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Reporting company payments to participators – modernising the reporting framework

Response from ICAS

Reporting company payments to participators – modernising the reporting framework

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 24,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 12,000 of our members are based in Scotland and 10,000 in the rest of the UK.

2. The following submission has been prepared by the ICAS Tax Board. The Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 committee members.

3. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and regulatory system design, and to point out operational practicalities.

General comments

4. We welcome the opportunity to respond to the HMT and HMRC consultation – Reporting company payments to participators — modernising the reporting framework - GOV.UK.

Specific Questions

Question 1: Is the close company definition well-understood in the small company population? Are companies always aware that they are close?

5. We have been made aware during our interactions with our members that the separation between the company and its owners in the small company population is not always understood and that a small proportion of spouses who jointly own a company do not specifically understand the concept of a close company.

6. We suggest that this position could be exacerbated as a result of the relative ease with which a company can be incorporated and accounts and tax returns can be filed without the assistance of a professional adviser.

Question 2: Are the loans to participators rules well-understood in the small company population?

7. We are aware that there are a number of situations where accountants are relied upon to put plans for clients in place to rectify unintended consequences arising from their lack of understanding of the rules. However, such scenarios generally result in taxpayers having increased awareness of the rules, having had the consequences of overdrawn Director's Loan Accounts explained to them by their adviser, having put such plans for timely repayments in place.

8. We believe that is likely that a lower level of understanding of the rules exists when companies do not use the services of a professional, particularly if there is little or no verification regarding the accuracy of documents filed at Companies House.

Question 3: Do small companies have a good understanding of relevant corporate law? For example, about when it is permissible to issue a dividend.

9. Where a company engages the services of professional advisers, there is likely to be a good understanding of relevant corporate law as a result of the advice they receive. As in our response at point 8, a lack of understanding, and a higher likelihood of error, may be present where

companies are unrepresented. This situation is not helped if Companies House do not verify the accuracy of documents filed or the level of compliance of disclosures with GAAP or company law or follow up cases of erroneous filings that are reported to them.

Question 4: Do small companies typically receive support from tax advisers or accountants with understanding their tax obligations and completing their tax return? If so, at what stage would the adviser be engaged, and what level of support is offered?

10. Often a small company is created as a result of the incorporation of a sole trade or a partnership, having received appropriate professional advice as to the relevant implications. Similarly, a taxpayer may seek professional advice before setting up their business, being aware of the relevant implications as a result.

11. Again however, if the taxpayer decides that they do not need or want professional advice, a decision perhaps becoming more likely as a result of the increasing availability of AI tools, the risk of a lack of understanding of the matters referenced in the earlier questions is increased.

Question 5: Other than engaging tax advisers, how else do companies find appropriate guidance or advice on these subjects?

12. Taxpayers are increasingly accessing information online for their research for guidance on these matters in addition to consulting friends or family members and engaging with other business owners when seeking advice.

Question 6: What challenges do tax advisers currently encounter in this space when handling company records and preparing returns? Are there examples available of 'good' or 'bad' client workflows?

13. Tax advisers face challenges when the taxpayer delays seeking professional advice, often until a few days before the filing deadline, on a potentially complex situation to resolve. The client can be reluctant to take responsibility for a potentially difficult consequential situation, which may involve increased tax liabilities for the client as a result of errors having been made. The adviser may face the challenge of the client preferring to believe that it is the fault of the adviser attempting to correct the situation, rather than their own responsibility.

14. An example of a 'good' client workflow is one involving engagement and timely communication from the outset eg the taxpayer contacts the adviser to discuss whether or not the company can pay a dividend. The adviser can advise the client of the implications of declaring the dividend, review company records to confirm the legality of the dividend declaration and prepare the relevant minutes of meetings and vouchers.

15. An example of a 'bad' client workflow is one where a sole-trader taxpayer sets up a new company online without professional advice, continues to take 'drawings' from the company in the same way they did as a sole trader, without either the appropriate declaration of dividends, or the operation of PAYE on these amounts.

Question 7: What data do close companies currently keep about their transactions with their participators? How do companies keep track of Director's Loan Accounts?

16. Clients with professional advisers may use cloud-based accounting software to keep financial records which will track participator transactions, including Director's Loan Accounts through specific nominal ledger codes. Similarly, payroll transactions are tracked through cloud-based payroll software. This generally will provide real-time information. Advisers are then able to periodically review the financial information to identify if the Director's Loan Account has become overdrawn, advise the client of the implications and recommend action, as appropriate.

17. Clients using different, non-cloud accounting systems are likely to have less visibility over these transactions and Directors Loan Account balances with the likelihood that reconciliations are generally only done on an annual basis to prepare year-end accounts.

Question 8: How often do companies collect or collate this data? For example: daily, weekly, monthly or on an as-and-when basis. If infrequently, what safeguards are in place to ensure that all transactions are captured in the records?

18. Cloud-based accounting software should be reconciled on a regular basis and usually at least monthly. A company with a dedicated bank account for processing all transactions provides a safeguard as to completeness. Where a professional adviser is engaged, this can be reviewed to ensure the relevant transactions are correctly identified.

19. See point 17 above regarding non-cloud systems and time-frames.

Question 9: How many separate transactions might occur annually in an average close company in relation to a single participator?

20. We have no comments on this question.

Question 10: What is the general size and frequency of these transactions?

21. We have no comments on this question.

Question 11: How many participators might an average close company be undertaking transactions with?

22. We have no comments on this question.

Question 12: Are there any categories or types of participators, or types of transactions themselves, where it may not be practical or beneficial to provide details to HMRC?

23. We note that the consultation does not specifically reference the Inheritance Tax consequences of transfers of value made by close companies eg a transfer to a trust for the benefit of the participator's children, as set out in the example in IHTM14852. Scenarios involving trusts and/or alterations of the company's share/loan capital resulting in a loss in value to one or more participators, and participators which are themselves close companies, will likely involve additional complexity and heightened administrative burdens in reporting as a result.

24. We can anticipate that a requirement to require reporting of payments to corporate participators may result in some onerous administrative burdens, which may increase as the complexity of group structures involved increases. However we believe that the measures proposed by this consultation could potentially result in disproportionate administrative burdens applying to smaller businesses. This would not be a desirable outcome, particularly in the current environment of increasing administrative burdens being placed on small businesses.

25. We believe it seems discriminatory to require a small standalone company to comply with a reporting requirement which does not apply to corporate participators. However we recognise the level of administrative burden that also exists in complex group structures. We suggest that further consultation with relevant stakeholders on any potential exemptions from reporting requirements for corporate participators/groups should be undertaken.

Question 13: How, and to what extent, are company and personal records currently aligned?

26. Often the same advisers will act for the company and its directors/owners. In these scenarios the adviser will be able to cross-check personal and company data to ensure accuracy and consistency. This is particularly important when the company has a year-end that is not aligned with the tax year (or 31 March etc.) and the adviser can perform any necessary reconciliations to ensure completeness of transactions. These processes may be more difficult if different advisers act for the company and its owners/directors.

Question 14: How are these records currently kept?

27. We understand cloud-based and desktop accounting software are maintained to record data for transactions relevant to directors.

Question 15: Do software products currently used by companies to prepare their accounts or tax return contain any functionality to help keep track of transactions such as shareholder loans, or possible charges under the loans to participators regime?

28. We understand that separate loan account codes are used when the company has more than one director/participator to enable accurate recording of data regarding transactions with each director/shareholder.

29. We have also been made aware of the view that some existing software used by smaller companies may not have sufficient functionality to enable more than annual reporting of directors' loan account balances.

Question 16: What would be the preferred way to transfer the required information to HMRC?

30. We would prefer that the information is reported annually as part of the existing corporation tax return reporting regime.

Question 17: Do you expect this to cause any additional administrative burdens for your business? If so, how could they be minimised or removed?

31. We believe that this will cause additional administrative effort for our members and their clients.

32. It has been suggested to us that the introduction of a de minimis amount for the value of transaction required to be reported could be considered.

Question 18: In what circumstances might it be difficult for companies to provide identifying details of participators?

33. We believe that the provision of identifying details of participators may be more difficult if the close company is part of a group structure, the difficulty potentially increasing as the complexity of the group structure increases.

34. The involvement of private equity holdings and/or beneficial ownership being held in jurisdictions where transparency of ownership is low is likely to increase this difficulty.

35. However, we believe that transparency in these situations could be improved as a result of the requirements envisaged by this consultation, given the professional requirements for advisers to identify beneficial ownership in, and fully understand corporate ownership structures, in the course of providing appropriate professional advice.

Question 19: Do you have a view on the relative administrative impact of this suggestion?

36. This information is already required in the CT600A form as part of the corporation tax self-assessment. It should therefore be readily available. An additional administrative impact would arise which would be directly proportional to the regularity of the reporting required.

Question 20: Do you anticipate any issues with the application of the normal CT penalty regime to this requirement? Can you see any scenarios where a more bespoke penalty regime might be more appropriate.

37. We believe that the penalty system applied should not penalise genuine mistakes over-harshly as the interaction between two complex tax systems can create confusion, particularly to unrepresented taxpayers in a system that does not require taxpayers to be represented by an agent.

Question 21: Are you responding to this survey as:

- A business
- **A representative body**
- An agent
- An individual
- Other (please provide details)

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