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AN ALTERNATIVE TO A MANAGEMENT BUYOUT

The Labour Party, in particular, is keen to encourage employee ownership of companies. The Scottish Government established "Scotland for EO" in September 2018 to create 500 employee owned companies by 2030.

An effective way of achieving this is through an Employee Ownership Trust (EOT).

The benefit to the vendor is that there is no capital gains tax liability at all, provided that the conditions are met. This is better than entrepreneurs relief and so the vendor can either receive more net proceeds or, the same net proceeds if he is willing to sell to the Employee Ownership Trust for a slightly lower price.

The Government's interest in, and encouragement for, employee ownership is understandable as, whereas Michelin can close down a factory in Dundee and transfer production abroad, a company owned by a EOT is unlikely to be shut down and its business transferred elsewhere by the workers who control it. Just as employees who benefit from share schemes, including Enterprise Management Incentives, should be motivated to help their employer succeed, so too should the employees of an EOT owned company.

As covered below, the EOT must own more than 50% of the shares of the company but, in many cases, the EOT will own all of the shares. In the latter scenario, it may be difficult to recruit or retain a managing director or other driving force if he has no direct stake in the company from which he can individually benefit on a future sale. This can be accommodated where the EOT does not own all of the shares but it is something to consider at the outset.

The legislation concerning disposals to EOTs is contained at Sections 236H-U TCGA 1992 and the main requirements for the disposal of ordinary shares in a company to an EOT to be deemed to be for a consideration which gives rise to neither a gain nor a loss are:

(a) The company must either be a trading company which is not a member of a trading group or be the principal company of the trading group from the date of disposal to the end of the tax year of disposal.

(b) The EOT must meet the "all employee benefit requirement" from the date of disposal to the end of the tax year.

(c) The EOT must meet the controlling interest requirement up until the end of the tax year of disposal. Broadly, the trustees must hold more than half of the company's ordinary share capital and voting rights, the profits available for distribution to equity holders and the assets available for distribution to equity holders on a winding up. There must be no agreement which would result in this not being satisfied, without the trustees consent.

(d) The limited participation requirement must be met. Broadly, the participator fraction should not exceed 2/5 at any time between the date of disposal and the end of the tax year. The participator fraction is a fraction of the total number of persons who are both participators and employees or office holders divided by the number of persons who are employees of the company.

(e) The capital gains relief must not apply to any related disposal by the same person, or a person with whom he is connected, which occurs in an earlier tax year.

There is a number of disqualifying events which apply if:

- The company ceases to meet the trading requirement.
- The EOT ceases to me the all employee benefit requirement.
- The EOT ceases to meet the controlling interest requirement.
- The participator fraction exceeds 2/5.
- The trustees act in a way which the all employee benefit requirement does not permit.

Clearly, there is a significant capital gains tax benefit to the vendor. The employees, as a group, control their employer company through the medium of the EOT. Additionally however, the company is able to pay tax free bonuses of up to £3,600 per annum to employees on similar terms. These could be amounts based on relative remuneration levels, length of service of hours worked. Again there are conditions which are covered by the legislation of Section 312 A ITEPA 2003.

The EOT legislation was introduced in the 2014 Finance Act, with some success but there has been much recent publicity of the advantages of selling to an EOT rather than a trade purchaser or a management buyout team or a trade sale, not least being the recent Scottish government support.

ENTREPRENEURS' RELIEF - IMPORTANT WARNING

You will be aware of the recent budget proposal that, in order to qualify for entrepreneurs relief, the qualifying conditions will have to be met for a 24 month period, rather than a 12 month period for disposals after 5 April 2019.

You can stop reading now unless you have clients who hold shares in a company with more than one class of share or which has received loans on an uncommercial basis.

Up until now the three main requirements have been that the vendor must:

- hold shares in an unquoted trading company,
- hold at least 5% of the ordinary share capital and voting rights.
- Have been an officer or employee.

Hitherto, these tests have to be met throughout the 12 month period to date of disposal but, as noted above, this is being extended to 2 years which does not appear to be too unreasonable.

It is the further proposals, which have already been passed by the Committee of the Whole House, which will potentially prevent even a controlling shareholder who has owned his shares for decades from benefitting from entrepreneurs relief.

The problem is that two additional tests are being introduced to the requirement that the shareholder must hold at least 5% of the ordinary shares and voting rights.

Firstly the holder must be beneficially entitled to at least 5% of the profits available for distribution to the equity holders of the company and secondly, the holder would be beneficially entitled to at least 5% of the assets of the company available for distribution to equity holders, on a winding up.

These tests will have to be met *throughout* the 2 year period to date of sale.

Profits Available for Distribution

If the ordinary shares are, for example, divided into, A and B shares and the Articles allow for dividends to be paid on these shares at differing rates then it is perfectly possible, under the Articles, that dividends can be voted in respect of one class of shares and not the other. No class of share may be *entitled* to a dividend and so entrepreneurs' relief will not be available.

The Articles could be amended to provide that, for example, all shares rank for dividends pari passu but this may defeat the purpose of there being different classes of shares. It may be possible to amend the Articles to provide that, on the declaration of a dividend, any shareholder who holds at least 5% of the ordinary shares and voting rights is entitled to a dividend of at least 5% of the total amount declared.

A number of people have taken this point up with contacts within HMRC who are saying that the proposed legislation will not be employed in this way. So far there is no official guidance but this begs the question of whether individuals should be taxed by statute and untaxed by concession or practice?

Furthermore, and conspiracy theorists may like this one, is whether someone within HMRC is trying to do away with multiple classes of shares in a company without actually abolishing them? Generally, and understandably, very few members of Parliament have a deep understanding of tax statute and it is therefore more likely that someone at a high level within HMRC, who does have a deep knowledge of tax, has come up with the 5% of profits available for distribution idea. There is previous history of HMRC practice not being followed by HMRC themselves. Readers will recall that HMRC's long standing practice in Booklet IR20 was ignored in the Gaines-Cooper case.

Assets on a Winding Up

The first issue is that assets available for distribution to equity holders is not defined in the entrepreneurs relief legislation but we are instead referred to part 5, chapter 6, Capital Taxes Act 2010 (CTA 2010). Section 166 states that the available assets of a company are the amount of the assets minus the amount of the liabilities as shown in its balance sheet at the end of the relevant period. What happens, as will often be the case, when a shareholder sells his shares at a date other than a date to which a balance sheet is prepared?

If the company has assets, such as goodwill or other intellectual property, whose value is not included in the balance sheet then these will be effectively ignored.

The second issue is what is an equity holder? Section 158 CTA 2010 says that an equity holder is any person who holds ordinary shares in or is a loan creditor of the company in relation to a loan other than a normal commercial loan. Bank loans are therefore not an issue. A director's loan provided to the company on an interest free basis and with no terms for repayment is unlikely to be a normal commercial loan. The definition adopted is that contained in Section 162 CTA 2010 and, inter alia, a normal commercial loan is not one which:

- Can be converted into shares or securities, (with limited exceptions).
- The interest payable is dependent on the results of the company, the value of its assets or exceeds a reasonable commercial return.

Apparently, the above changes are intended to strike against "funny shares" used in some private equity investments to obtain entrepreneurs relief in circumstances which Parliament did not intend.

However, the effect of the budget proposals can be that a shareholder who has worked for a trading company for many years holding far more than 5% of the ordinary shares and voting rights will not obtain entrepreneurs relief on sale because, for example an institutional investor holds a modest percentage of ordinary shares of a different class, or where a shareholder has very generously provided a substantial interest free loan to help the company out.

Resolution 40

A number of representations were made to the Government regarding the effects of the above proposals. These appear to have been taken into account and Resolution 40 introduces a new Clause 38 to Schedule 15, Finance (No.3) Bill which introduces an alternative test into the definition of "personal company" which can apply instead of the original two tests introduced by the schedule. A link to Resolution 40 is below.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767833/Amendments_2_and_3_to_Clause_38__Schedule_15_Entrepreneurs__Relief.pdf

Paragraph 7 introduces new sub section (3) which requires an individual to: hold 5% of the ordinary share capital of the company and have 5% of the voting rights, and meet one of the two new conditions found at new sub section (3)(c). These are (i) that the individual is entitled to both 5% of the profits available for distribution and assets available for distribution in a winding up or (ii) in the event of a disposal of the ordinary share capital of the company the individual would be entitled to 5% of the disposal proceeds.

As noted above, the tests under (i) can in certain circumstances result in entrepreneurs relief not being available but the alternative test under (ii) should remove the issue, particularly when dealing with a company with more than one class of share as generally, the differing classes will all be entitled to the same amount per share on a sale or winding up.

An issue may still remain where there are private equity or institutional investors as individual shareholders may own different classes of shares and may not meet the conditions of new sub section (3).

When enacted, the new provisions should achieve the Government's objective in relation to "funny shares" but leave the entrepreneurs relief position of "genuine" investors undisturbed.

ICAS TECHNICAL SERVICE GOES DIGITAL

ICAS has ramped-up its technical and regulatory help to members with the launch of an online bank of resources and a new digital service.

The online bank of resources is the first port of call for members with regulatory or technical queries. FAQs on ICAS regulatory matters and links to technical guides can now be accessed via one central point.

Our comprehensive FAQs and guides should resolve the majority of queries, but If an answer can't be found, a question can now be logged with our technical teams using the new digital technical queries portal.

The digital portal makes it easier for members to identify and contact the appropriate technical team, which will help provide a faster response time. It replaces the process of submitting queries by email. The new digital portal also offers greater security and data protection.

You can submit technical and regulatory queries on:

- Accounting and auditing
- Tax
- Practice support
- Anti-money laundering and GDPR
- Insolvency
- Ethics

Step one: Access our FAQs and online resources

Step two: Raise a technical query on our digital portal

DEATH OF AN (ISA) INVESTOR

Income and gains in respect of ISA investments are exempt from tax up to the date of death. The ISA will come to an end on the death of the investor. Thereafter, the executors were subject to tax on income and gains arising after the death of the investor.

The Individual Savings Account (Amendment Number 3) Regulations, SI2017/1089 allows income and gains received during the administration period to continue to qualify for the tax exemptions with effect from 6 April 2018.

No additional investment can be paid into the ISA but it will remain tax free until the earlier of:

- The completion of the administration of the estate.
- The closure of the ISA.
- Three years after the death of the investor.

This is perhaps of more relevance to the legal profession but is nevertheless worth keeping in mind.

VAT: RESIDENTIAL CONVERSIONS, NEW BUILDS, REFURBISHMENTS AND EXTENSIONS

Most of us know that, in certain circumstances, there are VAT reliefs for work done on residential properties. This article is a short reminder of where those opportunities arise.

Note that the article is restricted to comments about self-contained dwellings and excludes other residential purpose buildings, such as nursing homes or other institutional dwellings.

New Builds

The supply of services (and related goods supplied by a supplier of construction services) for the purposes of constructing a new residential property is zero-rated. Only articles incorporated into the building or the building site are included here, thus, built-in kitchens are included but the supply of free-standing items are not. Note that zero-rating does not apply to the supply of architect, surveyor or similar professional services.

It is important to bear in mind the distinction between new builds and extensions and alterations, however major. The zero-rated construction of a new building does not cover the conversion, reconstruction or alteration of an existing building. An enlargement of an existing residential property would only be zero-rated if the enlargement or extension created an additional dwelling or dwellings.

Also covered by the zero-rating legislation, is the supply of

qualifying services (and related goods) to a housing association for the purposes of converting a non-residential building, or part of a non-residential building, into a dwelling. Similarly, the supply of architects, surveyors etc do not qualify for zero-rating, but are standard rated.
In the past there was scope to zero-rate certain alteration services supplied in respect of protected buildings (essentially listed residential properties) however this relief was withdrawn in 2012.

Residential Conversions

VAT is charged at the reduced rate of 5% on qualifying goods and services, supplied in the course of certain residential conversions. The relevant goods include building materials and certain electrical goods incorporated into the property, by the supplier of the construction services. As above, the reduced rate does not apply to the supply of architects and other professional services.

The types of conversions that enjoy this relief are wide ranging:

- Any conversion that changes the number of dwellings. For example, the conversion of one house into two or more flats or the opening up of two flats into one large house;
- A conversion of a non-residential building into any number of dwellings;
- The renovation or alteration of a dwelling that has been unoccupied for at least two years.

Qualifying services means any services in respect of the fabric of the building (including repairs and maintenance) and also work within the immediate site of the property, for example, the means of providing water or drainage. All other services and related goods are standard rated, for example, the installation of goods that do not form part of the fabric of the building, such as carpets, the erection and dismantling of scaffolding, the hire of goods, landscaping and the provision of professional services such as architects, surveyors etc.

With respect to the renovation of a dwelling that has been empty for two years or more, the property must have been empty for the two years prior to the commencement of the works. In this instance, it is necessary for the supplier of services (and related goods) to hold evidence that the property has been unoccupied for the two-year period. Relevant evidence might include the electoral roll or council tax data.

Extensions

An extension will not qualify for any relief from the standard rate of VAT unless the extension forms a separate self- contained dwelling, in which case the construction services and related goods would be zero-rated or, if the property had been unoccupied for two years or more, in which case services would be liable to VAT at the reduced rate.

Do-It-Yourself Housebuilders

There is a special VAT refund scheme for DIY housebuilders (and converters) that refunds VAT incurred by someone undertaking such a project, not in the course of a business, to reclaim any VAT incurred. The purpose of this scheme is to put the DIY housebuilder in the same position as someone buying a new house, who would not incur VAT on the purchase (as it would either be a zero-rated sale of a new property or an exempt sale of an older property).

FRC PROPOSES AMENDMENTS TO FRS 102 – DEFINED BENEFIT SCHEMES

The Financial Reporting Council has issued an exposure draft FRED 71 which proposes changes to Financial Reporting Standard (FRS) 102 ‘The Financial Reporting Standard applicable in the UK and Republic of Ireland’ with respect to multi-employer defined benefit plans. It is the FRC’s understanding that some multi-employer defined benefit plans are carrying out exercises with a view to being able to provide, for the first time, sufficient information to participating employers to facilitate the use of defined benefit accounting.

FRS 102 does not set out requirements to specifically address the transition from defined contribution accounting to defined benefit accounting for a multi-employer pension plan. The FRC has become aware that there are differences of opinion as to how the extant related requirements of FRS 102 are be interpreted and applied to such transitions. The FRC is concerned that an inconsistency of approach and any resulting differences in accounting practice by employers participating in the same multi-employer defined benefit plan could be unhelpful to users of financial statements.

The FRC has therefore proposed to establish new and explicit requirements for how an entity shall transition from defined contribution accounting to defined benefit accounting when sufficient information becomes available. When an entity has previously applied defined contribution accounting to such a scheme and has entered into an agreement that determines how it will fund a deficit, it will have recognised a liability for the contributions payable arising from that agreement. The FRED proposes amendments to Section 28 of FRS 102 'Employee Benefits' to require the difference between any liability for the contributions payable arising from an agreement to fund a deficit and the net defined benefit liability recognised when applying defined benefit accounting, to be recognised in other comprehensive income.

The FRC proposes that the amendments are effective for accounting periods beginning on or after 1 January 2020, with early application permitted. A further article will be included in Technical Bulletin once the FRC has concluded on this matter.

WORRIED ABOUT WHAT GDPR MEANS FOR ACCOUNTANTS? EXPERTS ANSWER YOUR TOP 11 QUESTIONS

As accountants, we are no strangers to tackling complicated issues. But the questions our clients have been raising lately about GDPR have been harder to answer than our usual queries.

Throw in the assault of "sign in" emails we all received on 25th May, and we could be forgiven for our already jaded outlook on the new data protection legislation.

In an effort to keep things simple, here are the top frequently asked GDPR questions – and what the new law actually means for accountants and their clients.

1. **In a nutshell – what is GDPR?**

   It replaces the 1998 Data Protection Act for our current data landscape. Technology has moved on a lot in 20 years. It is aimed to protect individual's data and the way companies use it.

2. **I run a small accountancy practice in Scotland. Why should I care about GDPR?**

   The UK have adopted GDPR and have brought in fines and criminal sanctions for those who fail to implement it. If you deal with personal data, your client will care how you manage their sensitive information. Small companies are more at threat of being breached than ever before.

3. **Our practice keeps the personal data of clients both past and present, but we don't use our lists for marketing or advertising. Do I still need to take action?**

   Yes, if you hold the data then you are accountable for it. You must only hold onto data that you have legitimate reason to hold onto.

4. **I'm a sole practitioner and I only have a handful of clients. I'm exempt from this, right?**

   Afraid not – it's not about the size of your practice but the data you hold on to. For example, if you carry out a tax return for a celebrity and the data is desirable, you must still protect it. Just because you have a small practice does not make the data you handle any less desirable.

5. **I work in a small firm, and there's only a handful of accountants and our operations team. How many of us need to be trained on handling data?**

   Everyone! The biggest problem we see is that because you deal with sensitive data on a daily basis you can be more blasé with it. As above, just because you deal with payroll information on a daily basis and it is normal for you to handle it doesn't mean that it is not sensitive information that should be stored and managed correctly.

6. **I've heard we might need a Data Protection Officer. Why, and who should it be?**

   Might is the correct word. Even though for small practices it may not be required, it may be the moral and ethical thing to do. From a reputational stand point it would show that you take the data you deal with seriously and makes it easier for staff and clients to know who to contact in relation to data covered by GDPR.

If you register your DPO then they must comply with the duties of a DPO. We would also recommend making sure the contact details are for a group or more than one person as the timeline you must deal with matters can be strict.

7. **We regularly send our clients updates by email. What changes should I have put in place – and what's my next step?**

Email was never designed to be secure, it was designed to be a cheap and quick way to communicate over the internet. If you are sending emails, then you need to make sure the email does not contain personal sensitive information. If you are sharing data governed by GDPR then make sure the data is encrypted in an online portal or an encrypted email.

None of this security is designed to make it easier to share the data. In fact, it is designed to make it harder to access. A bit like putting a burglar alarm on your home or gate on your driveway.

8. **As an accountant I know a lot about risk assessment. But how do I apply my skills to GDPR?**

The same way as you did with the DPA. The fines are frightening but you are more likely to go out of business through poor reputation if you fail to comply. Simple things like encryption can be turned on for free and if a breach was to occur it would put you in a better light with the ICO.

9. **I've heard rumours about hefty fines. What happens if I don't comply with the law?**

Some people say it doesn't matter if you don't get found out, but if you are dealing with personal sensitive data under GDPR and using it unlawfully, then you are likely to get reported to the ICO. We are seeing more accountants' clients asking what their data protection policies are before they appoint them.

10. **We work with vendors for our IT resources, and they help us with file sharing and data encryption. How do I know if my IT vendor is GDPR compliant and what should I be looking for in an IT partner?**

They need to understand what you do and how you work. It is important as a practice to be transparent with your IT provider. If you are emailing unencrypted personal sensitive information, let them know and they can help solve the problem.

11. **OK – I've read everything and realise I need to make some changes. Where do I start?**

GDPR covers so many things and it's not all IT related. From an IT perspective though, we believe the government's Cyber Essentials scheme will take you through the basics and act as a good vehicle to get you and your IT provider to talk through your data security worries. Even though some things are free to 'turn on', the time taken, and the inconvenience can be costly.

No matter how much money you spend on technology, it can only help so much. People are the weak link in the chain and training and awareness should not be overlooked!

REVISED INTERNATIONAL STANDARD ON AUDITING (ISA) (UK) 540 AUDITING ACCOUNTING ESTIMATES AND RELATED DISCOLSURES PUBLISHED

Introduction

Given the increase in length of the standard it is not surprising that it contains new and enhanced application material as well as expanded documentation requirements. On a more positive note the introduction of objectives-based work requirements is welcomed.

ISA (UK) 540 Revised is effective for audits of financial statements for periods beginning on or after 15 December 2019 although earlier adoption is permitted and encouraged. It deals with the auditor's responsibilities relating to accounting estimates and related disclosures in an audit of financial statements. Specifically, it includes requirements and guidance that refer to, or expand on, how ISA (UK) 315 (Revised June 2016), ISA (UK) 330 (Revised July 2017), ISA (UK) 450 (Revised June 2016), ISA (UK) 500 and other relevant ISAs (UK) are to be applied in relation to accounting estimates and related disclosures. It also includes requirements and guidance on the evaluation of misstatements of accounting estimates and related disclosures, and indicators of possible management bias.

Objective

The objective of the auditor is to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures in the financial statements are reasonable and adequate in the context of the applicable financial reporting framework

Rationale for Revision

The new standard is substantively based on the standard recently issued by the International Auditing and Assurance Standards Board (IAASB) with only minor UK specific material being added. Initially the primary focus of the objectives was to meet demands from various regulatory bodies with regards to the response required from auditors in relation to the changes in accounting for financial instruments introduced by International Financial Reporting Standard (IFRS) 9 'Financial Instruments' the successor to International Accounting Standard (IAS) 39 'Financial Instruments: Recognition and Measurement'.

IFRS 9 includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting. However, during the development of the revised ISA this focus was widened to better reflect the need to consider the auditing requirements in relation to accounting estimates in a more holistic manner and not just those pertaining to financial instruments. The revisions are intended to introduce more robust requirements and appropriately detailed guidance to foster audit quality by driving auditors to perform appropriate procedures in relation to accounting estimates and related disclosures. These revisions would also emphasise the importance of the 'appropriate application of professional scepticism' when auditing accounting estimates.

Estimation Uncertainty

Accounting estimates vary widely in nature and are required to be made by management when the monetary amounts cannot be precisely determined. The measurement of these monetary amounts is subject to estimation uncertainty, which reflects inherent limitations in knowledge or data. These limitations give rise to inherent subjectivity and variation in the measurement outcomes. The process of making accounting estimates involves selecting and applying a method based on assumptions and data, which relies on management judgement and which can be subject to complexity in their measurement. The effects of these and other inherent risk factors, give rise to the susceptibility of accounting estimates to misstatement.

Although the standard applies to all accounting estimates, it recognises that the degree to which an accounting estimate is subject to estimation uncertainty will vary substantially. Therefore, the nature, timing and extent of the risk assessment and further audit procedures required will vary in relation to the estimation uncertainty and the assessment of the related risks of material misstatement. For certain accounting estimates, estimation uncertainty may be very low, based on their nature, and the complexity and subjectivity involved in making them may also be very low. For such accounting estimates, the risk assessment procedures and further audit procedures required by this ISA (UK) would not be expected to be extensive. This is likely to be the case in the audits of many smaller as well as less complex organisations, although of course there will be exceptions. When estimation uncertainty, complexity or subjectivity are very high, such procedures would be expected to be much more extensive. Guidance on how the requirements can be scaled is included at paragraphs A20–A22, A63, A67 and A84 of the ISA.

Separate Assessment of Inherent Risk and Control Risk

A separate assessment of inherent risk and control risk is required when assessing the risks of material misstatement at the assertion level for accounting estimates is required. Depending on the nature of a particular accounting estimate, the susceptibility of an assertion to a misstatement that could be material may be subject to, or affected by, estimation uncertainty, complexity, subjectivity or other inherent risk factors, and the interrelationship among them.

As explained in ISA (UK) 200 (Revised June 2016), inherent risk is higher for some assertions and related classes of transactions, account balances and disclosures than for others. Accordingly, the assessment of inherent risk depends on the degree to which the inherent risk factors affect the likelihood or magnitude of misstatement, and varies on a scale that is referred to in the standard as the spectrum of inherent risk.

In assessing control risk, the auditor takes into account whether the auditor's further audit procedures contemplate planned reliance on the operating effectiveness of controls. If the auditor does not perform tests of controls, the auditor's assessment of the risk of material misstatement at the assertion level cannot be reduced for the effective operation of controls with respect to that particular assertion.

Tests of Internal Controls and Further Audit Procedures

The standard refers to relevant requirements in ISA (UK) 315 (Revised June 2016) and ISA (UK) 330 (Revised July 2017), and provides related guidance, to emphasise the importance of the auditor's decisions about controls relating to accounting estimates, including decisions about whether:

- There are controls relevant to the audit, for which the auditor is required to evaluate their design and determine whether they have been implemented.
- To test the operating effectiveness of relevant controls.

Additionally, it emphasises that the auditor's further audit procedures (including, where appropriate, tests of controls) need to reflect the reasons for the assessed risks of material misstatement at the assertion level, taking into account the effect of one or more inherent risk factors and the auditor's assessment of control risk.

Professional Scepticism

The exercise of professional scepticism in relation to accounting estimates is affected by the auditor's consideration of inherent risk factors, and its importance increases when accounting estimates are subject to a greater degree of estimation uncertainty or are affected to a greater degree by complexity, subjectivity or other inherent risk factors. Similarly, the exercise of professional scepticism is important when there is greater susceptibility to misstatement due to management bias or fraud whether intentional or unintentional.

Evaluation

The auditor is required to evaluate, based on the audit procedures performed and the audit evidence obtained, whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or whether they are misstated. The assessment of "Reasonable" in the context of the applicable financial reporting framework means that the relevant requirements of the applicable financial reporting framework have been applied appropriately, including those that address:

- The making of the accounting estimate, including the selection of the method, assumptions and data in view of the nature of the accounting estimate and the facts and circumstances of the entity;
- The selection of management's point estimate; and
- The disclosures about the accounting estimate, including disclosures about how the accounting estimate was developed and that explain the nature, extent, and sources of estimation uncertainty.

Documentation

The auditor is required to include:

(a) Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control related to the entity's accounting estimates;

(b) The linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the assertion level, taking into account the reasons (whether related to inherent risk or control risk) given to the assessment of those risks;

(c) The auditor's response(s) when management has not taken appropriate steps to understand and address estimation uncertainty;

(d) Indicators of possible management bias related to accounting estimates, if any, and the auditor's evaluation of the implications for the audit; and

(e) Significant judgments relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated.

ISA 540 Revised (UK) is available at:

https://www.frc.org.uk/getattachment/0fa69c03-49ec-49ae-a8c9-cc7a2b65382a/ISA-(UK)-540_Revised-December-2018_final.pdf

HMRC GUIDANCE ON PREPARING FOR MTD

HMRC has released some guidance (8 February 2019) on Making Tax Digital for VAT as an agent: step by step. Rather than publishing something entirely new, HMRC has in essence created an index to existing material. This should make the material more accessible and provide a landing page for agents.

The guidance sets out six key steps and provides links to further material. The six HMRC steps are:

1. Talk to your clients
2. Get the right software
3. Create an agent services account
4. Link clients to your agent services account
5. Sign your clients up for Making Tax Digital
6. Authorise your software

Talking to your clients and getting the right software

From HMRC's perspective this involves identification of mandation date. Which clients are in from April 2019, which deferred until October 2019?

There is also a link to the Making Tax Digital for Business - stakeholder communications pack and the MTD software suppliers page.

From a practical perspective, firms should ensure that any clients in the deferred group have received a formal letter deferring their MTD start date. If not, they should contact the HMRC VAT helpline.

Clients voluntarily registered (with turnover under the mandation threshold of £85,000) may need reassuring that the existing arrangements continue for them.

Businesses seeking exemption will need to contact HMRC. Grounds for exemption are, per VAT notice 700/22 para 2.2:

You will not have to follow the Making Tax Digital rules where HMRC is satisfied that:

- *your business is run entirely by practicing members of a religious society whose beliefs are incompatible with the requirements of the regulations (for example, those religious beliefs prevent them from using computers)*
- *it is not reasonably practicable for you to use digital tools to keep your business records or submit your returns, for reasons of age, disability, remoteness of location or for any other reason*
- *you are subject to an insolvency procedure*

These may apply even if you are not currently exempt from online filing for VAT.

Creating an agent services account and linking to clients

To access HMRC MTD services, agents will need an MTD 'agent services' account. If you have used the Trust Registration Service, you will already have one.

For firms wishing to set up an account, there is a link to the agent services page. This asks for AML registration details. ICAS members should use 12 months from their membership renewal date as the expiry date.

Try the Link clients to your agent services account page to address the next stage of digitally linking to your clients on HMRC's new system.

For agents not based in the UK, there is separate guidance - Apply for an agent services account if you are not based in the UK.

Signing up

The final two stages from HMRC are signing clients up to the MTD pilot and authorising your software.

HMRC is encouraging businesses to sign up as soon as possible. You may wish to agree a start date with clients. Going in to the pilot is designed to be a one-way street: in essence it means entering MTD early and no longer using the existing portal.

As regards authorisation of software, HMRC says: *'Before you can send VAT returns digitally, you'll need to authorise your software. Ask your software supplier if you do not know how.'*

As with all computer systems, there are likely to be teething problems. Check the earliest likely MTD submission date for your firm – which may be for the June 2019 quarter – and try and get in some practice before the return is finally due.

WHAT NOT TO DO AT A TAX TRIBUNAL

In a recent case about ciabatta rolls and breakfast muffins, getting the basics wrong cost the taxpayer dear. VAT produces many conundrums. Is a chocolate brownie a cake or confectionery? Is a ski-lift public transport? And is hot takeaway food 'hot'?

In the recent case of EAT Limited we might have expected a repeat of the finely-balanced arguments over takeaway food. But instead, we had a dramatic reversal. The taxpayer's case was thrown out as a waste of time and an order given to pay HMRC's costs. What went wrong?

Orders for costs

Under the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, rule 10, the First Tier Tax Tribunal, for non-complex cases, may award costs against one of the parties only in exceptional circumstances.

The Tribunal may award costs where it 'considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings' or where there are 'wasted costs'. That is, costs incurred due to an 'improper, unreasonable or negligent act or omission on the part of any legal or other representative or any employee of such a representative'.

Costs of unreasonable behaviour

Awards of costs are not at all common at FTT and UT. In what sort of cases are costs likely to be awarded, and against whom?

A quick review of cases shows as many awards against HMRC as for it. And in all cases, the offending party's behaviour seems wholly unreasonable, such as being based on non-existent transactions and legally-impossible claims.

For example, in Nicholas Deluca, HMRC had 'pursued the wrong person for the tax'. PAYE regulations clearly made the employer liable and nothing could make Mr Deluca liable.

In a VAT case, Reddrock Ltd (Reddrock Ltd v Revenue and Customs Commissioners [2014] UKUT 61 (TCC)) the taxpayer was made liable for HMRC's costs after the Tribunal disallowed a claim for input tax because 'supplies to which the invoices related had not taken place'. No transaction, no input tax.

So what went wrong with the breakfast muffins?

Partially cooked breakfast

EAT Ltd was claiming a refund of overpaid VAT of £486,215 on breakfast muffins and another £123,014 in respect of grilled ciabatta rolls, on the basis that the sales should have been zero rated as food, not standard rated as hot takeaways.

The kernel of EAT Ltd's case was that breakfast muffins and grilled ciabatta rolls were delivered to the food outlets '90% cooked'. The final 10% of the cooking was done on site. EAT even had a colour chart so outlets could check deliveries for paleness.

As regards this 10%, was the food heated 'for the purposes of enabling it to be consumed hot'? In which case it should be standard rated, or could EAT Ltd provide a convincing alternative explanation?

Could this be viewed as similar to a supermarket selling pies which are baked on the premises, placed on racks and, potentially, bought by consumers while still warm?

What the law says - legally hot

VAT Notice 709/1: catering and take-away food and Value Added Tax Act 1994 (VATA 1994) s30 (2) provides zero rating for food. The detailed list of what is covered is in VATA 1994 schedule 8 group 1.

For the purpose of standard rating hot takeaway food, 'Hot food' is now defined as 'food which is hot when provided to the customer, and:

- has been heated for the purposes of enabling it to be consumed hot, or
- has been heated to order, or
- has been kept hot after being heated
- is provided to a customer in packaging that retains heat … or in any other packaging that is specifically designed for hot food, or
- is advertised or marketed in a way that indicates that it is supplied hot'.

'Hot' is defined as 'above ambient air temperature' and 'kept hot' includes re-heating or slowing down the cooling process.

Customer service

So, where did finishing off the 90%-cooked breakfast muffins and grilled ciabatta rolls fit? The process was described in the firm's training manual under 'Toasties'. A customer would purchase a muffin or ciabatta which would then be placed in the grill for 2 minutes, or longer if needed. As EAT's staff acknowledged, 'customers did not want cold bacon in a hot roll'.

The heated rolls were then placed in foil-lined bags labelled 'EAT HOT', before being given to the customer. The company said that this labelling should be read as 'EAT' being the firm's name, and 'HOT' meaning that the food was hot. Not as an instruction to 'EAT HOT'.

Checking off against our VAT checklist it looked rather as if the food had been heated for the purposes of enabling it to be consumed hot, and heated to order, and provided to a customer in packaging that retained heat …

Was it is also advertised or marketed in a way that indicated that it was supplied hot? HMRC thought so but did not produce evidence to prove the point.

Fresh not hot

EAT Ltd's main argument was that the food was heated so it could be served 'fresh' rather than 'hot'.

This is reminiscent of the Deliverance Ltd case ([Deliverance Ltd v Revenue and Customs Commissioners [2011] UKUT 58 (TCC)]). Here the business owners successfully argued that the food was heated in order to comply with health and safety rules and not in order for the customer to consume it hot.

But heated to be 'fresh'? EAT outlets also sold baguettes and croissant that were cooked at the outlet and allowed to cool before sale. EAT staff confirmed that these products were fresh, even if they were not hot when sold.

At this stage it became clear that the taxpayer had lost the favour of the Tribunal: '*Although not relevant to my decision (and I have not taken it into account), there is perhaps a certain irony in describing these products as "fresh", as they were prepared in a central kitchen, away from the retail premises, using pre-cooked or pre-prepared ingredients'.*

The Tribunal decided that it was standard rated hot takeaway food.

An unsurprising decision?

EAT Ltd's case, and others, had been stacked behind a case brought by a Subway franchise. This case went to the Court of Appeal ([Sub One Ltd (t/a Subway) v Revenue and Customs Commissioners [2014] EWCA Civ 773]) and was decided in favour of HMRC – standard rating the takeaway food.

But there had been an earlier decision John Pimblett (John Pimblett and Sons Ltd v Customs and Excise Commissioners - [1988] STC 358) concerning partially cooked pies 'finished off' on site, which was decided in favour of the taxpayer's – zero rating the pies.

So following Pimblett, EAT's case had at least a possibility of success, but looking at Sub One it seemed unlikely. How would the conflict be resolved?

Following Sub One

The Tribunal followed Sub One, setting aside the Pimblett judgement. It commented:

'There has been considerable litigation on the meaning of "hot food", and the decision of the Court of Appeal in Sub One Limited (t/a Subway) (in liquidation) v HMRC [2014] EWCA Civ 773 reviews the meaning of the legislation, and in particular whether the "purpose" test in the legislation should be construed objectively or purposively.

The decision of the High Court in John Pimblett v HMCE [1987] STC 202 adopted a subjective interpretation. However, this is inconsistent with EU law, which requires an objective test.'

Adopting the approach from Sub One, the Tribunal looked at the common intention of EAT and its customers. Objectively, EAT had to show this common intention was '*that the food ….. was not supplied in order to be eaten hot'*.

Conclusion

Given the previous conflicting decisions, the taxpayer might have thought it had a chance of success. But this case clearly shows the risk of taking a case to FTT where a higher court has recently ruled otherwise.

INCREASES IN MINIMUM PENSION CONTRIBUTIONS – APRIL 2019

Research published recently by The Pensions Regulator (TPR) shows that the vast majority of staff are continuing to save more into their pension following the increases in pensions contributions in April last year.

The on-going duties survey of employers showed less than 2% of staff in medium, small and micro businesses asked to leave their workplace pension as a result of the increase in contributions.

The survey also showed 47% of medium sized businesses are paying at least some or all of their staff more than the minimum employer contribution, with 25% and 22% of small and micro employers respectively paying more than the automatic enrolment minimum.

In April this year, the minimum pensions contributions will increase again from 5% total to 8%. Increasing contributions should be a straightforward task for your clients to do but there are a number of checks they need to make and you should encourage them to start in good time. TPR has information alerting employers about what they need to do.

While it's not a legal duty to tell staff about the increase, you should encourage employers to have the information they need about their staff's workplace pension and how it is changing. TPR's research shows most employers told their staff about the increases last year and when asked by their workers about workplace pensions, they felt they had the information they needed.

The vast majority of employers are successfully meeting their automatic enrolment duties and it's now business as usual for them. Automatic enrolment is creating a new savings culture and the increase in contributions is an important part of the policy to boost retirement outcomes.

Most employers want to do the right thing for their staff and it's very helpful to employers who are trying to get things right. However they will take action if an employer is not meeting their responsibilities. Failing to make and maintain the correct pensions contributions could result in a fine or court action.

It is not enough to just comply with automatic enrolment laws by putting staff into a scheme. Employers must also meet their duties to contribute into their employees' pensions every month and they must ensure they are paying in at least the minimum. Pension providers have a duty to tell TPR if an employer is not maintaining the correct contrbutions and staff can also use our anonymous whistleblowing service if they are concerned the correct payments are not being made.

Three things for employers to check:

- *Will their payroll provider deduct the increases?*

While many payroll providers may automate their software so contributions are increased automatically, employers should check if their payroll software will do this. Their payroll should be ready to deduct the increased contributions when they rise in April 2019.

- *Is their pension scheme making the changes needed to support the increases?*

Employers should also check their pension scheme is making necessary changes to support the increases and ensure they are continuing to use a qualifying scheme and the right amount of pension contributions are deducted. If an employer's chosen pension scheme doesn't support the increases, then they will need to talk to them about their options.

- *What are they currently contributing? They may not need to take action.*

Employers and their staff can also choose to pay in more than the minimum contributions if they want to and employers who are already paying above the increased total minimum amounts need not take any further action.

Useful links:

- Guidance for business advisers: www.tpr.gov.uk/phase
- Guidance for employers including a letter template to tell staff about the changes: www.tpr.gov.uk/increase
- For information relating to specific scheme rules, contact the pension scheme provider.

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