and unexpected way of simplifying the tax system, by removing the notional tax credit and removing any small investors from suffering income tax at all on their dividends, while at the same time raising tax from individuals who have substantial investment portfolios or draw dividends from their own private companies.

Inheritance Tax

The Chancellor has also been canny in providing additional tax reliefs against inheritance tax, but restricting them so that the really well-off do not benefit. An example of this is the inheritance tax main residence nil rate band, which does not come into effect until after 5 April

ICAS

2017, so this will no doubt make further appearances in forthcoming pre-budget reports and at least one further budget. The idea is that where a residence is passed on death to a direct descendent, such as a child or grandchild, an additional nil rate band of £100,000 will be available after 5 April 2017; £125,000 after 5 April 2018; £150,000 after 5 April 2019; and £175,000 after 5 April 2020. This will then rise in line with the consumer prices index. A slight sting in the tail is that the present £325,000 nil rate band will remain until at least 5 April 2021.

There had been criticism by some commentators that a main residence inheritance tax relief might encourage older people to remain in a large valuable property until death rather than downsizing and freeing up larger properties for younger families. The Chancellor has said very cleverly that, where a person downsizes or ceases to own a home altogether after 7 July 2015, then assets of an equivalent value, up to the additional nil rate band can be passed on death to direct descendants, taking advantage of the additional nil rate band.

If an estate has a net value of more than £2m, then the additional nil rate band is withdrawn at a rate of £1 for every £2 over the threshold and so the Chancellor can hold up his head and say that this will only benefit the modestly wealthy and not the super rich.

Where an individual is lucky enough to own two residences then, on death, his executors can nominate which residence they would like the additional nil rate band to be set against.

Furthermore, if all or part of an additional nil rate band is not utilized on the death of the first spouse, the unused portion can be transferred for use against the estate of the surviving spouse on second death.

Non-domicile

Non domiciled individuals, who are perceived to be very wealthy, have again been targeted. From 5 April 2017, an individual who has been resident in the UK for more than 15 of the last 20 years will be deemed to be domiciled in the UK for all tax purposes, not just inheritance tax. Furthermore, from the same date, individuals who are born in the UK to parents who are domiciled here will not be able to claim to be non domiciled at any time when they are resident in the UK.

From the same date, inheritance tax will be payable on all UK residential property which is owned by a non domicile, including the property which was held through offshore structures.

Pensions

In the run up to every Budget the pension providers produce dire warnings of the possibility of tax relief on contributions being restricted in some way, perhaps to basic rate relief only. While it is not as bad as that, from 6 April 2016, there will be a restriction of the £40,000 annual allowance where an individual has income of more than £150,000. This restriction will be tapered by £1 for every £2 that an individual's adjusted income exceeds £150,000 with a maximum reduction of £30,000. The effect of this is that certain high earners will only be able to contribute £10,000 per annum, which seems a very strange thing indeed, bearing in mind that the lifetime allowance is being reduced to £1m with effect from 6 April 2016.

For those of you who have heard of pension input periods, any that were open on 8 July 2015 closed on 8 July 2015 and thereafter, pension input periods will end on 5 April. This removes a confusing and complex provision which, in some instances, allowed individuals to contribute additional amounts to their pensions in a particular tax year.

Corporation Tax payments on account

Ending on what large companies may consider to be bad, but for which many will have little sympathy, with effect for accounting periods starting after 31 March 2017, companies with annual taxable profits exceeding £20m will have to pay their quarterly instalments sooner than at present in the 3rd, 6th, 9th and 12th months of their accounting period. Larger companies will therefore have paid their corporation tax liabilities in the accounting period, and the Chancellor will have obtained a one off acceleration of corporation tax receipts by some 3 months.

While there will be some simplification, we can probably expect another monster Finance Act with more complexity, greatly exceeding any simplification that might have been achieved between this and the last Finance Acts, and the Office for Tax simplification will be pulling out its hair!

WHY INCORPORATE A PARTNERSHIP?

Many businesses, particularly professional services firms, operate as partnerships because of the flexibility which this business vehicle offers. Some partnerships, however, transfer their businesses into limited companies with the shareholders and directors being the former partners, and there can be various reasons for such a move to incorporate:

1. **Limited liability**. Historically, this has been one of the main reasons for transferring a business into a limited company because, except where the individuals have given personal guarantees, any liabilities incurred by the company remain liabilities of the company; and assets owned by the individuals are not put at risk by what happens to the company's fortunes. For a number of years now however, limited liability partnerships have been available offering the 'limited liability' benefits of a company while retaining the flexibility of the structure of a partnership.

   Members of a partnership sometimes organise their personal affairs in such a way that their spouse owns all of the personal assets such as the matrimonial home, bank deposits and other investments. This protects the family assets if the partnership were to fail, as otherwise the unlimited liability of a partner could result in all of his personal assets being wiped out. This is all very well but sometimes both spouses are members of a partnership, while other times an individual in an unstable marriage may feel that the financial risk exposure is higher if the spouse were to hold the personal assets than it would otherwise be if assets were jointly owned.

2. In terms of capital financing, it is often more straightforward for a limited company to raise a loan with a bank or to raise capital in other ways, such as through the issue of shares and loan instruments. Some banks find it easier to lend to corporate entities than to individuals.

3. Where the partners do not need to draw all of the firm's profits, and are prepared to leave some profits to accumulate in their capital accounts, operating as a limited company instead could provide a deferral of tax liabilities. A company would suffer corporation tax at 20% on profits not drawn by way of salary or bonus by the director/shareholders. This can be contrasted with the situation where partners are subject to income tax on the profits of the firm, not just what they draw from it. Against this, many people prefer to operate as a partnership, where they are drawing out most if not all of the firm profits, as the national insurance suffered by a partner is significantly less than a combination of employees and employers national insurance payable on a salary or bonus. Extracting profits from a company by way of dividend can be more tax efficient, but dividends are payable in proportion to shareholdings and the acquisition of shares and disposal of shares to facilitate dividend payments can be quite complicated.

4. Many partnerships incorporated to take advantage of the 10% rate of capital gains tax on the sale of goodwill, as a result of relief mechanisms under the former taper relief and now the entrepreneurs' relief, where a goodwill value could be justified. Anti-avoidance legislation has been introduced to deny entrepreneurs' relief against capital gains tax for goodwill disposal, and also the possibility of the acquiring company amortising the goodwill and obtaining corporation tax relief. The disposal of goodwill is now subject to capital gains tax at the full 28% rate unless the disposal qualifies for relief as a business asset and is in exchange for shares using the provisions of section 162 Taxation of Chargeable Gains Act (TCGA) 1992, or alternatively gifting the chargeable assets to the new company and making an election under section 165 TCGA 1992.

   When a partnership business is transferred into a limited company, a frequent question is whether the properties owned by the partnership should be transferred or retained by the partners. Underlying this question is the concern that in the event of the company failing, then all of its assets would be exposed to claims by creditors. Financially, the individuals operating as a limited company with all the assets owned by the company are in no different position than when they were operating as a partnership. Had the partnership failed, then all of the assets owned by the individuals, including their interests in the business properties, would be available to creditors. So, to make the position different, should the business premises be retained by the former partners?

   If the business premises are retained by the individuals, there can be a couple of tax disadvantages:

   - Section 162 relief outlined above will not be available as not all of the assets are being transferred to the new company;
   - 100% business property relief is no longer available on the business premises, albeit relief will be available at 50% on the death of an individual who owns the property personally and controls the company which uses a property in its trade.

The best of both worlds may be obtained where the trade and assets of a partnership are transferred into a new holding company, which shortly thereafter transfers the trade, but not the property, down to a wholly owned subsidiary. The shareholders will be shareholders in the holding company of a trading group and 100% business property relief should be available. Furthermore, were the trade carried on in the subsidiary to fail, then save for any cross guarantees between the holding and the subsidiary, creditors of the subsidiary will have no claim against the assets of the holding company.

CHANGING ASPECTS OF INCORPORATION – SUMMER BUDGET 2015

The June 2015 Technical Bulletin considered changes in Finance Act 2015 to the treatment of capital gains on goodwill when incorporating an unincorporated business.

Following the Summer Budget there are now a number of new tax factors to be taken into account when considering the incorporation of a business. Not all of these changes take effect immediately; full details for many of the proposed changes are yet to be published, and there may be further changes as the Finance Bill passes through Parliament. With this proviso, the proposed changes are highlighted for reference here.

Changes to dividend taxation

These will take effect from 6 April 2016. The Dividend Tax Credit will be removed and replaced by a new tax-free Dividend Allowance of £5,000 a year for all taxpayers. Dividend tax rates will be set at 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. Precise details of how this will work have not been published yet and a number of different interpretations have been suggested. However where significant dividends are paid there will be an increase in tax.

The Budget Red Book specifically states that ordinary investors with modest dividend income will see no change in their tax liability and some will pay less tax but those with significant dividend income, including those "*receiving significant dividends through a closed company*", will pay more. It went on to say "*these changes will also start to reduce the incentive to incorporate and remunerate through dividends rather than through wages to reduce tax liabilities. This will reduce the cost to the Exchequer of future tax motivated incorporation by £500 million a year from 2019/20.*"

Further reductions in the Corporation Tax rate

The Summer Budget announced that for Financial Years 2017 to 2019 the rate will be 19% with a further reduction to 18% from Financial Year 2020. These changes have been included in the recent Finance Bill.

According to the Budget Red Book, the corporation tax rate cuts delivered since 2010 will save businesses £10 billion a year from 2016. The further cuts for 2017 to 2020 will "save small and large businesses a further £6.6 billion by 2021". However as the Red Book also makes clear the changes in dividend taxation are intended to reduce the incentive to incorporate which might have been enhanced by these further reductions in CT rates.

The Summer Budget also announced that there will be new payment dates for corporation tax but these will only affect companies with annual taxable profits of £20 million or more.

Removal of employment allowance for one person limited companies from 2016

The NICs Employment Allowance will be increased from £2,000 to £3,000 a year from April 2016. However companies where the director is the sole employee will no longer be able to claim it.

The Red Book explains that the exclusion is intended to ensure that the Employment Allowance is "*focussed on businesses and charities that support employment*".

For small companies which do have other employees, the intention of the increase is to allow firms to continue "to employ 4 workers full time on the new National Living Wage next year, without paying any NICS."

Review of IR 35

In the Summer Budget the government announced that "*HMRC would start a dialogue with business on how to improve the effectiveness of the existing intermediaries legislation, commonly known as IR35.*" A discussion document published on 17 July states that there is a growing body of evidence suggesting significant non-compliance with the current rules.

One option proposed is to make engagers take on more of a monitoring role. Those engaging a worker through a Personal Service Company would need to consider whether IR35 applies and, if so, to deduct income tax and NICs as they would for employees. Either as part of this proposal, or as part of any other reform, the test for deciding whether IR35 applies could be simplified, possibly by aligning it with the test used for temporary workers in the agency rules.

The outcome of this consultation could have significant implications for anyone using, or contemplating using, a personal service company.

Abolition of Class 2 National Insurance Contributions

Before the General Election the government had announced that it would abolish Class 2 NICs and reform Class 4 NICs to introduce a new contributory benefit test. The Summer Budget included the announcement of a consultation on implementation to be held in autumn 2015. The overall effect on unincorporated businesses is therefore currently unclear.

Individuals' property businesses: interest relief from 6 April 2017

The Summer Budget announced that relief for finance costs (such as mortgage interest) will be restricted to the basic rate of income tax. The change will be introduced gradually from 6 April 2017. Landlords will not be able to deduct all of their finance costs from their property income to arrive at their taxable property profits. Instead they will get a basic rate reduction from their income tax.

The phasing-in will work as follows:

- 2017/18: the deduction from property income (as is currently allowed) will be restricted to 75% of finance costs, with the remaining 25% being available as a basic rate tax reduction.
- 2018/19: 50% finance costs deduction and 50% given as a basic rate tax reduction.
- 2019/20: 25% finance costs deduction and 75% given as a basic rate tax reduction.
- From 2020/21: all financing costs incurred by a landlord will be given as a basic rate tax reduction.

The legislation has been included in the recent Finance Bill which provides that it does not apply to a property business carried on by a company other than where it is acting in a fiduciary or representative capacity. It also includes provisions which will mean that creating a partnership to hold the let property and borrowing to invest in the partnership will not avoid the restriction.

According to the Red Book the purpose of the change is to "*reduce the distorting effect the tax treatment of property has on investment and mean individual landlords are not treated differently based on the rate of income tax that they pay. It will also shift the balance between landlords and homeowners*". It also refers to the Bank of England's *Financial Stability Report* which noted that the rapid growth of buy-to-let mortgages could pose a risk to the UK's financial stability.

Is incorporation worthwhile?

This still depends on the precise circumstances of each unincorporated business, which will need to be analysed in detail. The Summer Budget has added some new tax factors to be taken into account and in some cases the position may not be clear until full details of proposed and possible changes are available.

It also remains very important to think about non-tax issues. For example limited liability could be one factor pointing towards incorporation but on the other hand companies are subject to the requirements of the Companies Act and the filing requirements for returns.

Disincorporation

Finally it is worth mentioning briefly the possibility of disincorporation for those who may decide that they no longer wish to trade as a company. Disincorporation has numerous tax consequences and is not straightforward. The Office of Tax Simplification recommended in 2012 that some form of tax relief should be introduced to help those who wished to disincorporate.

Finance Act 2013 subsequently introduced a disincorporation relief to allow transfers of goodwill and interests in land to shareholders without corporation tax arising on the transfer. It is available for transfers occurring in the period of 5 years from 1 April 2013 provided various conditions are met. However, it does not address all the tax consequences of disincorporation and there are also non-tax factors to consider so this remains an option requiring careful consideration.

HMRC INFORMATION POWERS

Introduction

It is the hope and dream of most practitioners that enquiries under Section 9A of Taxes Management Act (TMA) 1970 into a specific aspect of a client's tax return or into the tax return itself will progress smoothly, that a satisfactory conclusion will be reached with HM Revenue & Customs (HMRC) in as short a period of time as possible, and that the client suffers as little stress as possible. The same applies to an enquiry into a partnership (s12AC TMA) or into a company (Para 24 Sch 18 FA1998). In the best scenario, an enquiry may be concluded without any adjustment being made to the tax return at all.

Assuming the client is in business whether as a sole-trader, via a partnership or a company, any additional professional costs related to the enquires will be deductible in establishing the client's profits for periods of account of the year(s) in which the enquiry took place.

Enquiry practice

In its opening letter of enquiry, HMRC will indicate that a reply, with all the information sought, must be submitted to it by a specific date. That date could be attainable or might appear to be impossible to meet. If it appears to be a tight time scale then a letter or a phone call to HMRC setting a more realistic target date is a good idea. Remember the HMRC's "deadline" carries no statutory weight, at least not at this point on serving a letter of enquiry.

However, it may prove more difficult to meet that re-negotiated cut-off date with HMRC once the full extent of HMRC's enquiries are considered in depth. A further request to HMRC for more time may have to be sent. This may draw a response along the lines that HMRC will be prepared to agree to the extension of time on this occasion, but any further delays may result in HMRC relying on its "information powers" under Sch 36 FA 2008, of which more later.

Records to be kept

In preparing an individual's tax return the records required may appear to be obvious. Certificates of bank interest received, dividend counterfoils, stockbrokers' sale contract notes are all documents to which we are accustomed.

For those in business on their own account, the "records" test may appear more onerous, bearing in mind that clients are required, in terms of s12B TMA, to "*keep all such records as may be requisite for the purpose of enabling him to make and deliver a **correct and complete** return for the year or period*" (emphasis added). We often advise clients on a record keeping system for their business and it is important that, whatever method is put in place, it is sufficiently robust to meet the test set out in s12B(3) regarding the records required to properly identify income and expenditure.

The time limits for retaining records are also enshrined in s12B TMA. For those in business or carrying on a trade or profession the date to observe is "*the fifth anniversary of the 31 January next following the year of assessment …*". For all other taxpayers the time limit to keep records is "the first anniversary of the 31 January next following the year of assessment". Interestingly, in a recent edition of its "*Tax help series – Keeping records for business – what you need to know*", HMRC state: "*As a general rule, you should keep your records for a minimum of six years*". It is probably best to follow that advice!

VAT record keeping

VAT legislation has its own set of statutory rules with regard to record keeping.

Para 6(3) Sch 11 Value Added Tax Act (VATA) 1994 imposes a "period not exceeding 6 years", but in terms of the provision, permission may be sought from HMRC to retain records for a shorter period. Para 6(4) sets out the form in which records should be kept as augmented by Reg 31, SI 1995/2218.

VAT Notice 200, which was updated as recently as 1 April 2015, gives comprehensive guidance on the retention of VAT records. Para 19.2 provides the specific detail including the advice that "*You must get the agreement of HMRC before destroying any of your business records that are less than 6 years old*".

It should also be remembered that in addition to all accounting and business records the following additional records are required by statute:

- VAT account
- VAT sales and purchase invoices
- Import and export documentation, for example, delivery notes.

These provisions apply equally to sole traders, partnerships and limited companies.

It goes without saying that there are penalties applicable for failure to retain adequate records for both direct and indirect tax.

Information powers

Having established a right to enquire, HMRC are supported by powers to compel taxpayers to produce the documents or information it believes are relevant to its enquiry. In looking at "Enquiry Practice" above, a hint was given as to the steps HMRC might take if information is not supplied to it in keeping with timescales agreed with the taxpayer's agent.

The powers to compel were codified in Sch 36 Finance Act 2008, and are not new as such, but they are novel in that there is now one system to cover both direct and indirect tax.

Production of documents

It will be remembered that previously ss19A, 20 and 20A TMA 1970 gave the Inland Revenue and then HMRC wide powers to obtain documents and information from taxpayers and third parties. The taxpayer or other party had to be given a reasonable opportunity to supply the information sought by HMRC. The previous rules were unsatisfactory in that HMRC could seek such a notice from the General or Special Commissioners. The taxpayer was entitled to make written representations, but the hearing itself was ex parte with only HMRC's representatives in attendance. Sadly, certain aspects of these powers open to HMRC remain in their armament, particularly in terms of Part 2 to Sch 36 FA2008, which deals with the "Power to Inspect Business Premises".

Para 1 of Schedule 36 to FA2008 appears to be in innocuous terms at first blush:

"*(1) An officer of Revenue and Customs may by notice in writing require a person ("the taxpayer") –*
(a) to provide information, or
(b) to produce a document;

if the information or document is reasonably required by the officer for the purpose of checking the taxpayer's tax position."

HMRC take this to mean: "*Information or an inspection can only be reasonably required where it could affect a person's tax position.*"

However, from its Compliance Handbook at Para CH21620, HMRC further explain that:

" *'Reasonably required' means getting the balance right between*

- *the burden put on someone to provide the information or face an inspection, and*
- *how important the information or inspection is in deciding on the correct tax position.*"

Similar powers are set out in Sch 36 in respect of third-party notices to which reference is made later in this article.

It is important to have a grasp of what may be "reasonably required" by HMRC on the one hand, and on the other hand what kind of documents or information do not sit comfortably within the definition.

The First-tier Tax Tribunal (FTT) considered the concept of "reasonably required" in the case of **Dr Kathleen Long v HMRC [2014] UKFTT 189 (TC)**. An enquiry into Dr Long's 2010/11 tax return under s9A TMA was opened by HMRC. A meeting between HMRC and Dr Long took place, during the course of which it was recognised that some errors had been made in Dr Long's accountancy records as a result of which "*out of a total income of about £190,000, some £7,300 of cash sales had been omitted from the return ie a little less than 5%.*" Following the meeting HMRC wrote to Dr Long requesting further information, which included her business appointments diaries. Dr Long declined to supply her diaries explaining they contained confidential patient information.

A notice under Para 1 Sch 36 FA 2008 was then issued for the submission of the diaries to HMRC. In its accompanying letter HMRC stated:

"*The appointments diary will help me check your income and expenditure.*"

Having been offered an internal review by HMRC, which Dr Long accepted, HMRC maintained its line "that Dr Long's duty of confidentiality was overridden by the statutory provision authorising the information notice".

The appeal came before the First-tier Tax Tribunal (FTT), which indicated that there were two issues to consider:

- were the business diaries "reasonably" required to check the tax position, and
- did the confidential nature of the diaries mean that they did not need to be submitted to HMRC?

The FTT judge, Mr Gordon Reid QC decided that:

"*… it seems to me to be impossible to hold that the business appointments diaries are reasonably required in order to check the taxpayer's position. They contain no financial information. They are not necessarily an accurate record of patients seen and services provided or charged for. On the evidence, there is no way of correlating the number of patients with the turnover generated.*"

The FTT held that Dr Long did not have to produce the appointments diaries to HMRC.

It is, however, important to bear in mind that each case will stand on its own particular facts. The decision in Dr Long's appeal is only binding on the parties to that appeal. Circumstances may arise, for example if HMRC issue a notice under Para 1 Sch 36 to a hairdresser, that the appointments diary is "reasonably required" to establish the tax position. It might be more difficult to argue against the submission of such a diary to HMRC as they may be able to argue that an appointments diary might be persuasive evidence of the number of customers who had availed themselves of the hairdresser's services over a particular period. This might have a direct bearing on establishing the correct tax position.

The important phrase to bear in mind with HMRC is "reasonably required". Is there a direct link between the information sought by HMRC and checking the tax position? If there is not, and most importantly the client's records are accurate, then notices under Para 1 Sch 36 should be resisted by taxpayers and their advisers.

Another FTT decision which went in the taxpayer's favour and is worth considering in terms of Para 1 Sch 36 notices is **Kevin Betts v HMRC [2013] UKFTT 430 (TC)**.

Third Party Notices

It may, of course, be possible that HMRC will wish to check information via third parties. They may already hold information in respect of a taxpayer whose identity is known to them. However, it is important to bear in mind that a third party notice cannot be given without either the agreement of the person whose affairs are being reviewed by HMRC or the approval of the FTT. It is important to note that Paragraph 3 stipulates that tribunal approval can only be given by or with the agreement of "an authorised officer of Revenue & Customs". These conditions can be set aside under Para 3(4) if the FTT is satisfied that there are reasonable grounds for believing that to refuse the granting of the third party notice would result in HMRC being unable to collect the requisite amount of tax sought by the department.

Some guidance has been given in terms of the powers under Para 3(4) in the FTT decision of **HMRC v A Taxpayer [2014] UKFTT 931**, in which the judge stated at paragraph 15:

"*An example of a case where an application under Para 3(4) might be made is where the reasons for HMRC wishing to obtain information and/or documents include reasons arising from intelligence obtained by HMRC by virtue of the Proceeds of Crime Act 2002. Under that Act, certain bodies, including banks, solicitors and accountants are required to make "suspicious activity reports" in certain circumstances. HMRC may have access to such materials subject to the information being treated in such a manner that the contents of the suspicious activity reports and the identity of those who have made them is protected.*"

The judge went on to say at paragraph 17:

"*In considering an application for such a dispensation under Para 3(4), the tribunal will have regard to the question* *of prejudice to the whole system of the administration and collection of tax. That system recognises, by statute, the value of whistleblowing in certain areas, including tax evasion. Any requirement for reports to be made of suspicious activity carries with it a need for confidentiality, both for the protection of the reporter and to prevent "tipping off". Those are relevant factors for a tribunal to take into account in determining whether it is satisfied that the inclusion of such material in a summary of reasons given to the taxpayer might prejudice the administration or collection of tax."*

Criminal Investigation Powers

It should be noted that some of the legislation available to HMRC in terms of criminal investigation are only available to them in England and Wales. Reference will sometimes be made in HMRC publicity to the Police and Criminal Evidence Act 1984, and it is important to remember that this enactment does not apply in Scotland, as HMRC rightly point out in their guidance:

"*The Finance Act 2007 introduced a special set of powers that apply in Scotland with the Criminal Law (Consolidation) (Scotland) Act 1995 and the Criminal Procedure (Scotland) Act 1995. HMRC has introduced the Criminal Procedure (Legal Assistance, Detention and Appeals) (Scotland) Act 2010 (Consequential Provisions) Order 2011 to extend those rights and safeguards to suspects arrested for HMRC offences.*"

Entering Premises

Part 2 to Schedule 36 gives HMRC new inspection powers, which came into effect on 1 April 2009. The legislation has the sub-heading "Power to inspect business premises etc." It is important to remember that Para 10(2) states "*The powers under this paragraph do not include power to enter or inspect any part of the premises that is used solely as a dwelling.*" The extent to which HMRC will recognise the privacy of a taxpayer's home is something that remains to be tested before the tribunals. Indeed, it may be something that would require an application for judicial review, which is an expensive procedure.

HMRC's powers under Part 2 are extensive, but it it is important to remember that most visits are announced by HMRC in advance of them taking place. It is crucial to record any communications such as phone calls in anticipation of a visit to business premises for evidential purposes. Penalties will be sought by HMRC if they believe that their ability to carry out an inspection has been obstructed.

A nuanced distinction is to be noted for powers exercised under Part 2 to Schedule 36: the powers are for HMRC to carry out an inspection, **not** a search. However, an inspection may include an interrogation of computers. The inspection should only extend to business records. It should not cover private records unless, of course, the taxpayer has used private bank accounts for business transactions.

It is important to note that clients do not actually have a right of appeal against any intended or actual inspection unless it can be contended as unlawful on judicial review grounds. As with information notices, HMRC have powers to inspect third party premises. Part 7 to Schedule 36 includes the provisions in relation to penalties. There are fixed penalties of £300 and daily penalties beyond that of up to £60. Similar penalties can also be charged against any person who deliberately obstructs an officer in the course of an inspection. Appeals against penalties can be submitted to the First-tier Tribunal and there is a defence of reasonable excuse against the imposition of such penalties.

Circumstances will arise, however, where HMRC believe that an unannounced visit should be made – the dreaded "six o'clock knock on the door". In the event of such an event occurring, it is importance that the client satisfies himself that the identity of the HMRC officer is genuine. HMRC should be in possession of a valid warrant. If the warrant is invalid, the HMRC officer should be asked to leave.

In the first instance, the HMRC officer should be placed in a separate room together with any colleague(s) accompanying him. The client should not enter into any discussions with HMRC officers but should contact his accountant or tax adviser and await his arrival. HMRC have their own investigative branch which operates out of Bootle under "HMRC Criminal Investigation". It may very well be that, once the accountant has the opportunity to hear what HMRC have to say about the matter, there may be a suggestion from HMRC that criminal proceedings are anticipated. In such a case the meeting should be brought to a close by the accountant, and the advice of a lawyer expert in criminal law should be sought. Hopefully very few practitioners will be faced with such a situation.

Conclusion

It is clear that any taxpayer subject to HMRC's powers under Schedule 36 will find it a less than pleasant experience. Emotions can affect the taxpayer's judgement and, in some circumstances, also his health. It is also true that HMRC may be affected similarly, especially if the HMRC officer concerned believes that his investigation or enquiries are being stonewalled by the taxpayer and his accountant. It is best to be able to stand back and look at matters in the cold light of day; to weigh up the evidence available; and to try and put lucid and clear cut arguments to HMRC to arrive at a satisfactory conclusion for the client.

MORTGAGE VERIFICATION SCHEME - A CATCH 22?

The Mortgage Verification Scheme ("MVS") hit the headlines when it was launched in September 2011, but little has been heard of it since.

It is a partnership between the Council of Mortgage Lenders, the Building Societies Association, and HM Revenue & Customs (HMRC). In simple terms, for a fee of £14, a prospective mortgage lender can submit the income details as declared on a mortgage application by a prospective borrower to HMRC using a secure electronic platform. HMRC will check these details against information provided in respect of the particular individual seeking a mortgage against his/her self-assessment and PAYE returns, and advise the lender whether the details correspond.

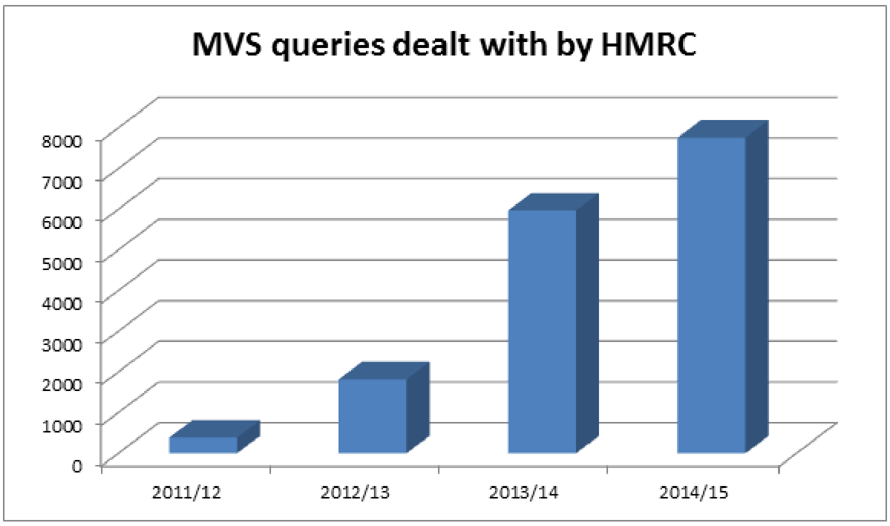
The process is intended to allow lenders to make more informed decisions in order to prevent fraud, or be given assurance where there is inadequate evidence of declared income provided by the potential borrower. However, the scheme also allows HMRC to risk-assess whether the information given on an individual's tax return is accurate. As Colin Barclay, then HMRC's Assistant Director of Risk and Intelligence Service said "*HMRC is determined to tackle fraud wherever we can. The MVS is an* ***unprecedented opportunity*** *for HMRC and lenders to work together to combat fraud in the mortgage industry*".

A recent Freedom of Information request shows that, while the scheme got off to a relatively slow start, its usage has increased over recent years. See Table 1 below.

This trend is likely to continue, and while the numbers are miniscule compared to the total number of UK taxpayers, it should be borne in mind that these are all cases where the mortgage lender either has insufficient evidence of income or suspects fraud. It is certainly an easy route for HMRC to target their enquiries where they are likely to produce results. If the figure on the mortgage application is correct but is more than the income declared to HMRC, it's open season! If the lower figure given to HMRC turns out to be correct, the prospective borrower will have committed mortgage fraud. Either way – the client will have some difficult questions to answer!

Hopefully cases that go through the MVS will not have been anywhere near a professional accountant before HMRC start looking at them! However, members in practice are regularly asked to help clients get mortgages by providing references to banks and building societies. These can range from a simple request for a copy of the Tax Calculation and Tax Year Overview, to asking much more detailed questions.

Table 1



In the first instance, the 'Tax Calculation' shows the breakdown of the income returned on the customer's tax return, while the 'Tax Year Overview' confirms the tax due from the return submitted to HMRC and shows any payments made, cross referencing the Tax Calculation with HMRC records. If you have used HMRC software to submit the tax return, then you can access both these documents online on the clients SA Online Account. However, if you have submitted the tax return using third party software, then you will have to print the Tax Calculation from your system, but still get the Tax Year Overview online. Further details can be found at: **http://www.ion.icaew.com/TaxFaculty/post/Certifying-income-to-support-a-client-s-mortgage-or-loan-application--update**.

From January 2015, HMRC and the Council of Mortgage Lenders have agreed that the 'Tax Calculation' and the 'Tax Year Overview' are the forms that mortgage lenders will accept. However not all mortgage lenders have adopted this approach yet, and some may never do so. In such cases, they are likely to continue to ask accountants to provide references, often on pre-printed forms or by answering certain generic questions.

ICAS cautions members to be very careful when providing such references. Details of what it is appropriate to say and what you should not say can be found at paragraphs 13 to 23, **http://www.icaew.com/~/media/corporate/files/technical/technical%20releases/audit/audit%2002%2001%20request%20for%20references%20on%20clients.ashx**, together with an example reference. Members in practice are strongly recommended to familiarise themselves with this guidance, which ICAS endorses, and to follow it.

HMRC TIME TO PAY ARRANGEMENTS – MANDATORY DIRECT DEBIT

If you have clients who can't pay their tax liabilities on time and need to request time to pay, HM Revenue & Customs (HMRC) have discretionary powers to agree to payment by instalments after the due date. Where the client is genuinely unable to pay by the due date and is able to commit to agreed payments to bring their tax payments up to date, it is likely that HMRC will agree to a payment plan.

From 3 August 2015 payment by direct debit is mandatory for any new time to pay arrangements, unless there are exceptional circumstances, for example where a customer is unable to set up a direct debit because their bank account will not allow it. In such instances, payment by other methods may be agreed.

HMRC say they are moving to direct debit by default because:

- It is more cost effective and more secure than other payment methods;
- It removes the chance that the client will forget to make payment;
- Payments are more likely to be correctly allocated;
- Direct debit as a method will reduce the need for subsequent contact, saving time for the taxpayer and HMRC;
- Direct debit arrangement comes with a guarantee to protect the payer.

HMRC have made clear that it is not their intention to revisit any existing non-direct debit agreements; however for any new agreements, they will expect payment arrangements to be set up by direct debit.

Further guidance can be found at: **https://www.gov.uk/difficulties-paying-hmrc**.

HMRC DIGITAL DELIVERY CENTRE – LONGBENTON

HMRC Longbenton isnt well known for being at the cutting edge of technology – even the name conjures up images of bleak "stalag" type buildings surrounded by barbed wire and heavy security. The reality is quite different! It is a very modern business park, discretely set back off the road, with no indication whatsoever that it is a HMRC facility. There are approximately 20 office blocks housing around 12,000 people, 80% or 90% of whom are HMRC staff, with the remainder working for the DWP.

On the ground floor of one of these buildings is HMRC's Digital Delivery Centre ("the DDC"), where a small group of around 150 people, tasked with delivering one of the most ambitious objectives of HMRC, the Digital Tax Account for individual taxpayers, have been working since the unit was set up in April 2014. Before looking at what this group is doing, and how they go about it, it's worth considering the history of HMRCs online services.

In 2006, the "Carter Report – A Review of HMRC Online Services" set an aspirational goal of "the universal delivery of business tax returns by 2012 and individuals' tax returns from IT literate groups by the same date" This aim covered Corporation Tax, VAT, PAYE, Self-Assessment, and Payment Facilities, and all have been delivered.

Following on shortly after, in November 2012, came the Cabinet Office's "Government Digital Strategy" which set out a "digital by default" policy for all government services. By digital, the government means "internet-enabled; such as desktop, laptop, tablet, mobile or digital devices not yet invented." The rationale is simple. Office of National Statistics suggest that 82% of the population access online regularly or occasionally, and the government believes that online contact is 20 times cheaper than by telephone; 30 times cheaper than by post; and 50 times cheaper than in person. With the closure of 14 HMRC offices last year, and the cut in staff levels of 40% since HMRC was created ten years ago, delivering services online is rapidly gaining ground over more traditional methods. However, recently HMRC recognised that its telephone call centre performance was abysmal and reallocated £45m to improving this but this is a re-allocation, not new money, so other areas will inevitably suffer cutbacks. Notwithstanding this the aim still is to drive "customers" online across government as a whole to try and achieve an anticipated saving of £1.8 billion a year.

The Cabinet Office chose seven departments, including HMRC, which have more than 100,000 transactions with the public a year. Each department had to identify 3 "exemplar" services to prioritise for digitisation. HMRC identified four – PAYE for individuals (which is now in beta testing); Digital self-assessment (which is now in beta testing); the Business Tax Account (which is now live); and Agent Online Self Serve (AOSS) (which is in private beta).

The DDC is focused on creating the building blocks for the Digital Tax Account, which HMRC plan will replace tax returns altogether. The approach they are taking is a massive departure from traditional HMRC work methods. Previously they operated a "waterfall" approach to writing software – a specification was written, tenders sought and received, a contract made and two years later the product was delivered.

Although this approach has delivered many award-winning IT projects over the years, sometimes the results have not been exactly what was required and making changes was often prohibitively expensive. Those days are gone. Now HMRC are adopting "agile" work practices used by industry leaders such as Google, where projects progress and develop in small steps, with a working product from a very early stage so that improvement can be made based on real user feedback and testing. Interestingly, only 38% of the staff are HMRC – 49% are preferred supplier contractors (currently Accenture) and the remaining 23% are local subcontractors. The aim by the end of 2016 is to transfer knowledge of these modern working practices to HMRC staff, which will by then account for 75% of the team.

There are about 20 small teams of between seven and ten people, each comprising of a product manager, who is responsible for the delivery of the project; a "scrum master" whose job it is to solve "blockers" so that the team can concentrate on writing software; several software developers; an HMRC business analyst, who is a subject expert; software architects and user researchers. The latter is particularly important, as "user needs and experience" are central to the whole process. Each team is self-organising, works collaboratively, plans continually, and is very end-user focused.

The teams work in two to four week "sprints". Each "sprint" has five to ten "stories" which are specific tasks a user may want to do online, or issues which need to be tweaked, improved, or fixed. The Digital Tax Account project consists of 125 components, each of which in itself might have 100 plus stories. Each story has six phases: pre-discovery, where the HMRC business analyst defines the components that make up each task; discovery, where the user researchers ask members of the public what they would like to see in doing that task; alpha phase, where the software developers create the code and test it internally; beta phase, where the software is tested by a group of end-users (often tens of thousands of them); and in service, where the website is up and running. Even then, it is regularly revisited, monitored and reviewed to ensure that it is functioning well.

This radical change in methodology has delivered good results in the last year, and is seen as the way forward for future software development within HMRC. There are currently over 40 digital projects underway using the "agile" approach, which should make a huge difference to the speed with which new services are delivered, and the quality of those services. The focus on listening to end-users and continuously improving the product is central to this process and should be warmly welcomed.

AGENTS AND TRUSTED ADVISER STATUS – RECENT DEVELOPMENTS

HM Revenue & Customs (HMRC) have acknowledged the contribution that tax agents make to the smooth functioning of the tax system in the UK. Jim Harra, the Director General of Business Taxation Tax for HMRC, stated in an article in March 2015 for the Tax Journal:

"Agents play a central role in the tax system. Our customers clearly value how agents can relieve them of the burden of managing their own tax compliance. And HMRC value the fact that agents know what they're doing, which cuts down on the effort that we have to make in corrective work, compared to dealing with unrepresented taxpayers."

These are reassuring words for tax agents and it is a welcome development for HMRC to acknowledge this contribution. How are HMRC planning to build on these warm words and really allow agents to work with HMRC on tax compliance issues?

The focus within HMRC has been on the delivery of additional services through digital channels. The "My Tax Account" product for individual and business customers has been launched and around 5 million taxpayers have signed up to use the service. The equivalent service for agents – Agent Online Self Service (AOSS) – is some way behind in its development.

The AOSS service is intended to:

- make it easier and quicker to register with HMRC as an agent
- let agents confirm and update client lists
- let agents access services and view clients' records in one place
- help keep clients' tax affairs up to date
- let agents carry out the same online tasks as your clients
- reduce the need to contact HMRC
- reduce costs for both agents and HMRC

There have been delays in introducing the service while the Government decided how to manage the issue of identification verification. It was recently announced that there would be no new identity assurance scheme - which would have required an external check on identity details for agents - and that the Government Gateway would be used to log into the new system. The details are covered under: **https://www.gov.uk/agents-new-online-services**.

There has been some progress on AOSS, and the testing of the PAYE component of AOSS has started. HMRC have invited some agents to test the product in private testing – covered in the Agents Blog here: **https://taxagents.blog.gov.uk/2015/06/22/calling-all-tax-agents-were-looking-for-volunteers-to-test-our-agent-online-self-serve/**.

ICAS has been at a demonstration of this product, which is designed to allow agents to see submissions through Real Time Information (RTI) made by their clients and the payments that have been made. It has been designed to highlight any anomalies and flag payments due by businesses. It appears to be the type of tool agents have been asking for to help them rectify problems with RTI.

The PAYE product is the first offering for AOSS and testing will carry on for the rest of 2015. There has been no announcement of when the service will go live and when any offerings for other taxes will be available – but HMRC are posting new details on the tax agents blog highlighted above. Despite the warm words about agents, the priority appears to be developing offerings for taxpayers through the "My Tax account" portal rather than improving digital services to enhance the tools available for agents in carrying work on behalf of taxpayers.

In terms of actually registering as an agent, the alternatives are:

- use the online service to register as acting for a client
- use the paper 64-8

The HMRC advice on submitting and managing authorisation as an agent is at the following url, and the information includes some useful reminders particularly on VAT: **https://www.gov.uk/client-authorisation-an-overview**.

There is another type of agent HMRC are now recognising – the trusted adviser. These are individuals who are not formal agents but who help friends or family with their tax affairs. HMRC have established a new way for trusted advisers to access online tax details. The process is:

- the adviser registers with HMRC
- the taxpayer accepts the adviser
- HMRC then allow the adviser to access the online tax details and deal with the taxpayer's tax affairs

A trusted adviser can deal with the tax affairs of up to 5 taxpayers. The taxpayer remains legally responsible for their own tax affairs.

This scheme is a recent innovation and trusted advisers can currently only update someone's company car details or view their income tax estimate. The plan is to roll out more functions in the future that a trusted adviser is permitted to perform on behalf of the named taxpayer. It is still the case that if a trusted adviser contacts HMRC by phone, the taxpayer is required to be present to confirm the adviser's identity and to give HMRC authorisation to speak to the trusted adviser.

There is more detail on the scheme – including links to registration – accessible at: **https://www.gov.uk/help-friends-family-tax**.

These are welcome developments – but as with other services for established agents there is still some way to go. There is now a willingness to give agents and advisers access to information to make the tax system run more smoothly. The challenge is to make sure this is turned into action by HMRC.

CAPS CA PRACTITIONER SERVICE

Road Shows 2015 - Dates for your Diary

Aberdeeen - 24 August (12-2pm)
Inverness - 14 September (12-2pm)
Dundee - 28 September (5.30-7.30pm)
Kilmarnock - 21 October (12-2pm)
Edinburgh - 26 October (5.30-7.30pm)
Glasgow - 28 October (8-10am)

To enrol online click on the town or contact Linda Laurie on +44 (0) 131 347 0249

EMPLOYMENT CORNER - PENSIONS - NO PAIN, NO GAIN?

Planning for retirement has always been something of an exercise in divination, and employees who are at the beginning of their careers are always less likely to take saving for a pension as seriously as those who are approaching retirement.

However, the new auto-enrolment legislation has made everyone think about pensions in a way they have never done before. The crucial change in perspective is that rather than choosing to opt in to a scheme as has been the case, an employee now has to choose whether to opt out. Put this latest change together with the recent recession, increasingly volatile markets due to various social, and political happenings across the world and some surprising statistics on the pension front are emerging.

First of all, there has been much lower than expected opt out rates reported by employers across the board, especially in some traditionally high staff turnover industries with younger age profile staff such as manufacturing, fast food, hospitality and retail, where only an average of 9% of staff have opted out of making pension contributions. The statistics can be interpreted as contributing to a pension may have the effect of making people feel more secure about their future. Furthermore, by opting out of the auto-enrolment regime, an employee is also forgoing the employer's contribution into their future pensions. This may explain why there is notably a lower opt out rate among employees whose employers are contributing to their pensions at a higher rate. (**http://www.cipd.co.uk/binaries/labour-market-outlook_2014-autumn-pension-auto-enrolment.pdf**). Some employers have decided that they will use the pension scheme to incentivise employees and have proactively communicated this valuable benefit to them as part of their total reward package offering. Thus, instead of paying the minimum contribution level, they have paid a higher percentage, which is also a more tax-efficent way of remunerating employees than through payroll.

The additional administrative burden and cost to the employers cannot be understated. For example, there are on average 33 additional tasks to be carried out by the employers on an ongoing basis. Much has indeed been made by employers and their representatives of the additional burden of administration and the additional cost. However, one thing which is clear is that there appears to be an acceptance among employers – that it is responsible to encourage pensions saving among their employees and that employers can publicise their funding arrangements as an engagement and motivation tool.

The press have reported mass confusion amongst employers in terms of the complicated nature of the auto-enrolment regulations, and especially in respect of who is eligible to join, the opt-out rules, re-enrolling opted out employees after three years, and enrolling new workers and those who were too young to join but have now met the age requirements. The answer seems to be to choose an auto-enrolment solution which can either complement the existing payroll as a bolt-on function, or change to a payroll provider who can offer a one-stop shop. For those employers wishing to DIY, that is to say who have been carrying out their payroll and/or pensions functions in-house, the primary consideration is whether they have the right resources and required expertise to handle auto-enrolment timeously and effectively.

Accountants who provide payroll support to their clients may be faced with a different auto-enrolment provider for each of these clients. It will therefore necessitate careful planning on the part of the accountant too, in order to ensure that the correct resource is applied within the practice to assist these clients, and that accuracy and high standards of service are maintained in the introduction of a new suite of compliance requirements.

Apart from the logistics of auto-enrolment, an important and primary consideration for any advisers is to encourage their clients to select the right kind of pension scheme that will best suit the income, contribution, and retirement profiles of their workforce. Employees will not thank them for selecting a pension scheme which fails to meet the workforce's needs in the longer term, or which does not perform well. As ever, planning – and well in advance -- is the key and leaving things until the last minute just won't do. The years 2015 and 2016 are crucial periods when 1.3 million small to medium employers are expected to stage. It is likely that pension providers will reserve the right to turn an employer down who is leaving things until the last minute and expects a quick turnaround. It is worth noting that a pension scheme may need to be set up even though there are no current members in it, as all employers will have to declare they are compliant with the scheme.

Advisers should be encouraging clients to plan ahead and be proactive about auto-enrolment due to the fact that on average it is taking around 6 months to prepare for the staging date, and so far, only 3% of employers have actually implemented auto-enrolment over the last three years.

Employers generally want peace of mind when dealing with pensions administration, so it is a good idea to find a pension provider who can take care of the administration and comply with the law so that the employers can concentrate on their core business.

Auto-enrolment can provide a natural opportunity to forge closer communication between the employers and their workforce. The opportunity to speak to the employees about a pension scheme provides the natural opening to mention other issues such as performance, pay and job roles and responsibilities – never underestimate the power of two-way communication to understand what employees are thinking about and to get them on board with the organisational goals of the business.

A word of caution here -- it is a criminal offence for an employer to discuss opting out with employees as this could be seen as coercion, so ensure your clients steer away from this topic of conversation. The information packs for employees should refer the employee to the pension provider for this conversation, should the employee wish to have it.

One-man limited companies where the only employee is a director does not have any auto-enrolment obligations until or unless it takes on its first eligible worker. However, the auto-enrolment preparation work needs to be undertaken while the director is still considering taking on that first employee as everything needs to be available to them from day 1, whether they are full-time or part-time, so long as the worker is an 'entitled worker' (see Table 1) or a 'non-eligible jobholder' (See Table 2). Advisers should be as proactive as possible here.

Penalties for non-compliance can be severe. In the last quarter of 2014 alone, over 166 companies received penalty notices for failing to carry out auto-enrolment properly. Penalty notices are aimed at punishing "persistent and deliberate non-compliance".

A fixed penalty notice is £400 and payable within a specified timeframe. Escalating daily penalties can then be issued for ignoring a statutory notice and stand at £50 to £10,000 depending on the number of employees.

On top of this, civil penalties, which weigh in at up to £5,000 for individuals and up to £50,000 for organisations can be levied in cases where the employer might have deducted the pension contributions but failed to pay them over.

Where employers fail to comply with a compliance notice or there is evidence of a breach, penalties of between £1,000 and £5,000 can be issued for "prohibited recruitment conduct".

Criminal prosecution is also capable of being enforced in cases of wilful non-compliance.

An appeals system governed by The Pensions Act 2008 is available. Appeals which have already been reviewed by The Pensions Regulator and are still in contention can be referred to the General Regulatory Chamber Tribunal for a hearing.

Despite all the various news articles and points of view out there, the best advice is available via the Government's website of The Pensions Regulator. All PAYE references are registered on the website and it is important that employers go to the site, enter their PAYE reference and obtain details of their staging date together with a whole suite of instructions on how to prepare for auto-enrolment. They can then familiarise themselves with this content so that they understand their obligations and responsibilities. Having done this, employers will then be in a better position to work with pension providers to ensure a suitable qualifying scheme is implemented, and that they stay on the right side of the law.

For more information go to: **http://www.thepensionsregulator.gov.uk** where there are separate areas for employers and business advisers

Table 1

Entitled Workers

These are employees who have a right to join their employer's pension scheme

- aged 16-74
- working in UK
- earning below £5,824 (2015/2016)

The employer only has to make a contribution for entitled workers if it is part of their contract of employment.

Employers do not have to auto-enrol workers who fall into this category into a qualifying workplace pension scheme but must offer them the opportunity to opt-in to one if they choose. If they opt-in to a scheme the employer is not obliged by legislation to pay employer contributions for them unless the scheme is an occupational schemes. 'Entitled workers' may also be referred to as 'entitled employees'.

Table 2

Non-eligible jobholders

These are employees who are:

- Aged 16 - 21 or State Pension Age - 74
- working in the UK
- earning above £10,000 (2015/2016)

OR

- aged 16 - 74
- working in the UK
- earning above £5,824 but below £10,000 (2015/2016)
- have a right to opt in to their employer's pension scheme.

Employers do not have to auto-enrol workers who fall into this category into a qualifying workplace pension scheme but must offer them the opportunity to opt-in to one if they choose. If they opt-in to a scheme the employer will have to pay employer contributions for them. 'Non-eligible jobholders' may also be referred to as 'non-eligible workers' or 'non-eligible employees'.

AGENTS' TOOLKITS

HM Revenue & Customs (HMRC) Agents' Toolkits are often maligned by practitioners, who perhaps see them as condescending "idiot's guides", but there are several reasons why you shouldn't dismiss them out of hand.

HMRC started developing toolkits about 3 years ago, following research which identified the 400 most common errors seen in tax returns filed by agents. They are, as HMRC put it, "*a useful tool in an agent's armoury to help avoid making mistakes in clients' tax returns*". There are now 20 of them, and over 300,000 copies have been downloaded so far. A full list and links to the toolkits is at **https://www.gov.uk/government/collections/tax-agents-toolkits**.

They cover a diverse range of topics, from fairly simple matters such as the correct treatment of drawings by the self-employed, to more complex issues such as whether all attribution rights and powers have been considered when looking at associated companies.

The first reason to use the toolkits is that they are what they say they are – a checklist or aide-memoire to help avoid mistakes. We all use, or should be using, reliable checklists in the preparation of a set of accounts. If checklists are indispensable tools in other areas of our work, why not use toolkits in completing self-assessment returns for clients? The fact that they have been prepared by HMRC does not diminish their value. If anything, because of the way they have been developed, their value is arguably greater than those prepared by others.

Secondly, the toolkits give an excellent insight into what HMRC are looking out for – the "risks" as they see them and how to avoid them. That in itself is a useful perspective which should not be ignored.

Thirdly, as the toolkits contain over 1,300 links to legislation, HMRC manuals and help sheets, and are updated regularly to take account of changes in legislation and the outcomes from decided cases, they provide an excellent and easy reference point for the host of related statutes and case law. It is probable that any relevant issue in a particular area covered by a toolkit will have been addressed. Using them is likely to give you an encompassing overview of a particular area much quicker than if you were to try to trawl through the new **https://www.gov.uk** website.

Fourthly, they are an excellent training tool, whether for students or those just coming into tax for the first time. They are also a useful refresher for those who have been preparing tax returns for a while. Changes happen, and can easily be missed without an update. These toolkits by HMRC are maintained to keep them up-to-date, and recent changes, would have been highlighted.

Finally, you should have a look at the toolkits and consider incorporating them into your tax return preparation procedures as an agent. To do so will be prudent and sensible; however, there is one caveat.

Paragraphs 3.21 and 3.22 of the Professional Conduct in Relation to Taxation, **https://www.icas.com/__data/assets/pdf_file/0006/116979/20150501-Professional-Conduct-in-Relation-to-Taxation-ICAS-FINAL.pdf**, states that:

"*whilst it is reasonable in most circumstances to rely on HMRC published guidance, a member should be aware that the Tribunal and the courts will apply the law even if this conflicts with HMRC guidance. Notwithstanding this, if a client has relied on HMRC guidance which is clear and unequivocal and HMRC resiles from any of the terms of the guidance, a Judicial Review claim is a possible route to pursue*".

The toolkits are guidance, and the implication is that if you follow them correctly, it would be hard for anyone to criticise you. The flip side is, if you make a mistake that could have been avoided by using the toolkit, you are leaving yourself open to criticism and potentially a negligence claim. One thing is clear though, you cannot switch your brain off and rely on a guidance without thought. You may disagree or depart from the guidance for whatever reason. If that is the case, you should document the reasons of your disagreement.

Many practitioners have found the following toolkits particularly useful:

- Property Rental
- Capital Gains Tax for Shares
- Directors' Loan Accounts
- Capital v Revenue Expenditure.

However, the Inheritance Tax toolkit applies English law, not Scots law, and as the process of confirmation in Scotland is significantly different from the English system of probate, you need to be aware which aspects of the toolkit are relevant north of the border.

The benefits of using the toolkits far outweigh the drawbacks. The fact that they come from HMRC is not really the issue. If you are not using them, have you a reliable alternative in place? If not, then adopting the toolkits as checklists should reassure or improve your quality control and reduce the risk of errors occurring in your return submission for clients.

HMRC PROPOSED CHANGES IN APPROACH TO LATE FILING PENALTIES

The late filing penalties were very much in the media spotlight earlier this year, which might have in part accounted for the consultation by HM Revenue & Customs (HMRC) that was open from 2 February to 11 May 2015 on a new approach to self-assessment filing penalties. The announcement by HMRC on 2 June 2015 would appear to herald a new approach to penalties that is aimed to make late filing penalties more proportionate, and to allow HMRC to concentrate on more serious defaulters on a risk-assessed basis. The announcement and the discussion document that reflected the consultation on the new approach can be accessed at: **https://www.gov.uk/government/news/self-assessment-penalties**.

In line with the likely direction of the general approach to penalties, the penalty regime for small employers who do not meet PAYE deadlines is scheduled for changes too.

Among the proposed changes is the plan to allocate resources to educate employers about their Real Time Information (RTI) filing obligations and to target serious failures to comply with reporting obligations. Earlier this year, HMRC made the announcement that delays of up to three days will not be penalised. **https://www.gov.uk/government/news/hmrc-will-not-impose-paye-filing-penalties-for-short-delays-from-march-2015**. This announcement should be taken as a change in HMRC's practice only, as there are no changes to the statutory provisions that underpin the filing due dates for returns.

ICAS has pointed out in its submission to the consultation on penalties that fixed automatic penalties do not distinguish between a taxpayer who is generally compliant but makes a mistake and the taxpayer who is persistently non-compliant. It is encouraging to see HMRC recognising this distinction and taking action to focus resources on the non-compliant taxpayers.

ICAS believes that this new risk-based approach should be adopted across all taxes and has raised particular concerns about the following:

- Debt management - where businesses are really struggling for cash flow they will often make payments on account rather than seeking time-to-pay arrangements. In these circumstances automatic penalties then roll up with alarming rapidity. HMRC should do more to encourage these businesses to enter into time-to-pay arrangements
- Penalties in relation to excise duties can be extremely expensive and often appear disproportionate to the default or compliance failure.
- VAT default surcharge is applied with escalating percentages to liabilities depending on the number of defaults within a surcharge period. The surcharge regime does not take any account of the length of period of lateness for each default. A lateness (whether for payment or filing) which is one day late has the same penalising effect as a lateness of a much longer period, and this non-differentiation of the period of lateness has led to many appeal cases to the First-tier Tribunal, particularly by unrepresented taxpayers.

The more practical approach to penalties is a step in the right direction but there are further challenges in updating the penalty regime in order to reduce the occasions that may lead to disproportionate outcomes and to promote a perception of its fairness as a mechanism to encourage taxpayer compliance.

HMRC UPDATE – ALL CHANGE AT HMRC

From 30 June 2015, HM Revenue & Customs (HMRC) have withdrawn their 0845 helpline telephone numbers and replaced them with 03 numbers.

This change was announced in August 2014 and since December 2014 anyone calling a 0845 number that has been taken out of service would have heard a message providing the new 03 number before the call ended. If you dial a 0845 number now you will hear a dead line tone. A useful list of HMRC contact details can be found on their 'Contact Us' page at: **https://www.gov.uk/government/organisations/hm-revenue-customs/contact**.

HMRC are also gradually changing their Business Help and Support email addresses. These will now come from **no.reply@advice.hmrc.gov.uk**.

HMRC CAMPAIGNS & TASK FORCES

Since 2007, HM Revenue & Customs (HMRC) campaigns have collected over £1 billion with £610 million from taxpayers making disclosures and over £395 million from follow-up activities by HMRC.

The last update was in Issue 131 (April 2015) when there were four active campaigns. One of these, the Solicitors campaign, which offered a way to disclose any previously undisclosed income for those within the legal profession (individuals or solicitors in a partnership or company), closed on 10 June 2015.

The remaining open campaigns are shown in Table 1.

Table 1

Campaign Name	Targeting	Disclosure by	Payment by	Notes
Credit Card Sales	Businesses with undeclared sales from credit cards	Open indefinitely	4 months from the date of disclosure	Helpline 0300 123 9272
Second Incomes	Employees with undeclared second incomes	Open indefinitely	4 months from the date of disclosure	Helpline 0300 123 0945
Let Property	Landlords with undeclared income from residential property	Open indefinitely	3 months from the date of receiving HMRCs acknowledgement of disclosure	Helpline 0300 051 4479

On the task forces front, it would appear that HMRC have been pursuing these task forces but without publicising them. We understand that HMRC task force activity is still very much alive, but there has been an "internal breakdown in communication publicising the current targets/geographical areas to a wider audience".

Let property income has been a feature of task force activity on a geographical basis for some time, and the Let Property Campaign appears to complement this. On the one hand HMRC are looking for voluntary disclosures, and on the other hand they are asking letting agents to report the names and addresses of landlords they act for and how much they have received on their behalf. Given that there have been less than 10,000 disclosures under the campaign initiative, HMRC believe there are still approximately a million errant landlords, and it would be safe to assume that let property income will continue to be a focus for some time to come.

VAT TRIBUNAL CASE – LEGAL FEES IN A PARTNERSHIP DISPUTE

Partnership disputes are usually pretty messy in themselves without the extra dimension of complication by being a dispute with HM Revenue & Customs (HMRC) over a subject like VAT on legal fees incurred to resolve matters. The anonymised case of **A Partnership v HMRC [2015] UKFTT 061 (TC04358)** shows that attention to detail regarding the engagement and invoicing arrangements are all important.

Messrs A, B, C and D were partners. D, who was reaching retirement age, served a notice to dissolve on his fellow partners, apparently in an attempt to obtain a payment of goodwill which would not normally be payable when a partner retired. The partnership agreement specifically provided for the repayment of capital on retirement, but not anything in respect of goodwill. However, on dissolution, the goodwill would be realised and paid out in addition to the capital. Mr D alleged "bad faith" on the part of A and B, but not C, in respect of previous efforts to sell the business.

A and B took legal advice from a firm of solicitors; C also took legal advice, but from a different firm of lawyers. The engagement letter from A and B's solicitor stated that "*we regard both of you as our clients and accept no responsibility to any other person or organisation in relation to the advice given*", and A and B paid the invoices personally; that is, not from the partnership bank account. In similar vein, the engagement letter from C's solicitor stated "*the work to be carried out will involve advising you regarding* *your partnership difficulties...*" and C paid his invoices personally. After the dispute was settled, D retired, leaving A, B and C to continue in partnership. The partnership reimbursed A, B and C for their legal fees, and then reclaimed the input tax. HMRC disallowed the input tax, and the partnership appealed the decision. The First-Tier Tribunal rejected the appeal and found in favour of HMRC.

HMRC argued that the services were not made to the partnership but to the partners as individuals, albeit to A and B together and C separately. HMRC further contended that there were, in fact, no invoices to the partnership itself. Finally, HMRC argued that even if the services had been to the partnership as a whole, the nature of the dispute was not sufficiently and directly linked to the taxable trade.

The Tribunal agreed with HMRC on the first point. It took the view that the partnership, consisting at the time of A, B, C and D, were not the solicitors' client, nor was a future partnership of A, B and C. The solicitors were quite specific in their letters of engagement that the clients were A and B in the case of the first firm, and C in the case of the second, and had there been a dispute over payment, the first firm would have pursued A and B, not C or the partnership; and the second firm would have pursued C, not A, B or the partnership.

A, B and C could have instructed the same firm of solicitors, but chose not to for a variety of reasons. The Tribunal concluded that as a matter of law:

"*Recovery of VAT is limited to VAT on supplies 'to' the taxpayer seeking repayment. The taxpayer is the partnership, but the services of the solicitors was not supplied to the partnership. The appeal must be dismissed on this ground.*"

The Tribunal also agreed with HMRC on the point regarding the interpretation of VAT Regulations 1995/2518, of which Regulation 13, 14(1)(e), and 29(e) were singled out for discussion. , The Tribunal concluded that the strict meaning should be applied, which means that the status of whether input VAT on an invoice is recoverable is predicated on the actual addressee on the invoice. For the input VAT on these invoices to be recoverable, the invoices were required to have been addressed to the partnership. As a matter of fact, the first firm of solicitors addressed its invoices to A and B, and the second addressed its invoices to C. These invoices are therefore addressed to the partners as individuals, not to the partnership as the VAT trader.

Finally, the Tribunal addressed the question of whether, had the invoices actually been made out to the partnership, the services rendered would have been business expenses for the purposes of section 24 of the VAT Act 1994, which states that a service must be "used...for the purpose of [the] business." The Tribunal stated that:

"*UK VAT law must be read (if at all possible) to be consistent with EU law. EU case law requires input tax to be 'attributable' to supplies made by the taxpayer, by which they mean it must have a 'direct and immediate' link to the taxpayer's business. The legal expenses in this case could clearly not be directly attributable to any particular taxable supply made by the partnership: if it was an expense at all, it was an overhead expense. Overhead VAT is recoverable if it has a direct and immediate link to the taxpayer's business overall (see Midland Bank C-98/98)*"

The Tribunal judge expressed the view that "*the partners' interests in preserving the business of the partnership are indistinguishable from the partnership's interest in preserving the business*". For this reason, the judge disagreed with HMRC on this point, and concluded that had the legal expenses been incurred on behalf of the partnership, she would have followed **Hartridge t/a Hartridge Consultancy (VTD 15553) (1998)** and "*found that they were directly and immediately linked to the business of the partnership*". However, while the appellants have won on this point, this part of the decision "*proceeded on the assumption that the supply was 'to' the partnership*". As related earlier, since the Tribunal have found the supply was not made to the partnership, the appellants still lost the appeal, even when they had won on the final point regarding section 24 of VATA 1994.

This case shows the importance of paying attention to the details of precisely to whom goods or services are addressed, and who benefits from them for the purpose of deciding the "direct and immediate link to the taxpayer's business overall". As partnership disputes are not uncommon, it is well worth noting the relevant considerations emanating from this case.

NEW UK FINANCIAL REPORTING STANDARDS FOR SMALL AND MICRO-ENTITIES

The Financial Reporting Council (FRC) has issued a suite of changes that update and, in many cases simplify, UK and Ireland accounting standards.

Amongst the core changes are new requirements for micro-entities and small entities, and the withdrawal of the *Financial Reporting Standard for Smaller Entities* (FRSSE).

The changes are largely in response to the implementation of the new *EU Accounting Directive*, and include:

- A new standard, *FRS 105 The Financial Reporting Standard* applicable to the Micro-entities Regime.
- A new *Section 1A Small Entities of FRS 102 The Financial Reporting Standard* applicable in the UK and Republic of Ireland.
- Other changes necessary for continued compliance with company law.

The changes to the Companies Act were made via the *Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015* which came into force on 6 April 2015. The FRC has also taken the opportunity to reconsider the most appropriate way that accounting standards can support the new micro-entities regime.

The company law changes and the new and amended standards are effective for accounting periods beginning on or after 1 January 2016, with early adoption permitted for accounting periods beginning on or after 1 January 2015.

UK Financial Reporting Regime for Accounting Periods Commencing on or after 1 January 2016

This new regime will then be as shown in Table 1 above.

Table 1

Micro-entities	FRS 105 The Financial Reporting Standard Applicable to Micro-Entities
Small entities	FRS 102 including section 1A – presentation and disclosure for small entities
Entities not required to apply IFRS (eg medium and large private companies)	FRS 102
Subsidiaries of groups applying IFRS	FRS 101 reduced disclosure framework
Subsidiaries (and ultimate parents) of groups	FRS 102 - Reduced disclosures for subsidiaries and ultimate parents
Companies listed on EU-regulated markets (consolidated accounts)	EU-endorsed IFRS

An entity may always opt to apply a more comprehensive standard; for example, a micro-entity may adopt FRS 102, or a large private company may adopt IFRS. The only exception to this is that charities are prohibited from adopting IFRS.

The remainder of this article sets out the key points of the new regime.

Micro-entities Regime

A micro-entity is a company which satisfies the following qualifying conditions:

- Turnover: Not more than £632,000;
- Balance sheet total: Not more than £316,000
- Average number of employees: Not more than 10

The turnover limit should be proportionately adjusted if the financial year is not 12 months. The usual two-year rule applies except in a company's first financial year. Any type of entity which is excluded from the small companies regime cannot qualify as a micro-entity. Furthermore, additional types of entity, eg charities, LLPs, investment undertakings, financial holding and insurance undertakings, credit institutions, qualifying partnerships, overseas companies, unregistered companies and companies authorised to register pursuant to *s1040 of the Companies Act 2006* are also specifically excluded.

If a company is a subsidiary undertaking and is included in consolidated group accounts by the method of full (as opposed to proportional) consolidation then it cannot qualify as a micro-entity.

A parent company can only qualify as a micro-entity for the purposes of its individual accounts if it qualifies as a micro-entity individually, and the group headed by it qualifies as a small entity. If a company is a parent company that prepares group accounts, then it cannot qualify as a micro-entity for the purposes of its individual accounts.

This regime was established in UK Company Law by the *Micro-entity Regulations 2013* and is optional. Directors of companies which meet the necessary criteria should consider carefully before deciding to follow the requirements of this financial reporting regime. Until now, entities which have opted for this reporting framework have followed the recognition and measurement requirements of the *Financial Reporting Standard for Smaller*

Entities 2008 (followed by 2015 version) subject to the specific requirements of the Directive ie such entities are not allowed to re-value or to use fair value for any of their assets and mandated disclosures are extremely limited. For accounting periods commencing on or after 1 January 2016, such entities ***will be required*** to apply the newly introduced *Financial Reporting Standard for Micro-Entities*.

The Financial Reporting Standard applicable to the Micro-entities Regime

FRS 105 is a single financial reporting standard that applies to the preparation of individual financial statements of companies that qualify as micro-entities and which choose to apply the Micro-entities Regime. If transactions are not addressed by FRS 105 either directly or by cross reference to FRS 102, a micro-entity is not required to refer to FRS 102 in selecting its accounting policies. The recognition and measurement requirements in FRS 105 are broadly based on FRS 102, and amended to reflect the specific legal requirements for micro-entity accounts.

Key features of the newly introduced Financial Reporting Standard for Micro-Entities

- All assets must be measured at cost - this means that property, plant and equipment and investment properties can only be measured at cost and previous revaluations gains would need to be removed on transition. Financial instruments cannot be measured at fair value, therefore are only measured at cost or amortised cost.
- The only required disclosures (additional disclosures can be provided voluntarily) are:
  - the total amount of any financial commitments, guarantees or contingencies that are not included in the balance sheet;
  - an indication of the nature and form of any valuable security which has been provided;
  - the amounts of advances and credits granted to members of the administrative, managerial and supervisory bodies with indications of interest rates, main conditions and any amounts repaid or written off or waived; and
  - any commitments entered into on their behalf by way of guarantees of any kind, with an indication of the total for each category.
- Accounts that comply with the minimal legal requirements are presumed to give a true and fair view.
- There is no requirement to account for deferred tax and equity-settled share-based payments.
- There are no accounting policy choices. All such choices have been removed, including the options to capitalise development costs and borrowing costs.

Small Entities Regime

One of the aims of the EU Accounting Directive was to simplify and harmonise small company reporting across Europe, and it imposed a number of changes to the small companies regime, including:

- setting a maximum number of disclosure notes that can be specified for small companies
- permitting small companies to prepare an abbreviated profit and loss account and balance sheet, if approved by all of the shareholders
- increase the small company thresholds to:
  - Turnover: not more than £10.2 million
  - Balance sheet: not more than £5.1 million
  - Average number of employees: not more than 50.

The introduction of FRS 102 and the micro-entities regime, coupled with the changes above, necessitated a new accounting framework for small entities. After extensive consultation, the FRC determined that small entities should apply FRS 102 for recognition and measurement, with separate presentation and disclosure requirements.

FRS 102 – section 1A

This new section of FRS 102 sets out the information that requires to be presented and disclosed in the financial statements of a small entity applying the small entities regime. Unless specifically excluded by the content of section 1A, all of the requirements of FRS 102 apply to a small entity, including the recognition and measurement requirements.

Unless a small entity chooses to apply EU-adopted IFRS, or if eligible, FRS 101, a small entity that chooses not to apply the small entities regime is required to apply FRS 102, *excluding Section 1A*.

Section 1A applies to all small entities applying the small entities regime, whether or not they report under the Companies Act 2006. Small entities that do not report under the Companies Act are required to comply with the requirements of Section 1A, and with the Small Companies Regulations (or, where applicable, the Small LLP Regulations), except to the extent that these requirements are not permitted by any statutory framework under which such entities report.

Key features of FRS 102 – section 1A

- Small entities are only required to prepare a profit and loss account and balance sheet – there is no requirement for a cash flow statement or statement of total recognised gains and losses.
- Small entities are only legally required to provide a limited number of specified disclosures. However, directors of small entities are still required to ensure the financial statements provide a true and fair view and therefore must consider

what additional information may be needed to achieve this and provide that information.

- FRS 102 *will* require small entities to recognise and measure more financial instruments than under the FRSSE eg interest rate swaps, forward foreign currency contracts.
- Small entities will be required to recognise deferred tax on the revaluation of fixed assets under FRS 102.
- FRS 102 requires that gains and losses on investment properties must be recognised in profit or loss, rather than in reserves as previously required by the FRSSE. Section 1A of FRS 102 does not reproduce all the reporting requirements from company law applicable to small entities unlike the FRSSE, but does include those relating to the financial statements. Small entities will need to satisfy themselves that they have met all their legal requirements.

Early adoption

The new standards are applicable for accounting periods beginning on or after 1 January 2016, with early adoption available for accounting periods beginning on or after 1 January 2015.

Early adoption is also available for the Companies, Partnerships and Groups (Accounts and Reports) Regulations which contain the small company threshold increases.

Early adoption is likely to be of most benefit to those medium-sized companies which will qualify as small under the new thresholds (there are estimated to be around 11,000 such companies). Early adoption of the *Regulations and FRS 102 – section 1A* (as explained above) will enable them to avoid moving from full UK GAAP for their 2014 accounts, to full FRS 102 for 2015, and then to FRS 102 – section 1A in 2016.

It is worth noting that the small company thresholds for audit purposes have not been increased, therefore even if a company adopts the new thresholds early for accounting purposes, it will still require an audit under the existing thresholds.

Other amendments

The FRC has also updated FRS 101 and FRS 102 for other minor amendments introduced by the Accounting Directive, for example:

- providing companies with the opportunity to use alternative layouts when preparing their profit and loss account and the balance sheet, provided that the information given is at least equivalent to the information otherwise required by the standard formats. (This option is intended to reduce the burden of consolidation for those in a group using international accounting standards.)
- requiring that, in exceptional circumstances, where the useful life of goodwill cannot be reliably estimated, that it shall be written off over no more than 10 years (changed from five years in the existing FRS 102).

Further information

The new and amended standards, together with a consultation overview document are available from the FRC website: **https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/July/New-accounting-standards-offer-simplification-for.aspx**.

Further analysis of the content of FRS 105 and FRS 102 Section 1A will be included in future issues of Technical Bulletin.

ACCOUNTING AND AUDITING QUERIES

Query: *I am a partner in a small firm of chartered accountants based in the north of England. One of our clients currently requires an audit but we would appreciate your views as to whether you envisage that the government will increase the audit exemption threshold in the coming months.*

Answer: The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015, which came into force on 6 April 2015, increase the small company thresholds for financial years beginning on or after 1 January 2016.

In accordance with Para 2(2)(b) of these Regulations, a company can choose to comply with the Regulations early; ie for financial years beginning on or after 1 January 2015, in terms of the small company thresholds.

However, as per Para 2(3)(b), this does not apply to the audit of the annual accounts. That is to say, if a company qualifies as a small company in relation to a financial year beginning on or after 1 January 2015, as a result of implementing the new Regulations early, but would not otherwise have qualified as a small company but for the increase of accounting thresholds, it will still have to produce audited accounts if the 2006 Act would have required it.

As it stands in the Regulations 2015 at the moment, the audit thresholds are still aligned with the small company thresholds; however, as you may note, there is currently uncertainty regarding whether the audit thresholds will ultimately remain aligned with the small company thresholds by 2016.

There is an explanation within the Regulations' Explanatory Memorandum at: **http://www.legislation.gov.uk/ukdsi/2015/9780111127896/memorandum/contents** (Section 8.7) which states:

"*stakeholders expressed mixed views on whether the small company thresholds* *for audit and accounting should remain aligned and consequently the Regulations permit the audit thresholds to rise automatically in step with the increase in the small company accounting thresholds. However, a final decision on the alignment is to be taken with the implementation of the Audit Directive and Audit Regulation. If it is concluded that the accounting and audit thresholds should remain aligned no further action will be taken."*

Responses to the Department for Business, Innovation & Skills (BIS) consultation on the Audit Directive and Audit Regulation had to be submitted by 19 March 2015. Section 4.6 of the Consultation summarises the various alternatives regarding the small companies audit exemption thresholds and invited comments as follows:

"*We are now seeking views on whether to make further amendments, before the application date of 1 January 2016, to introduce separate and different thresholds for the purpose of the small companies audit exemption. We anticipate these amendments could be made by the end of 2015 if it was concluded this was the right thing to do following consideration of responses to this discussion document.*"

It is currently still a case of "*watching this space*" to see whether the audit thresholds will ultimately align with the small company thresholds going forward.

The consultation can be accessed at: **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/400231/bis-14-1285-auditor-regulation-discussion-document-on-implications-of-eu-and-wider-reforms.pdf**.

Query: *I am a partner in a medium-sized practice. I have a client which has been asking me about the ability to take advantage of the micro-entity accounting provisions contained in the Companies Act 2006.*

The client is a group of three companies ie a parent company with two 100% owned subsidiaries.

All three companies individually qualify as micro-entities. The group is small in size and no group accounts are prepared. Neither the companies nor the group are excluded from the small companies regime. The Holding company and one of the subsidiaries want to prepare their accounts under micro-entity provisions but the second subsidiary would rather report under FRS 102.

Is this allowed?

Answer: Section 395 of the Companies Act 2006 "Individual Accounts: Applicable Accounting Framework" at: **http://www.legislation.gov.uk/ukpga/2006/46/section/395** states:

"*A company's individual accounts may be prepared:*

(a) in accordance with section 396 ("Companies Act individual accounts"), or
(b) in accordance with international accounting standards (IAS individual accounts").

This is subject to the following provisions of this section and to section 407 (consistency of financial reporting within group)."

Section 407 of the Companies Act 2006 "Consistency of financial reporting within group" at: **http://www.legislation.gov.uk/ukpga/2006/46/section/407** places constraints on the choice between Companies Act and IAS individual accounts when a UK parent company prepares group accounts.

Section 407 states the following:

"*The directors of a parent company must secure that the individual accounts of:*

(1)(a) the parent company, and
(b) each of its subsidiary undertakings,

are all prepared using the same financial reporting framework, except to the extent that in their opinion there are good reasons for not doing so.

(2) Subsection (1) does not apply if the directors do not prepare group accounts for the parent company."

Therefore, since the parent company does not prepare group accounts in this case, subsection (2) above applies, meaning that there does not need to be consistency between the members of the group.

Entities within a group can apply a mixture of FRS 102, or the FRSSE, as these fall within the same "Companies Act Individual Accounts" accounting framework (as per FRS 102 A4.9 "All companies, other than those which elect or are required to prepare IAS individual accounts in accordance with the Act, prepare Companies Act individual accounts."

The next step is to consider whether the parent and subsidiary are able to use the micro-entity provisions.

The small companies (micro-entities) regulations 2013 are available from the following link: **http://www.legislation.gov.uk/ukdsi/2013/9780111105207/contents** and state the following:

"*(8) In the case of a company which is a parent company, the company qualifies as a micro-entity in relation to a financial year only if:*

(a) the company qualifies as a micro-entity in relation to that year, as determined by subsections (1) to (7), and

(b) the group headed by the company qualifies as a small group, as determined by section 383(2) to (7)."

and:

"(2) The micro-entity provisions also do not apply in relation to a company's accounts for a financial year if:

(a) the company is a parent company which prepares group accounts for that year as permitted by section 398, or

(b) the company is not a parent company but its accounts are included in consolidated group accounts for that year."

Therefore, because group accounts are not prepared, and the group qualifies as small, the parent and subsidiary can take advantage of the micro-entity provisions, on the basis that they qualify as such in all other respects. Based on the guidance above, and the information you have provided, it appears that the remaining subsidiary would be permitted to prepare FRS 102 accounts – that is, there is no obligation for the subsidiary to prepare micro-entity accounts because its parent is preparing micro-entity accounts.

EMPLOYMENT OWNERSHIP TRUSTS – ANOTHER ALTERNATIVE EXIT ROUTE FOR BUSINESS OWNERS

Selling to employees is a business model that is gaining ground in the UK and the introduction of Employee Ownership Trusts (EOTs) provides further encouragement for business owners and their advisers to consider the model.

An EOT allows a vendor to sell their business to their employees exempt from Capital Gains Tax (CGT). It is designed specifically for bona fide employee owned businesses and as such HM Revenue & Customs are keen to limit the use of the trust to genuine arrangements and not for tax avoidance purposes. There are therefore several conditions to fulfill in order for an EOT to qualify for capital gains tax exemption:

First of all, the trust must hold a controlling interest in the business, as defined under section 236 M(1) of Taxation of Chargeable Gains Act (TCGA) 1992. Essentially, the trust must hold in excess of 50% of the ordinary shares, and these shares must represent majority voting rights.

Secondly, there are participation and equality requirements, (ss 236J(1)(a)-236K TCGA 1992). All employees should benefit from any distribution from the trust, and this distribution must be on equal terms. There is some flexibility allowed within this generic condition; for example, distribution can be varied in relation to hours worked, length of service, or remuneration.

Finally, the trust must always be applied for the benefit of all employees, (s236J(1)(A) TCGA 1992). The dispositive powers of the trustees can never be exercised so as to apply the trust property: (a) other than for the benefit of all eligible employees on the same terms; (b) by creating another trust, transferring a property to another settlement; or (c) making a loan.

Once an EOT has a controlling interest, the aim is to retain that shareholding in the trust permanently. In that way, the EOT is intended as a permanent vehicle for owning shares.

Another tax exemption benefit allowed by the EOT structure is conferred on employees. The company can pay a bonus to employees, which will be exempt from income tax up to a limit of £3,600 in any tax year.

It is important to stress that tax concessions should not be the sole driver behind the adoption of an employee owned model. Employee ownership can be a good fit for a business where the owner is looking to divest or exit from their shareholding, and is looking to do so in a controlled and staged way. It is especially attractive to businesses looking to protect a history, or preserve a unique culture.

Anyone advising on a sale of a business should now consider a sale to an EOT as one option. It is not a structure that will fit with every company, but may well meet many of the aspirations of the exiting owner, with the CGT relief being a welcome incentive.

More information about EOTs and any aspect of employee ownership can be found on Scottish Enterprises Cooperative Development Scotland micro-site at: **http://www.scottish-enterprise.com/microsites/co-operative-development-scotland**.

TOP PRACTICE TIPS – STAFF

This is the last piece in our practice excellence series and focuses on firms' staff. Put simply, a firm is nothing without its staff and so a great deal of emphasis should be placed on ensuring that staff are motivated and engaged in promoting the interests of the firm. We take it for granted that your staff are technically competent in what they do, but what distinguishes your firm and sets it apart from your competitors is often the attitude of your staff, and how they go about serving the clients.

Here we look at some of the key concepts and ideas that you may wish to instil in your staff:

1. Take action and follow up, This is something that your staff have to take on board if they are to deliver an excellent customer service. If an issue is identified by a client, or a message needs to be relayed and followed up on, it is no good if your staff do not take ownership and ensure that the

issue is dealt with in a timely manner. Arguably a system should be in place to ensure that queries do not get forgotten about.

2. Get your staff to buy into the firm's culture and ethos. If your firm is about providing the owner-managed business with the complete compliance and advisory service, encourage your staff to broaden their skills and knowledge so that they can provide the best possible service to the clients and impress them with their professionalism and ability to put the client first. This will also help when it comes to business development.
3. Trickle down. Following on from the point above, helping to instil culture and ethos may be achieved by "buddying" new staff with staff above them. This ensures that the new staff members are able to learn about what the firm stands for and makes them feel involved. This also goes for staff higher up where mentoring by senior staff within the firm becomes an important aspect, particularly in relation to succession.
4. Communication at an office-wide level is another crucial element in making sure that staff feel involved and their contribution valued. Holding regular work in progress meetings is a good way for staff to discuss the issues facing them, to encourage staff to collaborate, and to discuss ways of solving any problems which they might have come up against. A practice might also wish to discuss the performance of the business with staff on a regular basis to show them how their input is affecting the business and make them feel that their work is valued.
5. Get staff talking about the practice. This is something that will only happen if the staff are engaged, happy and motivated by what they do. Happy staff who are positive about the practice will help spread the word about what you are doing and this should translate into further leads.
6. Get staff thinking like marketeers. If staff are interested in social media, encourage them to use this to the firm's advantage and improve the firm's visibility when it comes to search results etc. Firms should consider a social media policy for employees so that everyone is "on the same hymn sheet" and the name of the firm is not damaged in any way.
7. Encourage feedback and offer rewards. This will help improve processes and make sure that the dialogue isn't all one way. Staff will probably have some useful insights into where processes are too cumbersome and improvements can be made. Encourage them to suggest improvements and foster an entrepreneurial spirit within the firm. In other words – practise what you preach!

MONEY LAUNDERING UPDATE

National Crime Agency Publishes 2015 Threat Assessment

The National Crime Agency (NCA) has published its National Strategic Assessment (NSA) for 2015 of the threats posed by serious and organised crime.

The NSA provides a fascinating picture of the wide range of criminal activity with which law enforcement has to deal. For ICAS members, especially those in practice and others working in the regulated money laundering sector, it is a very useful insight into money laundering issues generally and specific areas of concern. These include organised crime, drugs, cyber-crime, bribery, identity theft and human trafficking. Very often criminals set up legitimate businesses to launder their money, and their businesses, legitimate or otherwise, often use the services of accountants for accountancy and tax. Practitioners should take steps to avoid becoming "professional facilitators" by applying appropriate anti-money laundering procedures.

More information and a copy of the NSA Threat Assessment is available at: **http://www.nationalcrimeagency.gov.uk/news/news-listings/638-latest-analysis-of-uk-crime-threats-published**.

ASK RON ABOUT IT – WINDOWS 10

Query: *I've seen in the papers that Microsoft are launching Windows 10 by giving free upgrades for a year from other versions. We've been using Windows 7 as we really don't like Windows 8 which we think is difficult to navigate and often conflicts with other software. Should we upgrade to Windows 10? Is it any better than previous versions, and will it cost us to upgrade?*

Answer: In a short answer – yes, you should upgrade to Windows 10! Whether it is any better than previous versions may be down to personal preference. However it is being advertised as the Windows you know, only better! You'll be delighted to know that the 'Start Menu' is back, but this time in an expanded format.

It is important for organisations which want to grow to embrace new technology, and hats off to those who have stuck with Windows 8, which was thankfully superseded by a slightly more familiar, user-friendlier version as Windows 8.1. It is no surprise that Microsoft skipped Window 9 completely and went straight to Windows 10, presumably wanting to distance the new version from the one that went before as much as possible.

So what are the new features we can look forward to in Windows 10?

- Microsoft Edge, an all-new browser that has been built to give users a better web experience
- Maps, Photos, Mail & Calendar, Music and Video as refreshed built-in applications
- OneDrive to back up your information and sync seamlessly across your Windows 10 devices
- A single view of up to 4 applications to see all open tasks in one place. You can even create virtual desktops when you need more space or want to group things by project.
- Cortana, Microsoft's clever digital assistant on Windows Phone 8.1, makes the jump to PCs with Windows 10, where Cortana assumes control of the operating system's search functions. By learning more over time, Cortana becomes more personal and useful to you. Cortana is also good at reminders, delivering them at the right time and the right place, so you can do more with the mental space that is being 'freed up'.
- Windows Hello will let you log in to your computer just by getting a look at your face in the webcam.

The short answer is Yes – I would encourage you to upgrade from Windows 7 to 10. However you must bear in mind that the software you use in your organisation may not yet be supported on the new operating system, so don't rush to upgrade your software too soon. Please check with software vendors first to ensure all of your essential systems have been thoroughly tested on Windows 10 before upgrading. Most vendors will keep you abreast of their developments proactively, but if they have not, you may end up in a situation where software stops working and they refuse to support you. The free Windows upgrade has by that point lost all of its appeal!

Windows 7*

From Edition	To Edition
Windows 7 Starter	Windows 10 Home
Windows 7 Home Basic	Windows 10 Home
Windows 7 Home Premium	Windows 10 Home
Windows 7 Professional	Windows 10 Pro
Windows 7 Ultimate	Windows 10 Pro

Windows 8**

From Edition	To Edition
Windows 8.1***	Windows 10 Home
Windows 8.1 Pro	Windows 10 Pro
Windows 8.1 Pro Student	Windows 10 Pro
Windows 8.1 Pro WMC	Windows 10 Pro
Windows Phone 8.1****	Windows 10 Mobile

*Must be running the latest version of Windows 7 (Service Pack 1) to receive the free upgrade to Windows 10 via Windows Update.

**Must be running the latest version of Windows 8 (Windows 8.1 Update) to receive the free upgrade to Windows 10 via Windows Update.

*** Also applies to Windows 8.1 country specific editions, Windows 8.1 Single Language, Windows 8.1 with Bing.

****The availability of Windows 10 upgrade for Windows Phone 8.1 devices may vary by OEM, mobile operator or carrier.

"N" and "KN" editions follow the upgrade path of the parent edition (e.g. Windows 7 Professional N upgrades to Windows 10 Pro).

Some editions are excluded: Windows 7 Enterprise, Windows 8/8.1 Enterprise and Windows RT/RT 8.1. Active Software Assurance customers in volume licensing have the benefit to upgrade to Windows 10 enterprise offerings outside of this offer.

As you mentioned, Windows 10 is a free upgrade for a year from release date, therefore the offer will expire on 28 July 2016. You can register for the free update by clicking on the small Windows icon located at the right end of the taskbar. Not every device will see the notifications at the same time, as there will be a staggered roll out to all capable devices. However, there may be some other potential reasons that you cannot see the upgrade notification; for example, if your device is not running Windows 7 SP1 or Windows 8.1 Update; or Windows automatic updates are not enabled on your device. It is Microsoft's intent that most of these devices will qualify, but some hardware/software requirements apply, and feature availability may vary by device. The availability of Windows 10 upgrade for Windows Phone 8.1 devices may vary by manufacturer, mobile operator or carrier.

Once you click "Reserve your free upgrade" in the 'Get Windows 10' app window you will be asked to enter your email if you want confirmation of this reservation. You will get a notification when your upgrade is ready which lets you schedule this installation for a time that is convenient and when you are sure your software is compatible. You need to reserve Windows 10 for each of your eligible devices, as the reservation is associated with the device and not the user.

After you upgrade, Windows 10 is yours to enjoy and for the first time ever, Microsoft will continue to keep it current for the supported lifetime of the device. Microsoft are kindly keeping you on like-for-like edition of Windows. For instance, if you are using Windows 7 Professional, you will upgrade to Windows 10 Pro.

Specifications

These are for a pre-released version of Windows 10 and are subject to change.

System requirements

Processor: 1 gigahertz (GHz) or faster processor or SoC

RAM: 1 gigabyte (GB) for 32-bit or 2 GB for 64-bit

Hard disk space: 16 GB for 32-bit OS 20 GB for 64-bit OS

Graphics card: DirectX 9 or later with WDDM 1.0 driver

Display: 1024x600

So far as ongoing costs are concerned, it is not 100% clear what will happen yet, as Microsoft have not yet announced anything. Some people are speculating that it may simply remain free. Others think it will go back to a pricing structure similar to what we have at the moment. Others believe it may go down the subscription route. All will become clear in due course, but until any future pricing structure is known, there is an obvious risk in upgrading without knowing the cost after the free period expires.

I hope this has answered your questions and you already feel like a Windows 10 expert!

TECHNICAL BULLETIN

EDITORIAL BOARD

ICAS

CA House 21 Haymarket Yards Edinburgh EH12 5BH
practicesupport@icas.com +44 (0) 0131 347 0249 icas.com