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ICAS

WE TRUST YOU – MAYBE?

The unexpected highlight of the 2014 budget is the consultation document 'Freedom and choice in pensions' proposing massive reforms to the position of individuals drawing pensions, to be effective from April 2015.

At present, there are tight rules to prevent individuals from drawing their entire pension fund in a lump sum or over a short period with tax deterrents for those who do.

One of the proposals is to remove the requirement to purchase an annuity by age 75. There had been calls for this change to be made for a number of years but it now looks like becoming a reality.

It is also proposed to remove the penal rates of tax which apply when the withdrawal limits are exceeded. Instead, individuals will be subject to income tax at their marginal rate on the amounts which they withdraw from their pension fund.

Individuals would still be able to withdraw up to 25% of their fund as a tax free lump sum. Thereafter, they will be able to take as much income as they wish.

Individuals who wish certainty in their future income will still be able to purchase an annuity.

These proposals will apply to defined contribution pension schemes only and not to defined benefit schemes.

It seems at last that the Government is prepared to trust individuals who have built up their pension funds over many years to apply the proceeds in a sensible manner. While there may be the odd pensioner who will put his entire pension fund on a horse or purchase an expensive sports car, most people will apply common sense. If they extract large amounts from their pension fund and spend it then, unless they have other means, they will have a pretty miserable old age. The more prudent may utilise the flexibility to, for example:

- take a one-off additional amount from their pension fund to visit family in Australia or pay for an operation privately. With annuity rates at around 6%, removing £10,000 extra from a pension fund will result in a drop in annual income going forward of £600 per annum.
- decide to extract a large sum, suffering income tax at up to 45%, and gift this to family, particularly if they have other means to support their lifestyle rather than waiting until death and any remaining pension funds passing to beneficiaries after deduction of 55% tax under the current rules. In appropriate circumstances, the inheritance tax normal expenditure out of income exemption may apply to such gifts.

The Government recognises that it too may benefit from these changes in that, if individuals are able to withdraw more than they can currently then there will be an additional inflow of income tax to the Exchequer.

In The Meantime...

Currently, under pension draw down, an

individual can take a maximum of 120% of the equivalent annuity that he could have taken had his pension fund been used to purchase an annuity. From 27 March 2014, this limit is being increased to 150%.

Other Notable Proposals

The annual investment allowance yoyo continues but happily in the upward direction. The current £250,000 allowance was to revert to £25,000 after 31 December 2014. Instead it will increase to £500,000 from April 2014 and remain at this level until 31 December 2015. It will reduce to £25,000 from 1 January 2016, unless of course the Chancellor changes his mind in a future budget! While the increase is welcome it does not assist in the stability for which business craves.

The £8,500 higher paid employee threshold is to be abolished with a statutory exemption for trivial benefits. Is this the first small step in the simplification of employment taxes as the Government is to review the underlying tax rules of travel and subsistence expenses?

From 6 April 2014, the individual personal allowance is to increase from £9,440 to £10,000 but the basic rate band is to reduce from £32,010 to £31,865 from the same date. The personal allowance is to increase to £10,500 from 6 April 2015, whilst the basic rate band falls further, to £31,785.

Another simplification relates to individual savings accounts with effect from 1 July 2014. The annual subscription limit will rise to £15,000 and it will be possible to invest the whole of this in cash, stocks and shares or any combination of the two.

Investors do well to attain a 2% rate of interest on deposits and saving income tax on interest of £300 may not seem a lot but, if individuals are able to invest £15,000 per annum over a number of years in new ISAs, then they will be able to build up a sizeable fund producing tax-free income and perhaps gains.

Ma Ba'

It looks likely that the Government will continue with its proposal to require persons who have an open enquiry or ongoing appeal and have used a tax arrangement which is notifiable under Disclosure of Tax Avoidance Schemes (DOTAS) to pay the tax that they have "saved" to HM Revenue & Customs. This tax would be repayable to them if they are successful in litigation. While there is strong support for the proposition that people should "pay their full share", it is a frightening thought that the Government can move the goal posts when taxpayers have operated within the terms of the law. It is all the more worrying that there are some 65,000 open cases and that the proposals will be applied with retrospection. In other words, it will not just apply to new cases after a certain date. We have long said that UK tax legislation is far too complex and is in many cases enacted with little thought or debate in parliament and now a huge number of taxpayers, who may very well have complied with the law, are to be penalised for the ineptitude of successive Governments.

FIXED SHARE AND SALARIED PARTNERS IN LLPS – NEW TREATMENT

With effect from 6 April 2014, the draft 2014 Finance Bill stipulates that members whose remuneration is basically fixed and who have little exposure to risk should be treated as employees subject to PAYE and NIC.

While PAYE is a timing difference compared to the member paying his tax on 31 January and 31 July each year, NIC is a different matter in that the member will suffer more Class 1 NIC as an employee than the combined Class 2 and Class 4 liability he currently pays as a self employed person. The big hit will really be suffered by the partnership with employers' NIC at 13.8%, albeit this will reduce the profit of the firm and the taxable profits of members who remain taxed as self employed.

The member will be taxed as an employee where three conditions are met:

1. Where he performs services for the LLP and it is "reasonable to expect" that this remuneration is "wholly or substantially wholly, disguised as salary". Disguised salary is a fixed amount, or a variable amount which is not affected by the overall profits or losses made by the LLP.
   HM Revenue & Customs' (HMRC) technical note of 10 December 2013 states that "substantially wholly" is where 80% or more of the amounts payable to the member for services is expected to be in the form of disguised salary. In short, in order to fall out with this condition, more than 20% of the members profit share will have to be variable and the whole profit share must relate to the firms overall profits.
2. The individual does not have significant influence over the affairs of the LLP. Members of small partnerships are likely to have significant influence but members of large partnerships are unlikely to have significant influence unless they are part of the management board or team. Where firms have management boards then it is likely that fixed share partners who are not on the management board will be affected by the proposals while those who are on the management board will not.

3. His capital contribution is less than 25% of his disguised salary in the tax year. S108 Income Tax Act (ITA) 2007 defines capital contribution as excluding amounts that the member can withdraw while he is a member.

The draft legislation foresees the possibility of avoidance and specifically includes a provision to treat an individual as a salaried partner where he provides relevant services to the LLP but is not a member of it.

HMRC give an example of what they have in mind:

"J realises that he would be a salaried member. With the agreement of the LLP, he introduces as a member J Limited. J Limited receives a reward package that had been agreed for J. These arrangements have been entered into to avoid the impact of the salaried member legislation. J is deemed to be a member, the result is that the sum due to J Limited is treated as payable to J, and PAYE should be operated accordingly".

Where a member is treated as a salaried partner, the firm is able to claim a tax deduction for the remuneration package, including employers NIC.

Where it is desired that affected members should continue to be taxed as self employed then all parties will have to act quickly to ensure that the member falls outwith one of the three conditions. For example:

1. Would it be possible to amend the agreement to ensure that the member has a truly variable profit share with no guaranteed minimum amount?
2. Can it be argued that the individual has influence? This is probably difficult where there is a management board of which he is not a member.
3. Perhaps the simplest solution will be to require that the member introduces fixed capital to the firm. A bank may be willing to provide this, secured on firm assets and the member should be able to obtain income tax relief in respect of the interest charged.

Please note that, although the legislation is effective from 6 April 2014, there is an extension to 6 July 2014 for those members who are raising finance to pay into the LLP. The conditions for this extension can be found at section 2.6.7 of the HMRC technical guidance on salaried members of LLPs at: **www.gov.uk/government/uploads/system/uploads/attachment_data/file/298222/Partnerships_Salaried_member_rules.pdf.**

HMRC INFORMATION GATHERING ACTIVITY IN RELATION TO ENTERTAINMENT AGENTS - IS A DRAMA ABOUT TO UNFOLD?

It seems HM Revenue & Customs (HMRC) may be about to stage an assault on the entertainment industry.

Last summer, the HMRC Risk and Intelligence Service based in Cardiff wrote to entertainment agents and warned that a statutory information notice was going to be issued, requiring the submission of details surrounding payments they received on behalf of their clients.

The information notices were issued under Paragraph 1 of Schedule 23 Finance Act 2011 in November 2013 and the details requested had to be returned to HMRC by 14 January 2014.

Information required

The information requested by HMRC applied to all payments the agent received which were for or belonged to another person (including individuals, partnerships and limited companies) for the period 6 April 2012 to 5 April 2013 inclusive.

In respect of each payment received, HMRC required the following particulars:

- The name of the person for whom payment was received
- The person's address including postcode ('care of' addresses were not acceptable)
- The total amount of the gross payments received for that person for the year
- The currency code for the payment (eg GBP for Great British pounds)
- The period end date for the payments ie 5 April 2013
- A reference number from the agents' accounting system to identify the record in case of any subsequent questions
- The entertainment agent's company or organisation name.

The only payment information which did not have to be returned was where the total amount received by a performer was less than £1,000 during the year or where the payment received was liable to PAYE.

The information notices warned the agents that failure to comply would attract an initial penalty of £300 and up to £60 a day for a continuing failure.

Why the entertainment industry?

Performers typically have several streams of income during any given accounting year including one off fees, repeat fees, royalty payments, advertising and endorsement monies and writing payments to name a few.

From an expenses point of view, HMRC is always watchful of clothing, hairdressing and make up, travel and subsistence and use of home as office claims, which are all contentious areas of cost.

Several actresses, actors, music producers and musicians have been selected for Business Records Checks (BRCs) in the past and it may well be that HMRC has discovered elements of poor record keeping during the BRCs, which has given concern about the accuracy of the income declared and the application of the 'wholly and exclusively' rules for business expenditure.

How will HMRC use the information?

The letters issued last summer reassured the entertainment agents that '*This is not a check of your tax affairs*.' It can, therefore, be assumed that HMRC is risk assessing the income declared and expenditure claimed for by the performers.

Once the risk assessment process has been completed, HMRC could decide to simply adopt enquiries into those returns considered to be potentially incorrect.

Alternatively, if the process suggests widespread errors, HMRC may decide to launch a campaign to encourage voluntary disclosure of inaccuracies. HMRC is targeted to launch four campaigns every tax year and targets chosen to date include medical professionals, electricians, plumbers, online traders and fitness coaches.

A less likely option is for HMRC to use a Task Force approach. Task forces typically focus on geographical locations and involve multi-discipline teams from different Government agencies. Unless the risk assessment highlights a particular problem, for example in London, with actors falsely claiming benefits whilst working, the campaign approach would seem more inevitable.

However, it should be noted that HMRC has denied the entertainment industry is part of some sort of national activity.

When the initial letters were issued, warning of the impending issue of the information notices, HMRC was asked to comment. The response received was '*We routinely ensure everyone pays the right tax and that includes anyone who has taxable income they haven't told us about. We want to make sure no one builds up a tax debt that has to be paid off in the future.*'

Make of that what you will!

HMRC CAMPAIGNS AND TASKFORCES UPDATE

Taking aim at hidden wealth

HM Revenue & Customs (HMRC) has announced the launch of a new taskforce aimed at hidden wealth in London and East Anglia. The taskforce will target individuals with offshore accounts and those deemed to be living beyond their means due to assets from undeclared income. This taskforce follows on from a similar one which was rolled out in Northern England in October 2013.

Letters for Cayman Islands account holders

HMRC entered into an information exchange agreement with the Cayman Islands during November 2013. It has recently come to light that HMRC have begun to write to those individuals with Cayman accounts to encourage anyone with unpaid tax to come forward. The letters are accompanied by a "disclosure information sheet" which is presumably an attempt by HMRC to encourage people to be open and honest regarding their tax position.

New focus on National Minimum Wage non-compliance

The Government has announced an increase to the penalties for those employers who are openly flouting the national minimum wage laws. Penalties for offences increased at the end of February 2014 from a maximum of £5,000 to £20,000, and are due on 100% of the arrears rather than 50% as was the previous position.

Government plans are also afoot to change the maximum penalty to £20,000 per worker, increasing the impact on employers who fail to comply even further.

UK/Swiss tax cooperation agreement - issue of letters

HMRC is planning on issuing the next tranche of letters to individuals identified by Swiss data. Initially, HMRC has only contacted customers it believes to be unrepresented and these notices have followed the previous format.

Where HMRC believes there is an agent acting, issuing will take place in early April so that the appointed agent can be notified at the same time. HMRC has said it recognises the value that agents can add in helping their clients to make the most appropriate response.

HMRC expects to issue at least one further tranche of letters during 2014 and subject to feedback, will continue with this approach for that tranche.

ICAS Launches New Resource – The Practice Hub

ICAS has launched a new web resource for Practitioners, the Practice Hub. The aim of the Hub is to provide practitioners with one central location where they can access information to assist in the effective running of their practice. We would encourage members to login and access the hub at: **http://icas.org.uk/ca/practice-hub/**.

RESEARCH & DEVELOPMENT (R&D) TAX RELIEF

Research and Development (R&D) Relief is a Government incentive to reward companies undertaking R&D. Only entities which are liable to corporation tax may take advantage of this relief.

Since its introduction to SMEs in 2000 (and subsequent introduction to Large Companies in 2002) there has been a significant uplift in the number of claims made. During 2000/01 some 1,789 companies made R&D claims. This figure increased to 11,920 during 2011/12.

Contrary to popular belief, R&D is not the preserve of 'white coated lab technicians' – claims are made across a wide industry base. The Office for National Statistics demonstrates that claims are made by organisations operating in excess of 12 industry sectors including Agriculture, Mining, Construction, Education, Transport and Restaurants. The majority of claims arise in the Manufacturing and Business Services sectors (includes inter alia computer and property services).

The definition of R&D activities is broad. If an organisation is developing new or improved products, processes, services or systems, then significant additional tax savings may be available by making an R&D claim.

A successful R&D claim must prove/demonstrate:

- There was a scientific or technological advance;
- The existence of scientific or technological uncertainties;
- How and when the uncertainties were solved;
- Why the knowledge sought was not readily deducible by a competent professional.

This is often a difficult concept to articulate to a client. Critically, the individuals who were involved with the project must make a significant contribution to the drafting of the R&D claim.

There are two schemes for claiming relief, depending on the size of the company or organisation:

- The Small or Medium-sized Enterprise (SME) Scheme and
- The Large Company Scheme.

SME Scheme

For the purposes of R&D, an SME is an organisation with fewer than 500 employees and either:

- An annual turnover not exceeding €100 million

or

- A balance sheet not exceeding €86 million.

R&D relief can be claimed on employee costs, staff providers, materials, clinical trial volunteers, utilities, software and contracted out expenditure. 100% Capital Allowances may be available for capital expenditure. There is no 'de minimis' level of expenditure before a claim can be made.

If a successful claim is made, the relief is generous. There is a 225% deduction for qualifying expenditure and, if relevant, allowable trading losses are increased by 125%. Pre-trading R&D expenditure can be treated as allowable trading losses.

Alternatively, tax credits (in the form of cash payments) can be claimed instead of loss relief. The available tax credits are the lesser of:

- 14.5% of the surrenderable loss; and
- the organisation's PAYE and NIC incurred on the relevant R&D activity

If a grant or subsidy has been received for the project, an R&D claim may not be possible.

Large Company Scheme

This was amended in the 2013 Budget which introduced an 'Above the Line' (ATL) R&D expenditure credit to run concurrently with the enhanced deduction scheme. This can be claimed as an alternative to the existing 130% enhanced deduction scheme on qualifying expenditure (as defined above).

The Large Company Scheme can also be considered for any SMEs which are unable to claim SME R&D, say because they undertake sub-contracted R&D or its R&D expenditure is subsidised.

The ATL scheme will replace the enhanced deduction scheme from 1 April 2016.

ATL uses a 10%* tax credit based on the qualifying expenditure. The example at Table 1 compares ATL relief with the enhanced deduction.

*10% credit is for businesses other than Oil and Gas ring fence businesses, which operate a 49% credit.

Table 1	Enhanced Deduction		ATL
Turnover	2,000		2,000
Other expenses	(500)		(500)
R&D	(1,000)		
ATL credit		(100)	(900)
	500		600
Enhanced deduction	(300)		
Taxable amount	200		600
CT @ 23%	46		138
ATL credit			(100)
CT due	46		38

If there is insufficient CT to absorb the credit, then (subject to levels of PAYE/NIC on staffing costs) a cash repayment is generated. There is flexibility in the system to offset unused credits against CT liabilities in other periods, treat them as R&D credits in other periods, utilise as group relief or net off against other (ie VAT) liabilities.

An R&D claim must be made within 2 years of the end of the accounting period in which the qualifying expenditure was incurred.

PROFESSIONAL CONDUCT IN RELATION TO TAXATION – REVISED EDITION ISSUED FEBRUARY 2014

Updated guidance on how tax advisers should act was issued in February 2014 (the previous edition having been issued in 2011) and it should be read in the context of the ICAS Code of Ethics and the principles that should apply to all dealings by members with HM Revenue & Customs (HMRC).

Members are bound by the rules and regulations of ICAS. In addition to this, members are bound by the Code of Ethics, and they are also expected to give due consideration to the guidance and recommended good practice issued by ICAS. The guidance, Professional Conduct in Relation to Taxation (PCRT), sets out the high ethical standards which should govern the tripartite relationship between tax adviser, client and HMRC. Its aim is to support and assist the key role members play in helping clients comply with their tax obligations. The guidance is issued as a joint publication by ICAS, ICAEW, Chartered Institute of Taxation (CIOT), Association of Taxation Technicians (ATT), Association of Chartered Certified Accountants (ACCA) and Society of Trust and Estate Practitioners (STEP).

The PCRT is based on five fundamental principles:

- Integrity
- Objectivity
- Professional competence and due care
- Confidentiality
- Professional behaviour

The PCRT provides guidance on applying these principles to practical situations, for example, if there is an irregularity in a client's tax affairs and the client is reluctant to correct it, or when a client refuses to make a full disclosure to HMRC or receives an excessive repayment. It also expands the existing guidance on areas including tax avoidance and the new General Anti-Abuse Rule.

The document makes clear the obligation of tax advisers to advise their clients accurately and thoroughly of the risks and implications of their actions including reputational and practical aspects.

The key changes in this update include:

- A brief section on electronic filing (end of chapter 3)
- Advising clients who wish to rectify past irregularities (chapter 5)
- Dealing with clients who wish to take advantage of voluntary disclosure facilities and other special arrangements for rectifying tax affairs (chapter 6)
- An enhanced chapter on 'Tax planning, tax avoidance and tax evasion' (chapter 8)
- Guidance on the new General Anti-Abuse Rule (chapter 8)
- Guidance on dealing with situations where HMRC wants to visit the member to discuss practice matters eg as part of Agent and Client Statistics (chapter 10)
- Professional standards relating to participating in consultations or secondments with HMRC (chapter 11)

However, the underlying principles of the guidance have not changed, ie that it is to provide guidance on applying the five fundamental principles in the Code of Ethics in a tax context.

The PCRT has been reviewed by Counsel and HMRC has been consulted and '*acknowledges that this guidance is an acceptable basis for dealings between members and HMRC*'. It added '*HMRC welcomes the publication of the new edition of this guidance for tax agents as a positive step. We recognise the role they play and the responsibilities they bear in ensuring taxpayers understand and comply with their tax obligations*'.

The guidance can be read at: **http://icas.org.uk/PCRT.pdf**.

Online General Practice Procedures Manual

Eligible firms are reminded to register for the free General Practice Procedures Manual (GPPM).

For more information and how to register visit the ICAS Practice Hub at: **http://icas.org.uk/ca/practice-hub/** or email **practicesupport@icas.org.uk**

SCOTTISH TAXES – AN UPDATE

In December 2013 the Revenue Scotland and Tax Powers Bill (RSTPB) was introduced to the Scottish Parliament. This Bill is a consequence of the measures in the Scotland Act 2012, which gives the Scottish Parliament responsibility for the devolved areas of taxation. The RSTPB sets out to enable collection and management of devolved taxes and is expected to do so from 1 April 2015.

At present, the devolved taxes are on transfers of land and on disposals to landfill so Stamp Duty Land Tax will cease to have effect in Scotland and will be replaced by Land and Buildings Transaction Tax (LBTT) from 1 April 2015. The UK Landfill Tax will be replaced by Scottish Landfill Tax (SLfT), again, with effect from 1 April 2015. The Land and Buildings Transaction Tax (Scotland) Bill received Royal Assent on 31 July 2013 although some aspects are still to be provided for in secondary legislation, including rates and bands. The Landfill Tax (Scotland) Bill received Royal Assent on 21 January 2014.

These two taxes and the RSTPB are being introduced regardless of the outcome of the referendum this September.

The Scottish Rate of Income Tax (SRIT), effective from April 2016, remains a UK-based tax administered by HM Revenue & Customs (HMRC) – it is simply varied to permit the Scottish Parliament to set a different rate for Scottish taxpayers. Unlike the devolved taxes of LBTT and SLfT which are transaction-based taxes with a clear jurisdictional base in Scotland, the SRIT will have a wider impact that will be felt across the UK: there will be some taxpayers who work in various parts of the UK and their residence (Scottish or otherwise) may need to be established. There will also be Scottish residents who have employers based elsewhere in the UK who will need to deduct SRIT.

HMRC has issued a technical note clarifying the scope of SRIT that covers the following areas:

- Definition of a Scottish Taxpayer
- General Issues
- Charitable Giving
- Pensions Tax Relief
- Trustees and Personal Representatives
- Other Income Tax Issues

This can be found at: **www.hmrc.gov.uk/news/scottish-rate.htm**.

Other aspects of the RSTPB

The RSTPB has been drafted with two objectives: one, and the more immediate, is focused on and tailored to the effective operation of the two devolved taxes detailed above which are specialist taxes with which accountants have not traditionally had much involvement. A secondary objective is to create a framework that can accommodate the collection and management of other taxes regardless of whether there are more devolved taxes or a full range of taxes should Scotland become independent. The RSTPB is therefore worthy of attention.

The RSTPB establishes the tax authority 'Revenue Scotland'. It will be a non-ministerial department, with a membership of between 5 and 9 appointees, accountable to the Scottish Parliament. It is being created on the same basis as OSCR and the Scottish Courts Service.

Revenue Scotland's functions are defined in section 3 of the RSTPB as:

1. A general function of the collection and management of the devolved taxes, and
2. Particular functions of
   a) providing information, advice and assistance to the Scottish Ministers relating to tax,
   b) providing information and assistance to other persons relating to the devolved taxes,
   c) efficiently resolving disputes relating to the devolved taxes, and
   d) protecting the revenue against tax fraud and tax avoidance.

However, Revenue Scotland's operational aspects are to be delegated to two other public bodies – to Registers of Scotland for LBTT and to the Scottish Environment Protection Agency for the Scottish landfill tax. There will be a formal delegation of duties to the operational bodies, along with a Memorandum of Understanding, although responsibility for the functions of Revenue Scotland cannot be delegated.

Staffing of Revenue Scotland is currently around 15 and this is expected to double by next April. It will be interesting to see how the division of duties will evolve between the different bodies, particularly in areas such as enquiries, investigations and dispute resolution.

The RSTPB provides a framework for the powers, rights and duties associated with the collection and management of the devolved taxes. Note that the Scotland Act 2012 devolves certain taxes and their collection and management, which means that existing jurisprudence and case law regarding collection and management (and previously care and management (See Commissioners for Revenue and Customs Act (CRCA) 2005 s51(3))) is relevant. The RSTPB also defines the relationship between the tax authority and taxpayers: section 10 states that there will be a Charter, and section 68 lists a taxpayer's duties.

The devolved taxes will be self-assessed, and there will be a standard set of time limits applying for amending a self-assessment or for Revenue Scotland to issue an assessment. There will also be a penalty regime for non-compliance. However, the bill as currently drafted simply provides for much of the penalties to be in secondary legislation. There has been considerable unease regarding this, and as a result, it is anticipated that the Bill will be amended to bring the penalty provisions into the primary legislation.

A controversial aspect of the Bill is its aim to counteract tax avoidance. There is a general anti-avoidance rule, designed to enable Revenue Scotland to take counteraction in a wider range of circumstances than the existing UK GAAR. A tax avoidance arrangement is artificial if condition A or B is met: test A is met if the entering into or carrying out of the arrangement is not a reasonable course of action in relation to the tax provisions in question having regard to all the circumstances; whilst test B is met if the arrangement lacks commercial substance.

There is no statutory clearance procedure, nor is there an Advisory Panel. There is a strong political stance against tax avoidance and it remains to be seen how the Scottish GAAR will operate.

A structure for resolving disputes has been designed, firstly, within Revenue Scotland which will be required to carry out an internal review or it may also offer to enter into mediation with the taxpayer. Failing this, a taxpayer may take their case to a tribunal. A policy decision within the Scottish Government has resulted in the appeals process being separate from the existing UK Tribunals, so the Bill establishes a new Scottish Tax Tribunal, which is expected to be transferred into a new Scottish tribunals structure that has very recently been legislated for with the Tribunals (Scotland) Act 2014.

Significant parts of the Bill will be recognisable to tax practitioners, given that much of it replicates existing UK provisions but there may be some gaps or loose ends between the different parts. Current suggestions indicate that this Bill will be enacted by late summer of 2014. The ICAS Tax Team has reviewed the Bill and will continue to raise potential amendments and points where further clarity is sought over the course of the next few months so if there are any points that you'd like raised please forward these to **tax@icas.org.uk**.

PPI INTEREST – A REMINDER

The Low Income Tax Reform Group has sent out a reminder to those recipients of Payment Protection Insurance overpayments to ensure that they do not fall foul of HM Revenue & Customs (HMRC) for failing to declare any i nterest element of a repayment. Recipients of these compensation payments are reminded to check the details of what they have been paid and, where interest is included, should contact HMRC and inform them. Overpayment recipients should also be aware that their tax credit awards may be affected.

Full details can be found at: **www.litrg.org.uk/News/2014/cheque_missold_PPI?utm_source=LITRG&utm_campaign=912d94e184-RSS_EMAIL_CAMPAIGN&utm_medium=email&utm_term=0_58c63702e8-912d94e184-60596165.**

ANNUAL TAX ON ENVELOPED DWELLINGS – RATES FOR 2014/15 RELEASED

The Annual Tax on Enveloped Dwellings (ATED) was introduced in 2013/14 and is a tax on residential dwellings owned by a company, a partnership with a corporate member or another collective investment vehicle.

HM Revenue & Customs have released the ATED levels for the 2014/15 tax year and, as before, they are banded depending on the property value. The bands for 2014/15 are as follows:

Property value £	ATED amount £
2,000,001–5,000,000	15,400
5,000,001–10,000,000	35,900
10,000,001–20,000,000	71,850
20,000,001+	143,750

More information on ATED can be found at: **www.hmrc.gov.uk/ated/basics.htm**.

ICAS Launches New Mandatory Practice Management Course

To coincide with the launch of its new Practice Strategy, ICAS has announced 2014 dates for the newly written Practice Management Course. The content of the course will balance regulatory and technical content, with the focus on relevant and current issues. Attendance at this course is mandatory for all Practising Certificate holders every 5 years. More information and details on how to book can be found at: **http://icas.org.uk/ld/practicemanagement/**.

HMRC ANNOUNCES ROLL OUT OF FACE TO FACE SUPPORT SERVICE

After a successful pilot period in the North East of England, HM Revenue & Customs (HMRC) has announced that it will be going ahead with its plans to offer a flexible service for those taxpayers requiring extra assistance with their affairs.

To recap, HMRC currently has 281 enquiry centres and, of these, some are only open one day a week. There has been a steady decrease in the number of individuals using these centres since 2005/6. The decision was therefore taken to close all 281 of these and look at alternative ways to offer support to customers and it was decided that HMRC needed to offer more flexibility.

The new service will offer a telephone helpline as well as the option of booking an appointment with one of HMRC's mobile advisers where further support is required. The new regime is expected to be rolled out from Spring 2014.

More information on the new service can be found at: **www.hmrc.gov.uk/extrahelp/.**

VAT TREATMENT OF INVESTMENT MANAGEMENT SERVICES - THE PPG CASE

In April 2013, the Advocate General (AG) of the Court of Justice of the European Union (CJEU) delivered her opinion on the PPG appeal and on 3 February 2014, HM Revenue & Customs (HMRC) issued Brief 6/14 on the subject.

The factual background to the case is as follows. PPG, a Dutch company, established a defined benefit pension scheme for its employees. PPG was required by law to set up a separate pension fund for the purposes of the scheme. Thus, PPG received and paid for pension administration and investment management services from pension fund managers. PPG reclaimed the VAT it paid on the administration and management fees as input tax. The Dutch tax authorities challenged this claim, PPG appealed and the Dutch court referred two questions to the CJEU:

1. Can the defined benefit pension fund in question be classified as a 'special investment fund' so that the management of the fund was exempt from VAT? and
2. Assuming VAT was chargeable on these services, could the employer treat this VAT as its own input tax?

With respect to the first issue, the Advocate General did not need to answer this question as it had already been effectively dealt with in the case of **Wheels Common Investment Fund Trustees Ltd and Others v HMRC (C-424/11)** heard before the CJEU and decided in March 2013. That case asked the same question, the difference between the two cases with regard to this issue being that PPG was the employer of the members of the pension scheme, whereas in Wheels, the appellant was the trustee of the fund of a defined benefits scheme.

'Special investment funds' for VAT exemption purposes was defined by the CJEU to mean undertakings for collective investment in transferable securities within the meaning of the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, as well as funds which are sufficiently comparable to, and in competition with, such undertakings (for example, investment trust companies).

The conclusion in Wheels was that the fund was not "special" because the assets of the fund were pooled, no risk arising from management was taken by the members and the employer made contributions to comply with legal requirements towards its employees. Essentially defined benefit pension funds are neither comparable to, nor in competition with UCITS funds.

HMRC state in their Brief 6/14, that whilst the VAT liability of management services in respect of defined benefit pension schemes has now been determined by the CJEU, a judgment on the liability of management services in respect of defined contribution pension schemes is expected soon from the CJEU in the case of **ATP Pension Service A/S C-464/12**.

Because the appellant in the PPG case was the relevant employer, as mentioned above, this case also challenged whether the employer could treat the VAT on investment management services as potentially recoverable by the employer itself. The AG agreed that this VAT was partly the input tax of the employer. The relevant investment management services included administrative, management, consultancy and auditing. She took the view that the employer can deduct (subject to the normal rules) input tax on investment management of a defined benefits scheme only prior to the scheme being established. Once the scheme is established, however, this is a separate entity and it is the fund itself which benefits from the services and has the entitlement to deduct the input tax. Her point was that it was necessary to identify the entity most closely linked to these services and after it begins to exist, it can only be the fund itself. It should be noted that in the UK, HMRC does not distinguish between the timing of establishing the scheme.

The AG dismissed the fact that PPG actually paid for the investment management services as irrelevant.

With respect to the UK position, until now, HMRC policy has been to distinguish between costs incurred in relation to the setting up and also day to day administration of occupational pension funds and management of the investment activities of the fund. With respect to investment management costs, these were considered to be the costs of the pension fund itself and only related to the activities of the fund and were therefore only deductible by the fund (subject to the normal rules).

Where a single invoice covered both the administration of the pension fund and the management of the investments, HMRC allowed the employer to claim 30% of the VAT as relating to the general management of the scheme and the pension fund to claim 70% as relating to the investment management.

HMRC state in Brief 6/14 is that it is changing its policy (from 3 February 2014) on the recovery of input tax in relation to the management of pension funds as a result of the PPG decision. The 30:70 split will no longer apply. The crucial issue here is the point reiterated in PPG, that, in order to deduct the VAT incurred on a cost, a business must establish a direct and immediate link between the supply received and the taxable supplies that the business makes.

The extent to which there is a direct and immediate link will depend on whether the cost of the VAT bearing services is incorporated into the price of the supplies made by the business. A cost may be incorporated in one of two ways, into the price of specific supplies, or be part of its general costs and effectively incorporated in the price of all the supplies made by the business.

Regarding investment management services purchased, these will have a direct and immediate link to the supplies of the investments themselves and cannot therefore be general costs of the employer. If the services received go further than just the management of the investments, they are more likely to be general costs of the business. In this instance, the VAT incurred will potentially be deductible by the employer (treated as residual input tax, subject to the normal rules).

This means that there are circumstances where employers may be able to claim input tax in relation to pension funds where they could not previously.

HMRC state in the Brief that they will not accept any claim for input tax recovery by the employer where the:

- supplies were not made to the employer
- supply is limited to investment management services only (that is, it is not a combined supply of both investment management and pension administration services).

Where investment managers invoice the pension fund for their services, employers are being allowed a 6 month transitional period to get used to these new rules such that the 30:70 split rule may continue to be applied.

Employers that have provided pension schemes for their employees and have received supplies of services that have a direct and immediate link to the businesses supplies may claim a refund of any input tax which has not previously been claimed for the past four years.

EMPLOYEE RETIREMENT – KEY TAX ASPECTS

Issue 124 of Technical Bulletin included an article on the retirement of a business owner. This article considers the issues for an employer where an employee retires and looks at the tax aspects for both parties.

Lump sum payments

Retirement is not defined for tax purposes and so it needs to be given its ordinary meaning. This means that any lump sum paid by an employer to an employee on retirement will fall to be treated as employment income in line with section 13 Income Tax (Earnings and Pensions) Act (ITEPA) 2003. As readers will be aware there is an exemption under sections 401-406 ITEPA 2003 for amounts paid up to £30,000. Readers will also be aware that HM Revenue & Customs (HMRC) subject these payments to scrutiny and will look closely at the contractual arrangements in connection with payments made to identify if they can pursue the argument that the payment is anticipated by both parties – so that the exemption from tax and NI does not apply.

For both an employer and employee it will be important to make sure that where there are lump sum payments on retirement that the tax treatment of these is agreed and documented in the legal agreements. If any payment is not covered by the exemption then the employer should operate PAYE and NI via the payroll and account for this to HMRC. If payments are made after HMRC have been notified of the date of leaving on the First Payment Submission (FPS) and the P45 issued to the employee, the employer will also need to reflect these through PAYE following the advice issued by HMRC at: **www.hmrc.gov.uk/manuals/pommanual/paye74015.htm**. The employee will need to record the payment on his or her self-assessment tax return.

A company is able to claim a tax deduction in its corporation tax return for any lump sum payments that it makes when an employee retires.

Pension contributions and options

If there are additional contributions made into the employee's pension scheme these will be treated in the same way as normal contributions. If the scheme is a registered scheme then the amount can be paid in with no tax consequences for the employer or employee provided that the fund is within the lifetime allowance. If the scheme is an unregistered Employer-financed Retirement Benefits Scheme (EFRBS), Funded Unapproved Retirement Benefit Scheme (FURBS) or Unfunded Unapproved Retirement Benefits Scheme (UURBS), then there are likely to be tax charges arising on any contributions into the scheme. This can be a very complex area and it is sensible to take professional advice from pension advisers if these types of arrangements apply, to cover both the pension and tax position.

A company is able to claim a tax deduction in its corporation tax return for payments made into a registered pension scheme as an expense in computing the profits of a trade, profession or investment business, and so reducing the amount of an employer's taxable profit. There are some rules for spreading the deduction for larger payments and the link to the Registered Pensions Schemes Manual below covers the circumstances in which this would apply.

In the case of a trade or profession, employer contributions will be deductible as an expense provided that they are incurred wholly and exclusively for the purposes of the employer's trade or profession as per Income and Corporation Taxes Act (ICTA) 1988 s74(1)(a) and Income Tax (Trading and Other Income) Act 2005 (ITTOIA) s34 - income tax. Where the employer is a company with investment business, the employer contributions will be deductible as an expense of management per ICTA s75.

There is advice from HMRC at: **www.hmrc.gov.uk/manuals/rpsmmanual/RPSM05400000.htm**.

Long service awards

Consideration will also need to be given to the tax implications of any long service awards given when employees retire. The position on these is as follows:

- Cash awards – treated as earnings. Any awards of "readily convertible assets" are treated as cash.
- Non-cash award and service of over 20 years and no long service awards in the previous 10 years – up to £50 per year are non-taxable but awards over £50 per year of service are taxable on the excess over £50 if the employee earns over £8,500 per annum.
- Non-cash award and service of less than 20 years or previous long service awards in the past 10 years – if the employee earns over £8,500 per annum then the award is taxable. The full amount is taxable.

This can be a complex area for employers and the HMRC detailed guidance is at: **www.hmrc.gov.uk/payerti/payroll/special-pay/non-cash.htm** for PAYE and at: **www.hmrc.gov.uk/manuals/nimmanual/NIM02500.htm** for NIC.

After retirement – pension and payroll issues

Most pension payments to employees will be made by pension schemes who will be separately registered for PAYE. However, there may still be instances where there are payments made by companies and these notes cover those situations.

Once the employee has retired, the issue of pension payments will need to be considered. The PAYE and NIC implications are as follows:

- Employee will not be receiving a pension – the employee should be treated as a leaver on the PAYE records.
- Employee is receiving a pension but not continuing in employment - the employee will remain on the payroll and any companies pension payments made using their existing tax code on a week one/month 1 basis. The Occupational Pension indicator and the annual amount of the pension should be reflected in the FPS and a new payroll ID set up. A retirement statement should be provided to the employee with details of the position to the date of retirement.
- Employee is receiving a pension and is continuing in employment – before any company pension payments begin a separate payroll record should be created to reflect the pension payments. When the pension is paid employers should use OT code on a week one/month one basis for the pension and the existing code for the employment income. When the first pension payment is made the annual amount of the pension should be included on the FPS and the occupational pension indicator set. There should be a separate payroll ID for the pension and the employment income.

Once an employee is over the State Pension age they do not have to pay class 1 or 2 National Insurance Contributions. Employees should provide their employers with proof that they are eligible – a birth certificate or passport is considered to be appropriate. State Pension age is currently 65 for men and 60 for women. The age for women will increase to 65 by 2018 and there is guidance on pension ages at the gov.uk website **www.gov.uk/calculate-state-pension**.

Other considerations

For employers, the position on National Insurance Contributions on any salary paid to pensioners is that employers NIC should be deducted at the not-contracted out rate even if there is a contracted out scheme.

Employees will need to bear in mind that their pension income is taxable income. Income from occupational pensions is taxed at source but the state pension is paid gross (although it is usually coded out against the income due from any occupational pension). There may be issues with getting the coding associated with occupational pensions correct so that the right amount of tax is withheld at source. Notices of coding should therefore be checked to make sure these are accurate.

The basic problem and why things often go wrong with tax coding around retirement is that the Department for Work and Pensions does not operate PAYE on the state retirement pension. This forces the PAYE system to do something which it is not very good at, which is to collect tax on two sources of income through one tax code (usually collecting tax on both the state pension and an occupational pension through the coding issued for the occupational pension).

HMRC will be notified automatically by the Department for Work and Pensions once an individual has decided to claim their state pension. HMRC is advised automatically about five weeks before the date that an individual reaches state retirement age.

The higher personal allowance can complicate the notice of coding still further. There can often be circumstances where HMRC does not include the allowance at the correct time so that there are delays in giving an individual the allowances to which they are entitled. Keeping a careful eye on notices of coding should reduce any problems in this area.

There are many non-tax issues to consider for the employer and employee in the period preceding retirement but tax should not be overlooked, and it will be worthwhile for both parties to look at the position around the time that HMRC issue any forms to the employee.

HMRC ANNOUNCE NEW TIMETABLE FOR IMPLEMENTATION OF AUTOMATED RTI PENALTIES

HM Revenue & Customs (HMRC) has announced that it will be implementing a new timetable for Real Time Information (RTI) automated penalties for late filing/payment. HMRC has confirmed that this new timetable for introducing these penalties is as follows:

April 2014 – in-year interest on any in-year payment not made by the due date

October 2014 – automatic in-year late filing penalties

April 2015 – automatic in-year late payment penalties

The relaxation to the late filing penalties timescale means that employers who bring all their submissions for the period 6 April to 5 October 2014 up to date by 5 October 2014 will not be liable for any in-year late filing penalties.

HMRC also announced that its late payment and non-filing general notification service (GNS) messages will be effective from 6 April 2014 onwards. This was to allow some changes to be made to the messages as it was felt that, in their previous form, they could be deemed misleading.

A final cautionary note – employers may still be charged a late filing penalty if they do not comply with their obligations relating to the final return of the 2013/14 tax year. Those practitioners requiring information on final returns should visit **www.hmrc.gov.uk/payefinalsubmission**.

CROSS BORDER RULES FOR LOSS RELIEF – M&S CASE FOLLOW UP

The case of Marks and Spencer (M&S) v HM Revenue & Customs (HMRC) has been on-going for some time, with various appeals and counter-appeals being heard by both the UK and European Courts. As a recap, the case hinged on whether losses incurred by M&S' Belgian and German subsidiaries were available to relieve against profits made by the UK parent and the extent to which these losses were able to be group-relieved.

The implications of the various judgements, including that handed down by the Supreme Court in May 2013 (**UKSC30**) was covered in Issue 121 of Technical Bulletin and at that point there were still a further three issues where judgement was deferred by the court. These matters have now been considered by the Supreme Court.

The matters deferred were:

1. Whether M&S was entitled to make **sequential** or **cumulative claims** for the same losses in respect of the same accounting period. HMRC had

appealed against this in an earlier hearing but this latest judgement (**UKSC11**) turns this down, concluding that there is no support for only one claim being permissible.

2. Whether M&S was able to make **additional** claims after the European Court of Justice (ECJ) gave a ruling which set out the circumstances in which losses may be transferred across borders, when, at the time M&S originally made those claims, there was no way of foreseeing the test that was established by the court. Earlier rulings had stated that M&S would be able to make new claims but that these would be time-barred. M&S appealed but the original decision has been upheld and the time-barring remains.
3. Whether the **method** for calculating the losses eligible for cross-border relief were consistent. M&S's approach had been to apply local accounting rules to determine whether there had been a loss in a particular period and, following on from this, the amount of any unutilised loss. This unutilised loss was then converted using UK principles when determining the set-off available against the profits of the UK parent. HMRC had appealed against an earlier judgement and, once more, the appeal was rejected. The Court held that this method of calculating losses would not give the Parent Company a greater level of relief than would have been available if the subsidiary had been resident in the same state as the parent.

The overall position following these judgements, therefore, looks quite positive for companies with loss-making overseas subsidiaries. The key will be to make sure that the relevant cross-border claims are made within the allowed timescales.

Companies and their advisers should be aware that there are inconsistencies in the interpretation of the ECJ judgement in the case and the 2006 amendments to the group relief provisions, which were supposed to make the UK legislation compliant with EU law.

Full details of this latest judgement can be viewed at: **www.bailii.org/uk/cases/UKSC/2014/11.html**.

TAX CASES

HMRC v Jeremy Rice TC032273

Point at issue: Whether the disposal of a property used for the purposes of motor vehicle trading met the requirements of Taxation of Chargeable Gains Act (TCGA) 1992, s169I(4)(b).

Background: The appellant, Jeremy Rice, was a trader who sold second hand cars. In 2008 he sold the premises from which he had previously traded to a property developer after the site became a target for vandals. Mr Rice claimed entrepreneur's relief on the disposal on the basis that the used car business was wound down less than three years before the date of the disposal. HM Revenue & Customs (HMRC) rejected the claim, contending that information received from Mr Rice's former accountant, Mr Ward, indicated that the business was wound down more than 3 years before the property was sold.

Facts: Mr Rice was a sole trader, selling used cars. He purchased the land at Fletton Avenue in the late 1980s and traded from here as "Performance Cars". The site consisted of a forecourt and showroom and Mr Rice relied on passing trade for this business and the fact that the cars were generally of a "*sporty nature and attracted some attention*". The site at Fletton Avenue eventually became the target for vandals and Mr Rice decided to cease trading from here. He decided to close Performance Cars, selling off his stock of cars at auctions and in newspaper adverts. The site at Fletton Avenue was cleared by 1 September 2005 and eventually sold on 29 April 2008. At this point, Mr Rice had started up a new venture from his home address, selling second hand family cars and 4x4's under the name "Four Acres Car Sales". This venture was different to the activity at Fletton Avenue in that all stock was kept in storage and potential buyers were directed to a website with details of the vehicles available (photos, specifications, prices etc).

Mr Rice's tax return for 2008/9, which was filed on 25 January 2010, showed a capital gain on the disposal of Fletton Avenue of £274,649. Entrepreneurs' Relief of £21,204 was claimed, reducing the capital gains tax due from £47,709 to £26,505. As the return was processed, HMRC reduced the amount of tax to £20,244. Mr Rice stated that Mr Ward could not understand how this lower figure had been arrived at and that he had queried it twice with HMRC.

On 21 October 2010, HMRC wrote to Mr Rice, explaining that they were intending on checking Mr Rice's return for 2009, particularly regarding the Entrepreneurs' Relief claim. After a lengthy period of correspondence between the two parties, HMRC denied the claim to Entrepreneurs' Relief and increased the capital gains tax due to £47,709.

Mr Ward then went about writing a series of letters to HMRC after indicating to Mr Rice that he would "*sort it out*". In the first of these letters, in December 2010, he stated that Mr Rice's business did continue after the disposal of the premises at Fletton Avenue. He further stated that there had been "*no change in the operation of the business which was still the disposal of high-class second-hand cars*".

In a further letter, dated 7 October 2011, he stated that there was "*a material disposal of the business*". This clearly contradicts the letter of December 2010.

In a letter dated 3 February 2012, Mr Ward stated that the business moved out of Fletton Avenue in March 2004. He also said that he believed that the Fletton Avenue site was disposed of in May 2009.

Argument: The key matter for the court to determine was the date on which the disposal of the Fletton Avenue site took place as it is this point which seems to be the biggest source of contention. As well as this, the court needed to decide whether the change in the nature of Mr Rice's trade satisfied the requirements for cessation of a business activity to have occurred.

To qualify for Entrepreneurs' Relief, the requirements of section 169I TCGA 1992 is that a material disposal of business assets has taken place and that the disposal of these assets takes place within 3 years of the date of the business ceasing to trade and that these assets must have been owned for a minimum of one year up to this point. With the site being sold on 29 April 2008 to the property developer, the effective date on which Mr Rice's business needed to have begun winding down was 29 April 2005 onwards (within 3 years of the sale date).

Mr Rice had initially indicated under examination that he spent roughly 6 months up to 1 September 2005 (which was the date at which the council tax records indicated that the property was empty because it qualified for "Empty Property Rates Relief"). However, going back 6 months from this point would take Mr Rice to a date pre 29 April 2005 and he would therefore be ineligible for claiming Entrepreneurs' Relief. When Mr Rice was cross examined he conceded that it was probably more likely that it took him in the region of 4 months to sell off the stock and clear the site. He qualified this by recalling that he remembered making the decision shortly before his wife went into hospital for surgery, which was in June 2005. This evidence suggested that the cessation took place within 3 years and therefore Mr Rice would be eligible for the relief and the judges were in agreement with this, stating that it was more likely that this date would be correct.

In discounting the evidence presented by Mr Ward, Judges Brannan and Gable stated that "*the letters written by Mr Ward should be approached with some caution. In the first place, the correspondence proceeded on the mistaken assumption that in order to qualify for relief the disposal of Fletton Avenue had to be a disposal of the whole or part of the business. Secondly, there are a number of inaccuracies and inconsistencies in the correspondence which we have noted above (eg the date of the disposal of Fletton Avenue). Certainly, the letters written by Mr Ward did seem to us to be confused*".

The second aspect of the argument concerned whether there had been a business disposal or whether in fact the business had continued, with Mr Rice continuing selling cars from his home address as he did. In convincing the judges, Mrs Gallup highlighted two key issues which indicated that a business activity had ceased and a new one had begun because of changes in that activity:

1. The type of car sale had changed from "sporty cars" to family and 4x4 vehicles which itself indicated a change in the nature of the business.
2. The sales were now internet-driven with customers coming out to a small village in the countryside rather than being reliant on passing trade from a busy road.

The Judges agreed with this contention, confirming that they considered that this constituted a "*very significant change in the business carried on by Mr Rice*". In outlining this to the court, Mrs Gallup references the **Ingram (45 TC 151)** and **Rolls Royce (STC 162)** cases which referred to "organic unity" and "organic growth". Mrs Gallup explained that in these cases, "organic" was taken to mean a slow and gradual change, as opposed to a sudden and dramatic change. She contended that the changes to Mr Rice's business clearly belonged in the second category.

Decision: The appeal was allowed, the judges agreeing with the two key arguments put forward by the appellant.

Commentary: There are a couple of interesting points arising from the case:

- The case gives an example of where a change in premises can be treated as a cessation of trade and the type of differences that there would need to be between the old trade (sporty cars from high street premises) and the new trade (4x4 cars sold via the internet)
- As you see from the summary the appellant's accountant, Mr Ward (who did not represent him at the hearing for obvious reasons) appears to have got himself in a bit of a knot regarding the rules of TCGA 1992 and consequently put his client in a position where he had to defend his position in court. This should prove as a reminder to practitioners to ensure that they do not get themselves involved in the provision of advice which is outside their area of expertise and, if they do, to seek assistance from third parties before getting themselves into situations where clients seek redress. In this case the accountant, Mr Ward, had represented Mr Rice for 30 years and had built up a great deal of goodwill over this timescale and so was less at risk from repercussions.

The full transcript for this case can be found at: **www.bailii.org/cgi-bin/markup.cgi?doc=/uk/cases/UKFTT/TC/2014/TC03273.html&query=tc03273&method=boolean**.

J&M Interiors v the Commissioners for HM Revenue & Customs UKFTT 183 (TC)

Point at issue: Whether the appellant, J&M Interiors (Scotland) Ltd (J&M) had taken reasonable care in its failure to deduct the correct amount of tax from payments made to subcontractors.

Background: J&M is a company specialising in the supply and installation of, amongst other things, suspended ceilings and partitions. The business started trading in May 2000 and made use of a few subcontractors. Their main contractor was John Butchart (JB) who is and was a verified sub-contractor by virtue of being "grandfathered" under the previous Construction Industry Scheme (CIS). JB therefore had a unique taxpayer reference (UTR) and J&M knew that JB had been verified by HMRC. JB was a close friend of Michael Tracey (MT), the proprietor of J&M, who he had known for over 30 years.

Unbeknown to MT, JB had incorporated two companies, JB Ceilings (Tayside) Limited (JBC) and J Butchart Limited (JBL). During the tax year 2007/8, HM Revenue & Customs (HMRC) noted that J&M had received invoices from JBC and during 2008/9 from JBL.

HMRC visited J&M in May 2010 and asked why JBL & JBC had not been verified. It was HMRC's position that J&M should have sought advice as to whether this changed the amount to be deducted from 20% to 30% (the non-verified rate).

As a result of this, HMRC raised the following determinations, which are the subject of the appeal:

2008/9 - £12,779
2009/10 - £8,918

Argument: MT had been solely responsible for CIS administration and all accounting matters for J&M. When he noticed that the details in the invoice submitted by JB had changed to the two different companies, he contacted JB to enquire. JB informed him that there had been no change in status and it was only the trading names that had changed. He was advised that all other details remained the same eg bank account details for remittances. At the same time, MT was continuing to receive pre-populated CIS returns forms from HMRC in the original name of JB, which he continued to submit.

In order to satisfy himself that the administration was being handled correctly, MT had sought confirmation from JB's accountant. The explanation which he was provided with gave him further comfort so he continued as he was. As an explanation for the invoices, JB informed MT that he was using up the old stationery which related to a company that had previously been liquidated. Companies House records indicated that this was the case as of 19 April 2007 (ie liquidated prior to the enquiry period).

The appellant explained further that the invoices which were received did at no point display a company registered office or a company number. In addition, the contractor did not indicate to them that they were now trading as a limited company, nor did they provide them with a new company bank account into which payments were to be processed.

The appellant argued further that HMRC had continued to supply them with monthly returns detailing JB personally as the sub-contractor. They therefore continued to complete and return the forms, in the belief that they were administering the scheme correctly.

The appellant therefore contended that they had taken reasonable care to comply with section 61 of the CIS Regulations. Their failure to deduct the excess was an error made in good faith. In fact, this was their only error in 7 years of CIS return filing.

HMRC's position was that J&M neither took reasonable care, nor were they acting in good faith. The main crux of their argument was that MT, being familiar with the CIS process as he was, ought to have known that the invoices presented to him would lead to a "verification discussion" with HMRC.

Decision: The appeal was allowed, which is not surprising. The weight of evidence points to the appellant acting in good faith. There is little to say that they should have believed otherwise.

Commentary: The other key aspect (good faith aside) of this judgement relates to reasonable care. In this case, reasonable care is deemed to mean a level that is appropriate and proportionate to that particular contractor's business. In this case, the tribunal Judge, W Gemmell, explained that "*J&M's behaviour, although in error, was made in good faith and, because of making enquiries, the Tribunal hold that they took reasonable care*".

Full details of this case can be found at: **www.bailii.org/uk/cases/UKFTT/TC/2014/TC03323.html**.

UPDATE ON FRC AMENDMENTS TO FRS 102

Financial Reporting Standard 102 (FRS 102) was issued in March 2013. Since that date the Financial Reporting Council (FRC) has issued a number of amendments and clarifications to help clarify certain parts of the standard. They have now issued the amendments and clarifications in a single document for ease of use. It is anticipated that further changes and clarifications will be made to the standard before its application becomes mandated for accounting periods commencing on or after 1 January 2015. Members are therefore advised to check the FRC website (**www.frc.org.uk**) regularly and ensure that they are registered for FRC update emails. These amendments are detailed below.

March 2014

Editorial amendments regarding presentation requirements for financial instruments when an entity chooses to *apply the recognition and measurement provisions of International Accounting Standard (IAS) 39 or International Financial Reporting Standard (IFRS) 9 and/or IAS 39*

Paragraph 11.2 of FRS 102 has been amended and makes it clear that where a company chooses to use either options (b) or (c) that this is an accounting policy choice. The revised wording is as follows:

An entity shall choose to apply either:

(a) the provisions of both Section 11 and Section 12 in full; or
(b) the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement (as adopted for use in the EU); the disclosure requirements of Sections 11 and 12; and the presentation requirements of paragraphs 11.38A or 12.25A; or
(c) the recognition and measurement provisions of IFRS 9 Financial Instruments and/or IAS 39 (as amended following the publication of IFRS 9); the disclosure requirements of Sections 11 and 12; and the presentation requirements of paragraphs 11.38A or 12.25A;

to account for all of its financial instruments. Where an entity chooses (b) or (c) it applies the scope of the relevant standard to its financial instruments. An entity's choice of (a), (b) or (c) is an accounting policy choice. Paragraphs 10.8 to 10.14 contain requirements for determining when a change in accounting policy is appropriate, how such a change should be accounted for and what information should be disclosed about the change.

Paragraph 12.2 of FRS 102 has similarly been amended.

March 2014

Editorial amendment regarding transitional exemptions in relation to accounting for service concession arrangements

The FRC has amended paragraph 35.10(i) of FRS 102 to make it clear that a first time adopter is not required to apply paragraphs 34.12E-l to 34.16 to service concession arrangements. The revised wording is as follows:

Service concession arrangements – Accounting by operators

A first-time adopter is not required to apply paragraphs 34.12I to 34.16A to service concession arrangements that were entered into before the date of transition to this FRS. Such service concession arrangements shall continue to be accounted for using the same accounting policies being applied at the date of transition to this FRS.

November 2013

Clarification statement in relation to net investment hedges of foreign operations that are branches

This relates to the accounting treatment of net investment hedges of foreign operations, where it had been claimed that there appeared to be an inconsistency between FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and the Accounting Council's Advice to the FRC, and that this could potentially lead to confusion.

Paragraph 12.17 of FRS 102 permits entities to hedge account for the foreign exchange rate risk in net investments in foreign operations. The definition of foreign operations includes foreign branches however the final sentence of paragraph 62 of the Accounting Council's Advice appears to contradict this by stating that hedge accounting of a net investment in a foreign operation should not be permitted in the separate financial statements of a parent.

The final sentence of the Accounting Council's Advice is referring to foreign operations that are separate legal entities only and FRS 102 does permit entities to hedge account for net investments in foreign branches in the separate financial statements of a parent.

November 2013

Clarification statement in relation to deferred tax arising on a business combination

Paragraph 29.11 of FRS 102 requires an entity to recognise a deferred tax asset or liability for the difference between the amount that can be deducted for tax for an asset (other than goodwill) that is acquired in a business combination and the value at which it is recognised.

The phrase '*the amount that can be deducted for tax*' is not a defined term in FRS 102 and it had been brought to the FRC's attention that the meaning of this phrase would benefit from clarification.

The FRC has therefore advised the following:

"*In applying this paragraph an entity should consider the manner in which it expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. This assessment should include consideration of all taxes, including operating taxes and taxes arising from the sale of the item, if appropriate.*"

August 2013

Clarification statement on the early application of FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland by entities within the scope of a SORP

Paragraph 1.14 of FRS 102 permits early application of FRS 102 for accounting periods ending on or after 31 December 2012, except that where an entity is within the scope of a SORP, early application is only permitted where that does not conflict with the requirements of a current SORP or legal requirement for the preparation of financial statements.

All SORP-making bodies are working to update their SORPs for FRS 102, but current SORPs, despite being written in the context of the accounting standards that will be superseded by FRS 102, may not necessarily conflict with FRS

102. In considering whether a current SORP conflicts with FRS 102 an entity should have regard to the overall effect in practice.

In particular an entity should consider whether or not the recognition and measurement requirements of FRS 102 are consistent with a current SORP. For example, if a current SORP is silent on a topic, accounting policies determined in accordance with FRS 102 should not conflict with the current SORP. Similarly if a current SORP uses different terminology to express the same recognition and measurement concepts as required by FRS 102, compliance with FRS 102 should not automatically lead to non-compliance with that SORP.

In relation to disclosure requirements, where a SORP requires specific disclosures that are not required by FRS 102, additional disclosure can be provided in addition to that required by FRS 102 in order to meet both requirements.

Nevertheless, entities within the scope of a SORP will need to consider whether a legal or regulatory requirement prohibits the early application of FRS 102.

KEY VOTE ON EU AUDIT REFORMS

Agreement on the long-awaited audit reforms for public interest entities moved a step closer recently when the European Parliament voted in favour of the compromise package approved by the Legal Affairs Committee (JURI). It is now subject to formal approval by the Council of Ministers before the proposals come into force, twenty days following publication in the Official Journal. The changes will then apply from two years after coming into force for all articles except article 16(6), which will apply after three years.

The original reforms were proposed in 2011 following the global financial crisis. Under these proposals:

1. Auditors would be forced to rotate after a maximum tenure of six years (nine years if a joint audit was performed).
2. Firms above a certain size would be forced to split into audit only and non-audit firms.

Since 2011, the proposals have been through a number of iterations in the European legislative process and a compromise was finally reached at the end of 2013, subsequently receiving JURI approval earlier this year.

Although the revised proposals are much less severe than the original, there are still some significant implications for auditors and the audit market.

Some of the highlights of the new proposals are:

1. Restrictions on the provision of non-audit services to audit clients
   - A blacklist of prohibited services that includes all tax services, although there is a Member State option of a materiality test.
   - A limit on fees for non-audit services of no more than 70% of the average of the statutory audit fees paid for three or more consecutive financial years.
2. Mandatory auditor rotation
   - A maximum period of ten years which may be extended to twenty years where a public tendering process has been conducted.
   - There is an option to extend the maximum tenure to twenty four years if a joint audit has been performed and a joint audit report has been presented.
3. Oversight
   - A new framework in form of a Committee of European Auditing Oversight Bodies (CEAOB) should be established to ensure co-operation between Member States.
4. Auditor reports
   - Should include the date of the appointment and the length of the engagement.
   - Should provide details of the most significant audit risks.

In the UK, we have already observed some changes in audit appointments within the listed environment following the introduction of the UK Corporate Governance Code provision to tender the audit appointment after ten years, on a 'comply or explain' basis. It may take longer to assess whether the EU proposals build on this level of activity and succeed in the original objective of restoring confidence in the financial market.

Public Interest Entities (PIEs)

Public Interest Entities are defined as either:

1. Entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market
2. Credit institutions
3. Insurance undertakings; or
4. Entities designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees.

A full definition of what constitutes a PIE can be found at: **www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+AMD+A7-2013-0171+066-066+DOC+PDF+V0//EN**

ACCOUNTING AND AUDITING QUERIES

Query: *I am the financial controller in a medium-sized private company. For the year ended 30 September 2013 the company had turnover of £9m; balance sheet total of £4.2m and 39 employees. I have read that the recently enacted EU Accounting Directive will allow EU member states to increase the small company thresholds contained in the Companies Act 2006. Has the UK Government stated whether it intends to take advantage of this option to increase the small company thresholds? If so would any increase in the thresholds enable my company to become small?*

Also, I am aware that the EU Accounting Directive allows Member States the option to exempt medium sized groups from the requirement to produce consolidated accounts. Is there any possibility that the UK Government will take up this option?

Answer: The revised EU Accounting Directive replaces the existing 4th and 7th Company Law Directives. The UK is required to put through the necessary legislative changes required by the revised Accounting Directive by July 2015. It is anticipated that such changes would become applicable for accounting periods commencing on or after 1 January 2016. The UK Government could, however, enact some of the required changes in advance of that date.

Small Company Thresholds

The UK Government has not yet decided whether to take advantage of the option to increase the small company thresholds to the new maximum allowed under EU law. The new Directive allows Member States to use maximum thresholds for turnover and balance sheet total as follows: 12m Euros; and 6m Euros. These equate to approximately £10.1m and £5.05m. Therefore, this does provide the UK Government with an opportunity to significantly raise the thresholds from their existing levels of £6.5m (turnover) and £3.26m (balance sheet total). The number of employees' threshold remains unchanged: at not more than 50 in the new Directive.

The Government aligned the small company definition contained in the Companies Act 2006 with that used to determine audit exemption for accounting periods ending on or after 30 September 2012. The possibility does exist that the Government could once again decouple these definitions but this might be seen as unnecessarily adding to the regulatory burden.

The small company thresholds are important because they determine not only the corporate reporting requirements for such companies, but also whether an audit is required and in the case of parent companies, whether group accounts are required. Recent evidence in terms of consultations would lead to one to believe that the UK Government would be inclined to take advantage of the higher available thresholds. However, the UK Government will consult on this matter in the coming months and nothing as yet has been decided.

Consolidated Accounts

The new EU Accounting Directive allows Member States the option to exempt medium sized parent companies from the requirement to prepare group accounts. Indeed the Companies Act 1985 did not require such groups to have to prepare such accounts. However, the UK Government decided as part of its Company Law Reform Review, to require such companies to produce group accounts and this change was enacted in the Companies Act 2006. Only the parent companies of small groups are not specifically required to have to prepare group accounts. There are of course other exemptions for medium and large size parents to not have to prepare group accounts. At this moment it is not clear that the UK Government would elect to change a provision which has only been in place for a few of years.

Query: *I am preparing a set of accounts for a medium-sized private company. The company has recently renewed an operating lease for an office premises for a period of ten years with a market review after 5 years. In doing so, the lessor has provided a reduced rental charge for the first two years of the lease term. The current envisaged rental charges for the 10 year period are as shown:*

Year	*Rental (£000s)*
1	*50*
2	*50*
3	*75*
4	*75*
5	*75*
6	*75*
7	*75*
8	*75*
9	*75*
10	*75*

I am wondering how the reduced rentals should be recognised in the financial statements of my client which will be subject to audit by another firm. Additionally, the company is likely to renew another separate operating lease in 2 years. By that time Financial Reporting Standard 102 will be applicable – will this have any impact on the accounting for transactions of this nature?

Answer:

Existing UK GAAP

Transactions of this nature are covered by Urgent Issues Task Force (UITF) Abstract 28 'Operating Lease Incentives'.

This Abstract requires that:

"A lessee should recognise the aggregate benefit of incentives as a reduction of rental expense. The benefit should be allocated over the shorter of the lease term and a period ending on a date from which it is expected the prevailing market rental will be payable. The allocation should be on a straight-line basis unless another systematic basis is more representative of the time pattern of the lessee's benefit from the use of the leased asset."

Therefore, in your scenario the savings in each of the first two years will be spread over the period to the first market rent rate review ie five years. Therefore, the charge in each of the first five years is as follows:

Profit and Loss Account

Year	Rental (£000s)	Balance Sheet Accrual
1	65	(15)
2	65	(30)
3	65	(20)
4	65	(10)
5	65	-
6	75	-
7	75	-
8	75	-
9	75	-
10	75	-

Impact of FRS 102

FRS 102 becomes applicable for accounting periods commencing on or after 1 January 2015 although early adoption is allowed. With the introduction of the new UK GAAP, all existing UK accounting standards and UITF Abstracts will be withdrawn. FRS 102 adopts a different approach to transactions of this nature and requires that any such incentives received by the lessee should be reflected across the period of the lease. In your scenario assuming the same figures and assuming that FRS 102 was applicable, the savings would be allocated across each of the ten years rather than the five years as per UITF Abstract 28 and would end up as follows:

Year	Rental (£000s)	Balance Sheet Accrual
1	70	(20)
2	70	(40)
3	70	(35)
4	70	(30)
5	70	(25)
6	70	(20)
7	70	(15)
8	70	(10)
9	70	(5)
10	70	-

CLIENT DISENGAGEMENT – WHAT YOU NEED TO KNOW

Issues around client disengagement are one of the most common causes of complaint to the ICAS legal services department. It is therefore imperative that firms have the correct disengagement procedures in place so that they do not fall foul of any investigation.

The most common areas of complaint from a disengagement/engagement perspective concern:

- A failure to respond to correspondence from the incoming accountant;
- Unreasonable delays in the transfer of, or failure to supply, information to the incoming accountant;
- Failing to explain to the client that a right of lien has been exercised, and why this is the case; and
- Exercising a lien when it is not appropriate to do so.

For whatever reason a firm of accountants disengages, it is imperative that it communicates this to the client. Although not a requirement, we would recommend that firms send a formal disengagement letter which covers:

- Which of the clients' matters have been dealt with;
- Those items which remain outstanding;
- The dates by which any outstanding or incomplete matters need to have been dealt with;
- Details of any further work that your firm will complete; and
- The value of fees due to or from the client, covering both past work and any additional work to be performed.

ICAS would also recommend that a firm records on file the circumstances surrounding the disengagement, whether it is as a result of their own decision to resign or if the client has chosen to leave. Examples of some matters that may be worth noting are:

- If the decision to end the relationship has been taken by the client;
- If the decision has been influenced by a client specific matter eg relocation or restructuring;
- If there was dissatisfaction with the service provided and, if so, the reason (fees, standard of service etc);
- If the client has made a complaint

MICRO ENTITY – SPECIMEN SET OF ACCOUNTS

A set of accounts for a company which qualifies as a micro-entity is included at Appendix 1. This is the set of accounts which is required to be prepared for shareholders. For filing with Companies House such entities are not required to file either the directors' report or profit and loss account.

- against the firm and, if so, whether the firm's complaints procedure has been followed;
- If the client has indicated any intention to make a professional indemnity claim against the firm;
- If it was the firm's decision to disengage, confirm that the client has been informed of this decision.

Whether a firm disengages of its own free will or by client choice, that firm must ensure that it complies with section 210 of the ICAS Code of Ethics (The Code), which deals with changes in professional appointment.

Section 210.14 of The Code confirms that the incoming accountant must obtain the client's permission before contacting the existing (outgoing) accountant for professional clearance. Assuming that the client allows this contact, the outgoing firm has a duty to respond to the incoming firm. It is important that this response details the reasons for the change of accountant, but must not result in the client being "tipped off" if the outgoing firm is considering filing (or has already filed) a suspicious activity report under the Money Laundering Regulations 2007. Where that circumstance is present, the existing accountant still has legal and professional obligations to fulfil and, in order to comply with these, they may wish to:

- Contact the National Crime Agency to see if an appropriate wording can be agreed in a communication to the incoming firm;
- Include a factual reference to any irregularities; or
- Obtain third party legal advice.

If you are not given permission to respond to the incoming accountant's letter, then you should still respond, but indicate that permission has not been obtained and, if there are matters to be disclosed, for example a fee disagreement, then you should note that there are such matters but not provide any details (in this example, regarding the fee disagreement). You must not provide any more information; otherwise you would be breaching client confidentiality.

Another aspect of disengagement concerns transfer of information and records to the incoming firm. You must ensure that this information is transferred within a reasonable timeframe, ensuring that you do not prejudice the client's affairs in any way. This is usually done without a charge, although if there is a large amount of work to achieve this then a nominal fee may be appropriate, provided that the fee and scope of work has been agreed in advance with the client.

A frequent issue that ICAS comes across concerns incoming firms not being able to access client records because of an existing firm's refusal to release them as a result of a fee dispute. ICAS always encourages firms to try and resolve disputes amicably. An alternative solution is to use the ICAS fee arbitration service. More information on this can be found at: **http://icas.org.uk/Fee_Arbitration.aspx**.

In some circumstances, exercising a lien may be appropriate. However, if this action leads to the client's interests becoming prejudiced then an outgoing firm should not take this approach. Firms which are considering exercising a lien should consult section 240.4 D - G of The Code and/or contact the ICAS Investigations department before making this choice. They may also seek to obtain independent legal advice. Firms considering exercising a lien should ensure that:

- Only documents that are the property of the client are subject to the lien;
- Reasonable steps have been taken to resolve any dispute and there has been communication with the client regarding this process;
- A written record of reasons and correspondence has been kept;
- Only books and papers relevant to the dispute have been held; and
- Statutory books or records are not held.

It is worth noting that no lien can exist over books or records of a registered company which, either by statute or by articles of association of the company, have to be available for public inspection.

Regulated areas of work, such as audit, have separate/additional requirements, such as the statement of circumstances (s519 notice), which must be prepared by the outgoing auditor and submitted to Companies House. Further guidance as to the requirements of outgoing auditors can be found in the 'Access to Information by Successor Auditors' helpsheet at: **http://icas.org.uk/site/cms/download/Audit_Technical_Release_Sept_08.pdf**.

The ethical guidance in relation to engagement and disengagement can be found at: **http://icas.org.uk/ethics.pdf**.

The ICAS Code of Ethics can be found at: **http://icas.org.uk/ICAS-Code-of-Ethics-Applicable-1-Jan-2014.pdf**.

CONSENT REQUESTS AND ACCOUNTANTS – SOME MISUNDERSTANDING

Information has come to ICAS' attention which indicates that some confusion exists within the accountancy sector regarding what information should be included in a consent request and, perhaps more surprisingly, under what circumstances seeking consent is appropriate.

The information shows that in more than half of the requests that were submitted, telephone follow up was required. This was primarily due to omitted information in requests regarding:

- Suspicion
- Criminal property
- Nature of prohibited act
- Identity of persons
- Location of the criminal property

Obviously where telephone follow-up is required for a request, this will lead to delays which in turn can impact on the client. A "right first time" approach should therefore be targeted by firms making requests. Most instances of follow-up related to small and sole practitioners.

The second issue mentioned above, concerning the circumstances for requesting consent, is more interesting (or concerning, depending on how you look at it!). The data implied that a large number of requests were actually more about whether or not the firm should continue acting for the client than a genuine request for consent to act. Firms should not be using a consent request to circumvent the need to submit a SAR or even cease to act for the client. This is really an ethical issue for a firm to consider before it decides what form of action it should take.

As a reminder, consent to act should be requested in circumstances when it is anticipated that the firm's continued involvement will enable their client to either:

1. Conceal, disguise, convert, transfer or remove criminal property – as defined in section 327 of the Proceeds of Crime Act (POCA) 2002
2. Facilitate the acquisition, retention, use or control of criminal property by, or on behalf of another – as defined in section 328 of POCA, or
3. Acquire, use, or possess criminal property - as defined in section 329 of POCA.

Detailed guidance on consent can be found at: **www.nationalcrimeagency.gov.uk/about-us/what-we-do/specialist-capabilities/ukfiu/seeking-consent-for-financial-transactions** and also at: **www.nationalcrimeagency.gov.uk/publications/24-obtaining-consent-from-the-nca/file**.

Guidance on issuing a SAR can be found at: **www.nationalcrimeagency.gov.uk/about-us/what-we-do/specialist-capabilities/ukfiu/how-to-report-sars**.

MONEY LAUNDERING UPDATE

Ukraine unrest – risk of corrupt asset flight

The recent political unrest in the Ukraine has raised the risk of corrupt asset flight. Firms and financial institutions are therefore reminded of their duties under the Money Laundering Regulations and the Proceeds of Crime Act. Corrupt asset flight may be facilitated through companies and other legal arrangements, or other transactions designed to quickly liquidate assets held in the UK. Robust beneficial ownership checks by firms are therefore vital. Firms who have clients with links to the Ukraine should consider this potential increased risk when performing due diligence, ongoing monitoring and beneficial ownership checks.

The FCA press release can be viewed at: **www.fca.org.uk/about/what/protecting/financial-crime/money-laundering/events-ukraine#**.

Other matters

SAR online has changed address – the new address for filing suspicious activity reports is: **https://www.ukciu.gov.uk/(hgj04b55bkzuwo45b2r5st55)/Information/info.aspx?InfoSection=Submission**.

The consolidated list of financial sanctions targets has been updated and can be found at: **www.gov.uk/government/publications/financial-sanctions-consolidated-list-of-targets**.

MONEY LAUNDERING QUERY

Query: *I have a Partnership client for whom I prepare annual accounts, management accounts and VAT returns. After submitting the client's last return, HM Revenue & Customs (HMRC) requested that I send in a sample of purchase invoices to back up the return, which I duly did. HMRC then contacted me to advise that the VAT on some of these invoices had already been claimed by another entity which was under the control of one of the partners (this entity is not a client). I am unsure what I should be doing under these circumstances. One consideration is for me to disengage but I want to ensure that I do not tip-off the client. What would you advise?*

Answer: The fact that HMRC have asked to see a sample of purchase invoices to back up the VAT return is indicative of a degree of suspicion that the clients' returns contain errors. Whether or not they view these as genuine mistakes or something more sinister, we can only speculate. However, the fact that there is a suspicion there in the first place means that it may be more straightforward for you to delve into the clients affairs because HMRC have indicated that something may be amiss. The first thing to do is to check that what HMRC is telling you is indeed the case, which will require some investigation on your part. This investigation needs to be undertaken in such a way that the client is kept in the dark as to any possible suspicions that you may have, but the fact that HMRC have already queried the return gives you a reason to be looking into things more closely.

The result of this investigation should then indicate to you whether or not the client is aware that the invoices have been double-claimed and therefore whether or not you consider the error to be deliberate or not. If they are not aware of the error and it is an entirely honest mistake then you may not need to disengage and it may solely be a case of ensuring that the errors that have been identified are rectified in time for the next return.

In order to ascertain whether or not this is the case you will need to take account of the circumstances and your knowledge of the client and then come to a decision. The CCAB guidance states that under these circumstances you can make reasonable commercial enquiries to determine whether something is suspicious or not. It is likely that your preliminary investigations into the errors themselves will provide useful information from this perspective. As before, you will need to ensure that any further enquiries do not lead to the client being tipped-off and so you must ensure that your questions are framed in such a way that they do not raise suspicion that you may be thinking about making a Suspicious Activity Report.

The issue then becomes one of whether the client is willing to rectify the problem. If they are not willing to correct the mistake then you would have no option but to cease acting and to submit a SAR. If they are willing to amend the mistakes and disclose any past errors to HMRC then you can continue to act for them.

The sections of the CCAB guidance which are most likely to be of interest can be found at:

Section 6.26 – further enquiry
Section 9.5 – commercial enquiries and tipping off

The guidance can be found at: **www.ccab.org.uk/PDFs/070612%20CCAB%20Guidance%20Clean.pdf**.

APPENDIX 1

MICRO ENTITY LIMITED
ACCOUNTS
FOR THE YEAR ENDED
31 DECEMBER 2013

Micro Entity Limited

Company Information

Directors	Miss S Jones Mr R Smith
Secretary	Mrs Smith
Company Number	SC 00000000
Registered Office	22 Joker Street, Gotham City
Accountants	Riddler and Penguin CA
Business Address	Robin's Nest, Gothan City
Bankers	Wayne's Wealth Investments
Solicitors	James & Gordon LLP

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Micro Entity Limited

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Micro Entity Limited

Directors' Report

DIRECTORS

The directors during the year were as follows:

Miss S Jones

Mr R Smith

This directors' report has been prepared in accordance with the provisions applicable to companies entitled to the small companies exemption.

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Micro Entity Limited

Profit and Loss account for the year ended 31 December 2013

	Notes	2013 £	2012 £
Turnover		150,000	125,000
Other income		2,500	2,000
Cost of raw materials and consumables		(70,000)	(60,000)
Staff costs		(50,000)	(40,000)
Depreciation and other amounts written off assets		(7,500)	(8,250)
Other charges		(10,500)	(3,000)
Tax		(2,000)	(2,500)
Profit or loss		12,500	13,250
		=====	=====

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Micro Entity Limited

Balance Sheet as at 31 December 2013

	Notes	2013 £	2013 £	2012 £	2012 £
Called up share capital not paid			100		100
Fixed asets			100,000		90,000
Current assets		40,000		30,000	
Prepayments and accrued income		10,000		10,000	
Creditors: amounts falling due within one year		(30,000)		(20,000)	
Net current assets (liabilities)			20,000		20,000
Total assets less current liabilities			120,100		110,100
Creditors: amounts faling due after more than one year			(30,000)		(35,000)
Provision for liabilities			(3,000)		(2,500)
Accruals and deferred income			(6,000)		(4,000)
Net assets			81,100		68,600
Capital and reserves			81,100		68,600

For the year ended 31 December 2013, the company was entitled to exemption from the requirement to have an audit under the provisions of section 477 of the Companies Act 2006.

No notice has been deposited with the company under section 476 of the Companies Act 2006 requiring an audit to be conducted for the year ended 31 December 2013.

The directors acknowledge their responsibility for:

- Ensuring the company keeps accounting records in accordance with section 386 and 387 of the Companies Act 2006; and
- Preparing statements which give a true and fair view of the state of affairs of the company as at the end of the financial year and of its profit/loss for that financial year in accordance with the requirements of sections 394 and 395 of the Companies Act 2006.

These accounts have been prepared in accordance with the micro-entity provisions.

Notes to the Accounts

1 During the year Mr R Smith, a director of the company was given a loan of £4,000 by the company. The loan bears no interest and has no set repayment date.

2 Details of guarantees and other financial commitments as described in paragraph 57 of Part 3 of Schedule 1 to SI 2008/409 should be provided here.

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TECHNICAL BULLETIN

ICAS

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