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THE PIPS ARE SQUEAKING

What appeared to be two relatively modest changes in Philip Hammond's first budget as Chancellor have been met with some dismay and annoyance by many business people.

Firstly, the Chancellor's abandoned plans for a 1% rise in the rate of Class 4 National Insurance paid by the self-employed which was to take effect from April 2018 with a further 1% rise to take effect from April 2019, at which point Class 4 NIC would have been 11%. This would have been within striking distance of the 12% rate of employees Class 1 NIC payable by employees.

This reducing of the differential perhaps reflects the fact that both classes of contributors will ultimately receive the same state pension. There is, however, a number of valuable benefits which are available to employees, and not to the self-employed, particularly if they become unemployed or fall pregnant.

The other change is the reduction from £5,000 to £2,000 of the dividend allowance which will also take effect from 6 April 2018. The £5,000 rate will not have lasted long, a mere two years, before it suffers a severe cut.

Perhaps these changes reflect the growing number of self-employed individuals, as opposed to employees and also the significant number of self-employed individuals who have transferred their businesses to limited companies. The latter group, while becoming employees of the company, have tended to pay themselves fairly modest salaries just under the National Insurance threshold with the balance of their remuneration being extracted by way of dividend.

Dividends are generally still a more attractive extraction method than salary, but there is very definitely an erosion of the savings.

Many are now questioning whether it is worth incorporating at all. This largely will depend on whether the proprietor of the business needs to extract most of the profits or whether he is prepared to leave a substantial amount in the business. For someone who extracts most of the profit, there will be relatively modest savings achieved by operating a company rather than as a self-employed person. However, for someone prepared to leave a reasonable amount of profit behind and undrawn, there are savings or at least a deferral. This is because the individual will suffer income tax only on what he draws with the profits remaining within the company only suffering corporation tax at 19%, the new rate of corporation tax which applies from 1 April 2017.

A number of matters covered in the budget had been announced previously:

- The Finance Bill 2017 will contain legislation whereby, if an employee wishes to avoid a benefit in kind, he will have to make good the benefit provided by 6 July following the end of the tax year. This is to come into effect for the 2017/18 tax year and the benefit made good by 6 July 2018.
- The 2017 Finance Bill will also include legislation to remove the income tax and NIC benefits of salary sacrifice arrangements for most benefits.

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ICAS

Salary sacrifice will still be possible for some major benefits including pension contributions, employer provided childcare and workplace nurseries, cycle to work schemes and ultra-low emission cars where the emissions do not exceed 75 grams of CO_2 per kilometre.

- The taxation and NIC treatment of termination payments are to be aligned by legislation to be introduced in Finance Act 2017 such that employers' NIC will be payable on termination payments exceeding £30,000. For many years now, termination payments of up to £30,000 could be paid free of income tax and this will remain. Termination payments after 5 April 2018 will be subject to employers NIC above £30,000.

A consultation document, published on 20 March 2017, will look at the tax treatment of employer provided accommodation. This is an area ripe for simplification, at least with regard to the calculation of the taxable benefit. Currently, the first £75,000 of cost of the accommodation is measured based on the rateable value, while the excess above this is determined by applying the official rate of interest. There must be an easier way and indeed one which reflects rental values which are considerably higher than the official rate of interest.

Corporation tax rates have been reduced for a number of years now and, as noted above, from 1 April 2017 the rate will be 19%. From 1 April 2020, the rate drops to 17%. This, together with increases in the rates of National Insurance, taxation of dividends, and the current 45% additional rate of income tax, represents an encouragement to retain profits within companies rather than extracting them. We are already seeing a number of hybrid companies and groups whereby the main activity is trading but properties for rent are being acquired, and stock market investments are being made by companies rather than profits being distributed to shareholders and investments made personally.

An unpleasant surprise, which wasn't pre-announced but which will take effect from 8 March 2017 relates to the appropriation of capital assets, standing at a loss to trading stock. The possibility of appropriating assets, to trading stock has existed for decades with specific tax provisions applying. The Government have now decided that these are "unfair". Hitherto, it has been possible to elect for an asset, such as a property, held as an investment, to be transferred to trading stock on a no gain/no loss basis. When the asset is subsequently sold, the original capital base cost represents the cost of trading stock and, if this is sold at a loss, a trading loss results. Generally, trading losses can be utilised in a more flexible way than capital losses and so, what is now section 161 (1) Taxation of Chargeable Gains Act (TCGA) 1992 and the election possibility obtained in subsection 3, which has probably been around since capital gains tax was introduced in 1965, is now considered unfair.

Happily, the Government considers that it is "fair" to retain the possibility of an election where the appropriation to trading stock at market value would give rise to a chargeable gain.

Therefore, when a property investment company appropriates a property to trading stock, and the property is standing at a gain, an election will still be possible. Where however the property is standing at a loss and such an appropriation is made, then a capital loss will crystallize at that stage which may not be able to be utilised for some time, if at all.

Changing rules which have stood the test of time and been with us for decades seem to be rather unfair. As witnessed by the Brexit vote, and the Class4 NIC uproar, the natives are getting restless. Budget day was exactly a week before the Ides of March. Perhaps treasury ministers should dust off the copy of Julius Caesar which is no doubt lurking somewhere in the House of Commons library.

VAT: CHANGES TO THE FLAT RATE SCHEME

As part of the Autumn Statement on 23 November 2016, changes were announced to tackle perceived "abuses "of the VAT Flat Rate Scheme (FRS). A policy document and draft secondary legislation were published on 5 December 2016. Businesses had 8 weeks to respond and comment.

Essentially, a new 16.5% FRS rate for businesses with limited expenses will be introduced. This will largely affect labour-only businesses which are registered, or intend to be registered for VAT under the FRS on April 2017.

In order to determine whether this 16.5% flat rate, which is the highest flat rate within the scheme, will apply to a particular business, it will be necessary for the trader to consider, using actual historic data, whether the annual cost of goods (but services) is less than 2% of turnover, or greater than 2% of turnover but less than £1,000. Goods must exclude capital expenditure, food, vehicles, and vehicle parts and fuel.

H M Revenue & Customs (HMRC) intend to introduce an online tool that will enable current and prospective users of the FRS to determine whether they must use the new rate.

Reminder as to how the FRS works

When the FRS was first introduced in 2002, small businesses were strongly encouraged to apply for it on the grounds that it would simplify VAT accounting. However, HMRC are now of the view that the scheme is being abused, as the financial reward enjoyed by certain businesses is, in its opinion, too great.

Under normal VAT accounting, input tax on costs may be offset against output tax on sales, provided the input tax is incurred for the purposes of making taxable supplies. Under the FRS, there is no recovery of input tax, apart from on large items of capital expenditure, and the output tax payable to HMRC is calculated by applying a flat rate to the gross value of sales. This allowed HMRC to reduce their investigation work for business registered under the FRS. The flat rate is determined based on the trade sector, and the flat rate for each sector should act as an approximation of the amount of net VAT which would be payable by a business registered for VAT by a business in that sector operating the normal rules.

Because some businesses with very low levels of costs, and therefore with a minimal amount of input tax, can make a reasonable financial gain from being VAT registered under the FRS, it has been decided to introduce this legislation in order to limit that advantage.

FRS provisions can be found in VAT Notice 733 which now contains new anti-forestalling provisions, with the immediate force of law.

You will have to review the use of the FRS for every client who currently uses that scheme. It is very likely that, as a result of this change to the FRS, a large number of small traders will remove themselves from the scheme or even deregister for VAT if their taxable turnover is lower than the registration threshold.

HMRC'S MSBWC DIRECTORATE

The somewhat clumsily named Mid Size Business and Wealthy Compliance (MSBWC) Directorate was formed in October 2015 and brought together the High Net Worth Unit (HNWU), the Affluent Unit, and the Mid Size Business Unit. It has around 3,000 members of staff in approximately 80 different locations across the UK, and sits within Enforcement & Compliance. Although the three units are under one directorate, they have very specific targets and operate independently of each other.

The High Net Worth Unit

The HNWU was established in 2009 to ensure compliance amongst the wealthiest 6,500 or so taxpayers in the UK who have a net worth of £10m or more, which was recently reduced from £20m. Collectively this group pay between £3bn and £4bn in income tax and capital gains tax each year, and represents the top 0.02% of taxpayers.

There are several specialist teams within the unit, who deal with either specific groups of taxpayers, or who have particular skills. For example, the "Finance Team" focuses on individuals within the Financial Services sector, and have specialist knowledge of the affairs of those involved in hedge funds, private equity, and merchant banking; and the "Rising Star Team" deals with individuals who appear to have a rapidly increasing wealth and who will meet the HMWU's criteria within the next few years. On the technical side, there is an "Analysis and Intelligence Team" which focuses on using data and analysis to understand the behaviour and financial structures that wealthy individuals use, and where their interests lie; while the "Dispute Resolution Team" works to resolve disputes with wealthy individuals.

A recent National Audit Office (NAO) report entitled "Collecting tax from high net worth individuals" reveals that at any one point in time, a third of taxpayers looked after by the HNWU are under "formal enquiry", but surprisingly that only one individual has been successfully prosecuted in the past five years. Indeed, the NAO is fairly critical of the HNWU's effectiveness, pointing out that although the unit generated an additional £416m from them, the "*amount of tax paid by this very wealthy group of individuals has actually fallen by £1bn since the unit was set up*". This is a fall of 20%, whereas the tax from all taxpayers increased by £23bn (9%) over the same period. Astonishingly, meetings and phone calls with high net worth taxpayers are not recorded. The NAO believes that "*HMRC are hampered by not having the power to demand more information about what assets high net worth individuals hold, and by the way certain tax rules have been set up and interpreted, such as the complex rules on image rights.*"

The Affluent Unit

The Affluent Unit was established in 2011 and currently has around 400 staff. It investigates the tax affairs of individuals with an annual income in excess of £150,000 or a net worth of more than £1m. With the increase in house prices over the past few years, many middle-class people who wouldn't regard themselves as "affluent" actually fall under this unit's remit. Taxpayers with offshore tax accounts, overseas property, significant UK property holdings, or previous involvement with a tax planning scheme are also likely to attract the unit's attention.

The unit will use information on a taxpayer's tax return, data in the public domain (such as postings on Facebook), and information gathered from other government departments through their Connect data mining programme, to select individuals for closer scrutiny.

This unit has not been the subject of NAO consideration yet, and performance figures are not available.

The Mid Size Business Unit

In recent years HM Revenue & Customs (HMRC) have been focusing primarily on Large Businesses by conducting "Know your Customer" meetings with them to identify any lax employment tax procedures. As HMRC have nearly exhausted the employer compliance yields from Large Businesses they, are now turning their attentions towards Mid-sized Businesses, which it defines as those with a turnover of between £10 million and £200 million.

Over the past 6 months and going forward, HMRC will be targeting mid-sized business to undertake a "Check of Employer Records". This is a new initiative designed to enable HMRC to quickly assess whether or not they should conduct a full-blown Employer Compliance Review on the employer. The check firstly consists of a Compliance Check Questionnaire requiring to be completed by a senior financial figure in the business, which is then followed up by a detailed telephone call from an HMRC compliance officer for them to assess if the business has or has not been adhering to their employment tax obligations. Common danger areas include keeping accurate business mileage records; correctly identifying permanent and temporary workplaces; getting the employment status of off-payroll workers right; and the correct taxation of termination payments. If the business cannot answer HMRC's questions fully; or do not appreciate the significance of some their questions, they will be asked to submit further records for review. If these records are deemed to be inadequate by HMRC, they will have no qualms about commencing an Employer Compliance Review.

Mid-sized businesses have been left alone by HMRC compliance officers for a good number of years while HMRC concentrated their resource on Large Businesses. Therefore, there is a very high chance that unintentional errors may have arisen over time that HMRC will now seek to exploit.

A sign of the times and things to come

HMRCs mantra these days seems to be "every penny counts" and they are allocating resources to areas where they think they can get the biggest return on their compliance efforts. High net worth and affluent individuals, and mid-sized businesses have become a focus of their attention in recent years, and this trend is likely to continue, with additional scrutiny of taxpayers who HMRC think are not paying what they should.

SEVEN EMPLOYMENT CHANGES FOR 2017

The Autumn Statement revealed yet more changes to employment taxes, albeit not necessarily the ones most employers, professional advisers and other bodies put on their Christmas list, such as, the Office of Tax Simplification's recommendation to fully align income tax and National Insurance Contributions within the next five to 10 years.

1. Employee shareholder relief abolished

The damp squib of employee shareholder relief was, in the end, only taken up by 40 companies over a three-year period. The tax breaks involved were abolished with effect from 1 December 2016, and the scheme will be shelved as soon as possible.

The scheme was originally introduced after much negative commentary across employer sectors, as it effectively allowed companies to encourage employees to exchange employment rights, including unfair dismissal, for shares in the business. The companies who took it up were found to be start-ups favouring "old boys' networks" where, in reality, there was no risk of employment rights being breached. Those who did take up the incentive will now need to unpick the arrangements and reinstate employment contracts to include employment rights.

2. Restrictions to salary sacrifice/ exchange schemes

From April 2017, new salary-exchange schemes will only be permitted where they include:

- Pension contributions
- Childcare
- Cycle-to-work bicycle purchases
- Ultra-low emission cars

For all other salary exchange schemes, tax relief will end in April 2018.

Employers need to concern themselves with two issues:

a) Deciding whether they will continue "as is" in terms of the suite of tax-efficient benefits they currently offer – which means either they, or the employees, will need to bear the additional tax cost – or unpick everything except the above four benefits.

b) Whether or not salary exchange is to cease, the terms and conditions of employment will need to be amended to reflect the position in terms of each separate benefit and who is expected to bear the tax. However, employees have rights under their contracts of employment and must be consulted before any changes are made, and agree to the changes. Accountants and tax advisers should bear in mind that the risk of employment tribunals is increased if this is not handled properly, and employment lawyers should ideally be involved to cover off this area.

3. **Rise in the National Living Wage**

The National Living Wage (NLW) for employees 25 and over increases from April 2017 to £7.50, representing an additional £500 of pay per annum for each full time equivalent (FTE) employee.

This also means additional costs to employers in terms of pension contributions, additional National Insurance Contributions, increased holiday pay and, for large employers with pay bills exceeding £3m, the Apprenticeship Levy. Be aware that some previously exempt employers may be brought into Apprenticeship Levy territory because of this.

Employers should be vigilant that this rise, which equates to 4.2%, does not create disengagement and motivation issues with other higher-paid workers who are not in receipt of a 4.2% pay rise. Careful management of expectations is required and employee communications should reflect this.

Many employees at the grade above NLW have complained that they have more responsibility but the lowest paid people in the organisation are catching up with them pay-wise, and that employers have stopped paying other things such as perks and bonuses to cover the additional cost of the NLW.

4. **Changes to treatment of workers engaged via Personal Service Companies (PSCs) in the public sector**

Public sector advisers will be aware that the majority of the 20,000 or so public sector contractors no longer automatically have the right to be treated as "self-employed" where they are contracted to work through a Personal Service Company. Where a deemed employment relationship exists, the agency, recruitment firm, or public sector body must now operate payroll taxes on these individuals, and report and pay over liabilities to HM Revenue & Customs (HMRC). Previously, the PSC was responsible for operating payroll taxes on relevant fees received under the so-called IR35 legislation.

There are several implications. Advisers must:

- consider their PSC clients and help them to decide whether to continue running a company; and
- advise their public sector clients of additional liabilities which may be incurred as a result of this change, including pension contributions, apprenticeship levy, and employer national insurance liabilities. These liabilities could occur if the individual worker is simply brought on to the payroll and not paid through his PSC. Some public sector bodies may simply decide to adopt this as their default position to avoid losing the contractors.
- There is likely to be a struggle between procurement departments and finance departments in that headcount reduction and budgetary cuts are important whilst continuity of service and retention of relevant expertise and knowledge are also a priority.

Advisers should also bear in mind that this measure is highly likely to be rolled out to the private sector in due course.

5. **Boosting productivity**

In a bid to improve managerial skills, the Government has recognised that investment needs to be focussed on improving workplace productivity, starting with eradicating bad management practice. It has pledged £13m to the Productivity Leadership Group to deliver this.

While the investment is not monetarily significant, it does represent a step in the right direction. However, other areas need to be tackled simultaneously such as adult skill sets, apprenticeships and continuous learning and development.

The Brexit vote appears to have caused consternation among HR professionals in the fields of recruitment, learning and development and talent management. They consider more managers will be required to help companies compete in a global arena, as opposed to a European one.

This, combined with low productivity forecasts from the Office of Budget Responsibility, could hamper businesses in terms of their strategic ambitions, and advisers should bear this in mind for the next couple of years.

Indeed, Brexit will require employers to focus on strategic markets, and require them to consider potential global mobility issues, closures, new opportunities, and to decide whether there is instability or confidence to be coped with in this new British agenda. Serious financial and political problems in Spain, Italy, France, Greece and Portugal also require reconsideration of those markets.

6. **Executive pay and gender pay reporting**

It would appear that Prime Minister Theresa May has done a u-turn on insisting that elected employees should be present at Board meetings. Now she says that the "*voices of workers and consumers*" should be represented at board level; advisers should watch out for a green paper which examines this, together with the disparity of executive pay with that of ordinary workers.

These issues, together with the gender pay gap reporting requirements which are being introduced from April 2017 for employers with 250+ employees, will provide a significant challenge to advisers in terms of costings, reputational issues, grievances from employees who consider their pay to be gender-biased, and the overall requirement for employee relations to be more transparent.

7. The "Gig Economy" labour market and tax implications

The so-called 'gig' economy really began to rear its head in the 1990s and is now extremely prevalent in the UK, where around 5 million workers work on a self-employed basis, with many of these workers undertaking a series of short term jobs and contracts in a number of different roles, from taxi driving to pizza or Amazon delivery, for example. This new portfolio style of working is born out of the rise in online trade, a decline in manufacturing, and rise of service based offerings including home delivery services.

There are a number of reasons for people working in this way – those who choose to supplement their income, those who need to supplement their income, those providing professional services, and those who would probably prefer to be employees but have had to accept an off-payroll working arrangement.

All of this is leading to a loss in traditional revenues into the Exchequer, particularly in NICs due to the 5% per annum rise in Personal Service Companies since 2008, a favouring of dividend payments over traditional salary payments meaning lower income tax receipts, reductions in employer's NICs and lower NICs being paid by the self-employed. The Office of Budget Responsibility forecasted a loss of up to £3.5bn by the end of this Parliament, and the Chancellor introduced several measures in the 2017 budget to address several of these issues.

This "gig-economy" could account for the rapid fall in unemployment since the last recession. That said, many people feel that overall they are losing as a result of the gig economy due to job instability and multi jobbing, which often leads to longer working hours. However, winners tend to be those who are providing highly skilled services, such as computer programmers and graphic designers.

AUDIT EXEMPTION RULES - A REMINDER

It has emerged that there is still some confusion as to how the transitional provisions affect the first year of application of the revised audit exemption thresholds which became effective for accounting periods commencing on or after 1 January 2016 (effectively 31 December and later year-ends). As summarised in an earlier article, the transitional provisions on first application are that the current year and previous years need to be assessed on the basis of the revised qualifying conditions.

The audit exemption test remains that a stand-alone company (ie one which is not a member of a group) must meet the definition of a small company. In summary, this means that it must meet these conditions taking account of the two-year rule (see Table 1), and must not be ineligible.

Table 1

Revised qualifying conditions

	New threshold	**Previous threshold**
Turnover	Not more than £10.2 million	Not more than £6.5 million
Balance sheet total [1]	Not more than £5.1 million	Not more than £3.26 million
Number of employees [2]	Not more than 50	Not more than 50

[1] Balance sheet total means the sum of all the amounts shown as assets in the balance sheet (ie fixed assets plus current assets) without any deduction for liabilities.

[2] Number of employees is calculated by summing the number of persons employed under contracts of service by the company in each month (whether throughout the month or not), dividing by the number of months in the financial year.

Two-year rule

The qualifying conditions are deemed to have been met in a year when an entity meets at least two of the three criteria in that year. However, consideration has to be given to the two-year rule (obviously excluding a company's first year).

The wording of section 382 of the Companies Act 2006 (the Act) was amended by the Small Companies (Micro-Entities' Accounts) Regulations 2013.

This, however, did not result in a change in substance. The revised wording of section 382 of the Act - "*that affects its qualification as a small company only if it occurs in two consecutive years*" - is intended to have the same meaning in substance as the previous wording ie:

(a) if the qualifying conditions are met in that year and the preceding financial year;

(b) if the qualifying conditions are met in that year and the company qualified as small in relation to the preceding financial year;

(c) if the qualifying conditions were met in the preceding financial year and the company qualified as small in relation to that year.

First-time application

This provision is particularly relevant when determining whether a company qualifies for audit exemption in the first year that these new regulations take effect, ie for accounting periods commencing on or after 1 January 2016.

To illustrate how the transitional rules apply in the first year of application, if we assume that a stand-alone company has a year end of 31 December 2016 then the simplest way of applying the transitional rules is to see whether the company satisfies the revised qualifying conditions in both the years ended 31 December 2015 and 31 December 2016.

If it does, then the company will be entitled to take advantage of audit exemption provided it is not ineligible (ineligible entities as per section 384 of the Companies Act 2006) ie it would satisfy condition (a) above.

REVISIONS TO FRS 101 AND FRS 102

In December 2016, the Financial Reporting Council (FRC) amended Financial Reporting Standard (FRS) 101 Reduced disclosure framework, to delete paragraph 5(a), thereby removing the requirement for a qualifying entity to notify its shareholders about the proposed use of disclosure exemptions.

A qualifying entity under FRS 101 is: "*A member of a group where the parent of that group prepares publicly available consolidated financial statements which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and that member is included in the consolidation. A charity may not be a qualifying entity.*"

FRS 101 sets out a reduced disclosure framework which addresses the financial reporting requirements and disclosure exemptions for the individual financial statements of subsidiaries and ultimate parents that otherwise apply the recognition, measurement and disclosure requirements of EU-adopted IFRS. Disclosure exemptions are available to a qualifying entity, as defined in the glossary to this FRS, in its individual financial statements, but not in consolidated financial statements which it is required or voluntarily chooses to prepare. However, a qualifying entity which is a financial institution is not exempt from the disclosure requirements of certain specific disclosures contained in IFRS 7 Financial Instruments: Disclosures, IFRS 13 Fair Value Measurement and IAS 1 Presentation of Financial Statements.

A qualifying entity under FRS 102 is: "*A member of a group where the parent of that group prepares publicly available consolidated financial statements which are intended to give a true and fair view (of the assets, liabilities, financial position and profit or loss) and that member is included in the consolidation.*"

The reduced disclosure framework for qualifying entities can be found at paragraphs 1.8 to 1.13 of FRS 102 (particularly paragraph 1.12).

This FRC amendment applies to qualifying entities for accounting periods beginning on or after 1 January 2016. A similar amendment was made to FRS 102 to delete paragraph 1.11(a) removing the requirement for a qualifying entity to notify its shareholders about the proposed use of disclosure exemptions for accounting periods beginning on or after 1 January 2016.

Practice Management Courses 2017 - Book your place now

In 2014, ICAS introduced a new mandatory requirement to attend the Practice Management Course once in every five years. If you haven't attended this course previously then you must do so this year or next. The dates for 2017 are as follows:

Inverness: Wednesday 24 May

Edinburgh: Tuesday 20 June

London: Wednesday 21 June

Glasgow: Tuesday 12 September

Newcastle: Tuesday 26 September

USE OF AUDIT DATA ANALYTICS

The Financial Reporting Council (FRC) has published a thematic study on the use by the largest six audit firms of Audit Data Analytics (ADA) on the audits of financial statements. The study related to audits of financial statements with a 2015 year-end, so the FRC recognises that the use of data analytics may have changed in the interim period.

The paper provides a brief history of the use of data analytics type tools on audits which stretches back some considerable time to the use of computer assisted audit techniques. A catalyst towards increased use of such tools occurred in early 2005 with the introduction of the specific requirement in the International Standard on Auditing (ISA) 240 'The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements' to test the appropriateness of journal entries as part of the auditor's responsibilities in relation to fraud. This was used as an opportunity by audit firms to introduce more standardised tools to facilitate the audit of journals. With recent and ongoing technological advancements, it is now easier than in the past, although challenges do still exist, for an auditor to capture, transform, store, and analyse entire datasets. This therefore potentially allows for the interrogation of all of transactions within an entire population. Whilst audit teams continue to develop ADA in relation to specific auditing issues, a key characteristic of the current increase in the use of ADA is the roll out of standard ADA tools and techniques, coded and tested by specialist staff and deployed with central support. This means that ADA use becomes more efficient, consistent and reliable.

One of the key features of a lot of these standard ADA tools is that they employ data visualisation techniques which provide insights to the data being analysed by placing it in a visual context. Thus, the analysis may make use of graphs, plots, information graphics etc which can help to make the communication of key messages much easier. The use of such visuals helps enable patterns, trends, correlations, and outliers to be identified more easily. Additionally, as well as helping the auditor execute the ADA, visualisation techniques may also be useful in communicating insights arising from the ADA work to the audit committee.

FRC – Summary of Findings

The key findings of the study were as follows:

1. Surprisingly, the use of data analytics in the audit is not as prevalent as the market might expect. The FRC highlights that audit firms and teams feel pressure to promote the use of ADA techniques on audits to meet audit committee expectations, to achieve efficiencies, and to win competitive tenders. This may result in the pace of ADA development and usage being overemphasised.
2. Audit quality can be enhanced through the use of data analytics. The FRC acknowledges that appropriate use of ADA techniques can provide audit evidence that is more focused to the audit risks and provide useful insights to an entity's management and the audit committee.
3. Supported roll out of standard ADA tools works. Where firms focus deployment efforts on supporting a small number of ADA tools, use is more successful and uptake by audit teams increases. As auditors gain more confidence they are more likely to use the tools again in subsequent years and on other audits.
4. Specialist, dedicated support for data capture for use in ADA tools increases effective use. Where audit teams are able to obtain entity data efficiently, they are more encouraged to use ADA tools, improving their successful use on audits. This is facilitated by the use of specialist resources.
5. Appropriate use of standard ADA techniques in audits is important. Audit teams need to have a clear understanding of the purpose of the ADA technique within the audit methodology to ensure that they obtain sufficient and appropriate audit evidence.
6. Evidencing of ADA is crucial. An experienced auditor should be able to understand the nature, timing and extent of the audit procedures performed, including where ADA tools have been used. The FRC apparently observed a number of instances where such evidencing was insufficient.

REVISED ACCOUNTS PREPARATION GUIDANCE NOW AVAILABLE

The ICAS 'Framework for the Preparation of Accounts' has recently been updated and the revised version is available to download at: **https://www.icas.com/technical-resources/framework-for-the-preparation-of-accounts-revised-january-2017**.

The latest version has been updated to reflect the implementation of New UK GAAP, changes to the ICAS Code of Ethics and amendments to the Companies Act 2006 but does not contain any further substantive changes.

7. Audit regulators need to consider how they assess the integrity of ADA tools used by audit teams and, in particular, whether they are functioning as intended.
8. Where ADA tools are adopted globally, group teams can instruct that specific tools are used. Where entities use global systems, ADA can be used to execute testing centrally. This promotes efficiency and central oversight, but provides additional evidential challenges for component auditors.

The paper can be viewed at: **https://frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Audit-Quality-Thematic-Review-The-Use-of-Data-Ana.pdf**.

ACCOUNTING AND AUDITING QUERIES

Query: *We are a medium sized firm of Chartered Accountants. We have a client that is a medium sized limited company and its preparing its first set of financial statements under Financial Reporting Standard (FRS) 102 for the year to 31 October 2016. The company operates an activity that provides a public sector related service and its employees are therefore entitled to membership of the local authority pension scheme.*

In the past the company has been able to avoid the related cost of defined benefit scheme actuarial valuations as required under FRS 17 on the grounds of its requirements in relation to multi-employer schemes. Whilst this required the employer to normally account for such a scheme as a defined benefit scheme on the grounds that, although the employer's contributions are affected by a surplus or deficit in the scheme, the employer was unable to identify its share of the underlying assets and liabilities in the scheme on a consistent and reasonable basis. Therefore, in line with the requirements of FRS 17, the company accounted for the contributions to the scheme as if it were a defined contribution scheme and made the related required disclosures.

What are the company's obligations re. multi-employer defined benefit schemes under FRS 102?

Answer: The requirements for multi-employer schemes are contained in paragraphs 28.11 and 28.11A of FRS 102 which can be found at: **https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-applicab.pdf.**

"28.11 Multi-employer plans and state plans are classified as defined contribution plans or defined benefit plans on the basis of the terms of the plan, including any constructive obligation that goes beyond the formal terms. However, if sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall account for the plan in accordance with paragraphs 28.13 and 28.13A as if it was a defined contribution plan and make the disclosures required by paragraphs 28.40 and 28.40A. An entity shall account for a state plan in the same way as for a multi-employer plan.

28.11A Where an entity participates in a defined benefit plan, which is a multi-employer plan that in accordance with paragraph 28.11 is accounted for as if the plan were a defined contribution plan, and the entity has entered into an agreement with the multi-employer plan that determines how the entity will fund a deficit, the entity shall recognise a liability for the contributions payable that arise from the agreement (to the extent that they relate to the deficit) and the resulting expense in profit or loss in accordance with paragraphs 28.13 and 28.13A."

Therefore, FRS 102 also allows a defined benefit multi-employer scheme to be accounted for as a defined contribution scheme if sufficient information is not available to use defined benefit accounting. However, an additional requirement is that where such a scheme is accounted for as defined contribution and the entity has entered into an agreement with the plan to fund a deficit, the entity must recognise a liability for the contributions payable under that agreement – meaning that additional liabilities may be recognised than under old UK GAAP.

Query: *I am a partner in a small firm of Chartered Accountants and have a small company client which, until now, has prepared its accounts under the Financial Reporting Standard for Smaller Entities (FRSSE). This year is the first year that the company has to use Financial Reporting Standard (FRS) 102 and it will be taking advantage of the reduced presentation and disclosure requirements of Section 1A of FRS 102. My client has always prepared a cash flow statement on a voluntary basis in its financial statements. It wishes to continue to do so but will it be able to do so?*

Answer: Section 1A of FRS 102 was added to FRS 102 to take account of the reduced mandated disclosure requirements for smaller companies following the introduction of the EU Accounting Directive, which takes effect for accounting periods commencing on or after 1 January 2016.

Paragraphs 1A.7 and 1A.8 of FRS 102 state

"*1A.7 A small entity is not required to comply with the requirements of paragraphs 3.3, PBE3.3A, 3.9, 3.17, 3.18, 3.19 and 3.24(b) which relate to presentation and disclosure requirements that are not required of small companies in company law, Section 4 Statement of Financial Position, Section 5 Statement of Comprehensive Income and Income Statement, Section 6 Statement of Changes in Equity and Statement of Income and Retained Earnings and Section 7 Statement of Cash Flows.*

1A.8 Instead a complete set of financial statements of a small entity shall include all of the following:

(a) a statement of financial position as at the reporting date in accordance with paragraph 1A.12;

(b) an income statement for the reporting period in accordance with paragraph 1A.14; and

(c) notes in accordance with paragraphs 1A.16 to 1A.20."

Therefore, a small entity is not required to prepare a statement of cash flows. However, noteably, it does not say "shall not" prepare a cash flow statement. Therefore it would appear that a small entity can include a cash flow statement whilst applying Section 1A if it so desires. This would also appear to be in line with the overall spirit of FRS 102. Additionally, if a statement of cash flows is prepared then the relevant cash flow notes should also be included.

EMPLOYER PROVIDED CHILDCARE VOUCHERS AND SCOTTISH INCOME TAX

Following the introduction of the Scottish Rate of Income Tax (SRIT), the Scottish Parliament have set the Scottish income tax rates and thresholds for the 2017/2018 tax year. This article sets out the income levels that should be used to calculate the appropriate tax and NICs relief for childcare vouchers following the introduction of SRIT.

Eligibility to tax-free childcare vouchers depends on an employee's income level. Employers have to estimate the employee's relevant earnings for the tax year since the 'exempt' amount of childcare vouchers is based on their relevant earnings.

Section 270A of Income Tax (Earnings and Pensions) Act 2003 sets out the levels of income at which the exempt amount changes.

If the estimated relevant earnings amount:

- exceeds the higher rate limit for the tax year the exempt amount will be £25 for each qualifying week;
- exceeds the basic rate limit but not the higher rate limit then the 'exempt amount' for that tax year will be £28 for each qualifying week;
- otherwise the 'exempt amount' for that tax year will be £55 for each qualifying week.

Eligibility criteria for employer provided childcare vouchers are not devolved to the Scottish Parliament and, therefore, the basic and higher income tax rates mentioned above are the UK rates. This means that the same limits apply for all employees in the UK in receipt of childcare vouchers.

HMRC CAMPAIGNS AND TASK FORCES

Until recently, HM Revenue & Customs (HMRC) were reasonably open about their compliance activities, to the extent that there was a page on gov.uk that listed the current campaigns and task forces that were in operation across the country. The information publicly available has been severely curtailed over recent months, and now we must rely on intelligence from other sources to get a picture of what is currently their focus. This is a round-up of the initiatives we are aware of.

Football Clubs – 12 clubs, 43 players and 8 agents are currently under investigation. Dedicated activity in this area has brought in an additional £153 million in the past two years, so it is reasonable to assume that this industry will remain a focus of attention for some time to come.

TV Presenters – we understand that a significant number of "self-employed" TV presenters are currently under enquiry. They have been issued with a questionnaire asking for clarification on over 80 points of their contracts with various broadcasters, predominantly Sky. In a recent programme, Radio 5 Live's Stephen Nolan revealed that he was previously self-employed but is now PAYE after the BBC reviewed their policy on how they paid their talent.

Secondary Ticket brokers – as well as attracting the attention of the media in the last few months, the online ticket touts who resell concert and sports tickets, sometimes for vastly inflated prices, have been under the scrutiny of HMRC

Dog breeders – there has been a major initiative looking at undisclosed revenue from the sale of puppies by dog breeders. HMRC have used a mixture of social media analysis, dog lover press advertising analysis, and third party information notices to the likes of the Kennel Club, to identify and trace breeders who have not disclosed profits from their activities. The average tax recovered in a typical case is more than £25k, and in many cases HMRC are looking at Code of Practice 9 (COP9) settlements.

As a general observation, there has been a sharp increase in the number of deliberate fault penalties, with HMRC appearing to be taking the default view that errors are deliberate, and seeking penalties accordingly. There has also been a rise in s12B Taxes Management Act 1970 penalties of inadequate record keeping, which does not bode well for taxpayers once Making Tax Digital is introduced.

SCOTTISH RATE OF INCOME TAX

The Scottish Parliament have now agreed the rates and bands for Scottish income tax in 2017/18.

The Scottish Parliament has agreed that:

- for the purposes of section 11A of the Income Tax Act 2007 (which provides for income tax to be charged at Scottish rates on certain non-savings and non-dividend income of a Scottish taxpayer), the Scottish rates and limits for the tax year 2017-18, based on someone in receipt of the standard UK personal allowance, are as follows:

a) the Scottish basic rate is 20%, charged on income above £11,500, up to a Scottish basic rate limit of £43,000

(b) a Scottish higher rate of 40%, charged on income above the Scottish basic rate limit of £43,000 and up to a Scottish higher rate limit of £150,000, and

(c) a Scottish additional rate of 45%, charged on income above the higher Scottish rate limit of £150,000.

The revised P9X, featuring the thresholds set by the Scottish Parliament which can be found at: **https://www.gov.uk/government/publications/p9x-tax-codes**.

For further information please visit: **http://www.gov.scot/incometax**.

PENALTIES – DELIBERATE ERROR DECISION BY HMRC TURNS TO TAXPAYER'S ADVANTAGE

The recent decision in **Promo International Ltd [2017] UKFTT 0161 (TC) TC05654** (**http://financeandtax.decisions.tribunals.gov.uk//judgmentfiles/j9628/TC05654.pdf**), shows how important it is to know the twists and turns of suspended penalties SMART conditions (defined below).

After a catalogue of disasters, Promo International was facing VAT penalties for careless and deliberate errors of over £73,000. Would they be able to get off the hook?

Promotional business

Promo International's business is supplying high volume, low value promotional items to drinks companies such as Magners and Proctor & Gamble. Sourced in China, the items were sometimes routed to the customer via Germany. The supply process is drawn out and cash flow all important.

In 2010 disaster stuck as turnover plummeted by £3 million, and it became clear that staff in the Hong Kong office were defrauding the company. While civil and criminal proceedings were started against a Hong Kong manager, the UK business was left in the hands of the in-house accountant.

Unfortunately, and inexplicably, the previously reliable and commended accountant made serious errors in VAT returns and hid the fact - even giving a misleading report of an HM Revenue & Customs (HMRC) inspection and mis-posting penalties to keep them hidden from the directors.

Deliberate behaviour

By the time the directors found out, HMRC had already decided that the errors in the VAT return were deliberate – scaling up the penalties. Penalties for deliberate errors cannot be suspended. And, for earlier errors accepted as careless, HMRC would not suspend the penalties.

Not bothered about accuracy

The HMRC officer involved would not entertain suspension of penalties as he considered that the company accountant "*gave the impression that she was 'not too bothered' about the errors and he formed the opinion that she would not comply with any conditions put in place and so the imposition of conditions would not help the Appellant to avoid future inaccuracies*".

SMART Suspension

Under para 14 of Schedule 24 FA 2007, HMRC may suspend the penalty "*only if compliance with a condition of suspension would help P [the person completing the return] to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy*".

This is amplified by HMRC in its guidance, as being able to set SMART conditions. Per HMRC factsheet 'Compliance checks: suspending penalties for careless inaccuracies in returns or documents – CC/FS10' "SMART means:

- Specific - it must be directly related to the cause of the inaccuracy
- Measurable – you'll need to be able to show us whether you have met the condition
- Achievable – you'll need to show us that you are able to meet the condition
- Realistic - we can realistically expect that you'll meet the condition
- Time bound - you must meet the condition by the end of the suspension period."

(**https://www.gov.uk/government/publications/compliance-checks-suspending-penalties-for-careless-inaccuracies-in-returns-or-documents-ccfs10/compliance-checks-suspending-penalties-for-careless-inaccuracies-in-returns-or-documents-ccfs10--2**).

While the Tribunal has challenged HMRC's interpretation of 'specific' as being too narrow (for example in **Paul Steady - [2016] UKFTT 0473 (TC) TC05225** (**http://www.financeandtaxtribunals.gov.uk/judgmentfiles/j9206/TC05225.pdf**), the Tribunal in Promo held that HMRC's decision not to permit suspension was not wholly unreasonable. HMRC had, not unreasonably, concluded that the attitude of the accountant was such that setting conditions would make no difference to the outcome.

That the directors were unaware of what was going on did not change the outcome. The company accountant was acting on behalf of the company.

No overall loss of tax

When viewed in an EU context, there had been no overall loss of tax in respect of one set of errors.

The company had re-claimed German VAT on the freight forwarder's invoices through its UK VAT return, when it should have been recovered from the German authorities. This had been pointed out to the accountant on more than one occasion, as had an appropriate remedy.

The fact that neither the company, nor the accountant, gained from the mistake made no difference. The error was still liable to a penalty.

Furthermore, the potential lost revenue on which the penalty should be based is the UK tax incorrectly claimed, not the EU wide impact, or the overall tax advantage to the company.

Reasonable behaviour

The Tribunal had to decide a number of points, Had the company taken "*reasonable care" in submitting the returns? Had it acted "deliberately*"? Had HMRC discharged the burden of proving these things?

Is an employer responsible for the malfeasance of an employee? Whether HMRC had acted "*unreasonably in refusing to suspend the first penalty and in refusing to make special reductions in other penalties?*".

The accountant is the company

The taxpayer argued in line with the **Mahendran v HMRC [2015] UKFTT 278 (TC)**, quoting the Special Commissioners' decision in Rowland that it "*was sensible and reasonable for Mrs Rowland to employ and rely upon persons whom she reasonably believed to have the relevant specialist knowledge and expertise that she did not possess personally.*"

But the Tribunal held that while a taxpayer using the services of a professional adviser may make a defence of reasonable care, this does not apply to an in-house accountant employed by the taxpayer.

Considering the position of Ms Cudlip, the company accountant of Promo International, the Tribunals said "***with respect, the question is not whether the company acted reasonably in relying on Ms Cudlip, but whether Ms Cudlip was the company for this purpose.***"

It decided that in the context "*we find that Ms Cudlip's actions can, and are to be, attributed to the Appellant in determining the Appellant's liability to HMRC for VAT penalties in relation to the returns completed by Ms Cudlip.*"

The company is careless, or guilty of deliberate error for schedule 24 penalties, if its responsible employee is.

Careless or deliberate?

The basic nature of the first set of errors – a formatting error, the mixing up of the postings of items as duty or VAT and the use of the figures for import VAT in the freight forwarding invoices instead of the C79s – and the fact that they had been repeated, despite an VAT inspection visit, showed that the errors were careless.

"*A reasonably competent accountant exercising reasonable care would not have made the basic errors which were in fact made in the 09/12 VAT return and certainly would not have repeated errors which had recently been pointed out to her.*"

The careless errors were therefore confirmed.

For the second set of errors, HMRC maintained that the errors were deliberate. HMRC sought to include the situation where the taxpayer "*buries its head in the sand*" and deliberately refrains from finding out the true position (deriving this approach from **Anthony Clynes v HMRC [2016] UKFTT 369 (TC)**).

But the Tribunal preferred to follow **Auxilium Project Management Ltd v HMRC [2016] UKFTT 249 (TC)** – "*In our view, a deliberate inaccuracy occurs when a taxpayer knowingly provides HMRC with a document that contains* *an error with the intention that HMRC should rely upon it as an accurate document. This is a subjective test.*"

Tribunal further went on to find "*it is difficult to find a motive for Ms Cudlip knowingly submitting an incorrect return. There was no personal benefit to Ms Cudlip, nor was there any overall benefit to the company. Had matters been dealt with correctly, the reclaim would not have been made in the UK, but the same amount could have been reclaimed in Germany, and repaid sooner because of the monthly accounting.*"

The Tribunal therefore decided that HMRC had not proved on balance of probabilities that these errors were 'deliberate'. Their status was reduced to that of careless.

Special Reduction

Para 11 of schedule 24 permits HMRC to make a Special Reduction in the amount of a penalty if "*they think it right because of special circumstances*". This is taken to mean exceptional circumstances, perhaps such as bereavement or unexpected ill health, no evidence of which was given here.

How unreasonable

The Tribunal reminded the appellant that before it can displace an HMRC decision of Special Reduction or failure to suspend penalties it has to decide that the HMRC decision is '*Wednesbury unreasonable*', that is "*something so absurd that no sensible person could ever dream that it lay within the powers of the authority*": **Associated Provincial Picture Houses Ltd v Wednesbury Corporation [1948] 1 KB 223, 229**. This was not so in this case, and it is a very high hurdle to overcome.

Final twist

Having confirmed the penalties, the Tribunal now pointed out that, as the company's 'deliberate' errors had now been re-classified as simply 'careless', HMRC could now entertain the idea of SMART suspension. With the directors back in charge, rather than the accountant, effective conditions could now be set. "*We note that the directors have now put in place effective procedures to ensure that the mistakes which were made cannot happen again and that recent compliance visits have not discovered any inaccuracies. We suggest that HMRC may wish to consider suspending the penalties in full now that they are able to do so.*"

Conclusion

Make sure you contest penalty cases on the right grounds, and are aware of all the possible remedies. Even a change from deliberate to careless may be enough to get your client off the hook.

HMRC flowchart on penalties can be foumd at: **http://www.hmrc.gov.uk/gds/ch/attachments/suspension_of_penalties_flowchart.pdf**.

IR35 PUBLIC SECTOR – NEW ROLES FOR AGENTS AND HIRERS

What's new

From April 2017 the responsibility to decide if IR35 rules apply in public sector engagements passes from the PSC worker to the hirer. There are new obligations to share information and make payroll deductions, together with a new employment status online tool. Calculations are not for the faint hearted – impacting VAT, Corporation Tax, payroll and even dividends. The new rules don't just apply to new contracts: both existing contracts covering work after 5 April 2017 and payments made for work before 6 April but made after 5 April 2017 are caught.

Practical implications

Agencies are likely to be more cautious about giving independent contractor status to workers supplying services through their own Personal Service Company ("PSC"). Hirers, obliged to make a decision on rules with which they may be unfamiliar, may default to a finding of employee status.

PSC clients could face highly complex new calculations, on top of unwanted tax and National Insurance deductions. While the new rules default to the hirer paying employer's National Insurance (and Apprenticeship Levy), contract terms may need revision to maintain profitability.

A key change is the new employment status tool **https://www.tax.service.gov.uk/check-employment-status-for-tax/setup**. HM Revenue & Customs (HMRC) will "*stand by the result given unless a compliance check finds the information provided isn't accurate*"; but to counter avoidance, results achieved through "*contrived arrangements designed to get a particular outcome*" will not be accepted and penalties could apply.

Hirers are not obliged to use the new online tool, but workers might do well to encourage hirers to do so. Agents might want to review client contracts for PSC workers in the public sector. For example, substitution is going to be a significant issue. The workers position in challenging a decision by a hirer is weak: better by far to make hirers aware of the rules and encourage accurate decision making up front.

Some workers may now prefer to be self employed, rather than work via an intermediary PSC.

Scope of the rules

The new IR 35 rules apply where the hirer or 'end client' in HMRC speak, is a

'Public Authority'. The definition used is that of the Freedom of Information Act. For a Scottish public authority look to the Freedom of Information (Scotland) Act 2002 (Schedule 1) and to the Freedom of Information Act 2000 for the rest of the UK.

While the boundary is sometimes obvious, there are borderline cases. Wholly owned subsidiaries of public authorities are caught, but partly-owned subsidiaries are not. University spin-off companies, for commercial exploitation of research can fall within the rules, while a partially owned subsidiary of the BBC or a local authority would not.

The rules will primarily affect workers supplying their services through PSCs, but also cover workers supplied where an individual or partnership acts as intermediary.

Employment chains and information flow - what to watch out for

Where there is an employment chain, the organisation nearest the worker's PSC takes responsibility for making payroll deductions. In the new jargon, they become the 'fee payer'. If the chain is partially overseas, then the UK resident organisation nearest the worker's PSC becomes the fee payer. Where the chain is entirely overseas, the 'end client', the organisation benefiting from the worker's services, becomes the fee payer.

Where there is no chain, the hirer becomes the fee payer – with the obligation to add the 'deemed employee' to the payroll for RTI.

The worker must give the hirer sufficient information to enable it make a decision on IR35 status. The hirer then informs the fee payer (usually an agency) of its decision. The hirer must, if asked, give the fee payer a decision and written explanation within 31 days. In default, the hirer becomes liable for operation the payroll obligations, as if it was the fee payer.

The worker must give the fee payer new employee starter information in cases where IR35 public sector rules apply.

Deliberate miss-statements

If a worker, or their PSC or anyone connected with them, which could include their accountant, makes a false statement in order to avoid the IR35 rules, then the worker's PSC becomes the deemed employer, with responsibility to deduct payments, and the worker becomes a deemed employee of their own company.

Payments and calculations

Using the figures from HMRC's example in the guidance notes, the payment flow for those within IR35 public sector rules becomes:

1. PSC invoices the fee payer (usually the agency) for work done. For a monthly contract at £6,000 per month, this is £6,000 fee, plus VAT of £1,200 = £7,200 gross.
2. The fee payer deducts employee's National Insurance and income tax under RTI from the fee; and accounts for employer's National Insurance and Apprenticeship Levy (but not student loan deduction, holiday pay or auto-enrolment for pension).
3. Using rounded figures, the employee NIC is £413 and income tax £1,458. So the net 'deemed direct payment' to the worker is £4,129 (£6,000 less tax and NIC of £1,871).
4. The VAT of £1,200 is added back and the fee payer pays the PSC £5,329. (There is no requirement for the worker to be given a payslip but they will receive a P60 in due course).
5. The PSC accounts for the VAT of £1,200, but for corporation tax, shows a turnover of the amount received net of VAT - £4,129 - rather than the full invoiced amount of £6,000.
6. To avoid double taxation, the worker is then entitled to take £4,129 from the company tax free, either as dividend or salary.
7. For income tax self assessment, the worker includes the income from the fee payer as an employment on the employment pages of their Self-Assessment return.

The complexity of the calculation looks like a recipe for mistakes.

Conclusion

The rules will soon begin to be tested in practice. It is unclear how effective they are likely to be in raising additional tax revenue. But from a simplicity point of view, a more precise definition of employee status, binding for both employment rights and taxation, starts to look like a more attractive option.

Clients are likely to need significant help to understand and correctly apply the new rules.

More information

Guidance for agents can be found on the Gov.uk website at: **https://www.gov.uk/government/publications/off-payroll-working-in-the-public-sector-reform-of-the-intermediaries-legislation-technical-note/off-payroll-working-in-the-public-sector-reform-of-the-intermediaries-legislation-information-for-agents**.

FIVE THINGS YOU NEED TO KNOW ABOUT PRACTICE SOFTWARE UNDER MTD

Are you ready for the transformation? The current timetable is for Making Tax Digital for Business (MTD) to go live from April 2018 for those unincorporated businesses above the VAT threshold, and for other unincorporated businesses a year later. The predominate focus so far with MTD has been on technical tax changes, digital accounting and what it means for taxpayers. But there are significant implications for tax software. To get your practice ready for MTD here are five things you need to check.

1. Access is via your practice software

Access to client data under MTD is via your practice software. HM Revenue & Customs (HMRC) current agent online services will be gradually withdrawn as they are replaced by MTD. The new model, supported by a five-year digital transformation at HMRC, creates a new platform and data pool across all taxes. Your access will only be as good as your practice software. Find out what your supplier is doing. If you don't yet use practice software, you'll need to investigate the options. There is only just over 12 months to get ready. How soon will you know? Ask your software supplier now.

2. Before you can access client data, you will need to subscribe to HMRC's MTD services for agents

This is not two parallel systems – old-style self assessment will fade out and future engagement will be via MTD for agents. In order to continue working, you will need to enrol for HMRC MTD services for agents. The information HMRC require initially will be limited, but your visibility to HMRC will change. You and your clients will be linked on the HMRC radar. HMRC is going to have a big pool of data and will be able to monitor compliance history. There is talk of agent segmentation, with 'good' agents obtaining preferential services from HMRC. Consider your business model and the implications of higher visibility.

3. It's all about APIs

"*We're a tax authority, not a software provider*" – so runs the headline in Civil Service News as HMRC defended its digital plans before the House of Lords Economic Affairs Finance Bill Sub-Committee. So HMRC is developing Application Program Interfaces (APIs), which enable third party software to access HMRC systems, rather than programmes which allow direct access.

This has significant implications. Not all suppliers are developing their software at the same rate. And development of APIs for agents has lagged behind progress for individual taxpayer digital accounts. When will your practice's tax software be ready for MTD, and will it offer all the APIs available? Practice software may not be MTD ready before autumn 2017.

In the longer terms, will your supplier develop functionality for all HMRC APIs? Some suppliers may decide not to offer some of the more unusual/ less common options. While it is speculation at this stage could this cover, for example, averaging for farmers, artists and writers, seafarers and other areas where there are special rules? Your software will need to match your client's needs.

4. Will your practice software talk to client's software?

Details of the exact mechanism for finalising returns for business profits and how this links in with personal tax information, such as savings or rental income, claims and elections, pension contributions etc. is not entirely clear. The most likely scenarios are that HMRC will develop APIs to enable all the income, claims, elections and adjustments currently made under Self Assessment to be made via the practice software. Alternatively, there may be limited options for adding data to Personal Tax Accounts.

Whatever happens, it may be necessary for your tax software to import data from your client's MTD compliant digital records. As clients upgrade their records to become fully digital and fully MTD complaint, will you still be able to manipulate their data easily?

There are still some details needed about how MTD quarterly updates will operate in practice, and how year-end finalisation will work, and the implications these have.

5. Free software – what's it about?

HMRC has said that there will be no free software for agents. But it has promised free software for some small businesses. In the recently published specification, the target of the free software is unincorporated business with turnover below £83,000, without any employees and using cash basis accounting.

So if free software is available, and one of your client's would like to use it, what is the answer? We are told "HMRC would not require free software to link or integrate with an Agent product". The conclusion surely must be that to have an agent, taxpayers will need to buy software, and not rely on any free software.

Even with an extra year for smaller business provided in the Budget, it is worth talking to your clients now to ensure compatibility.

Conclusion

MTD moves into a new phase from April 2017. But it seems unlikely that agents will be able to join before the autumn. Given the very condensed timescale, it is essential that you know what your tax software provider is offering and what implications this may have for being MTD ready by April 2018.

Given that the 2017/18 pilot will not cover the year-end finalisation period, the key point of agent involvement, you may want to speak to your software provider about timescale and risk.

CAPS TECHNICAL BULLETIN

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