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ARREARS OF PAY – CUT AND DRIED?

Arrears of pay can accrue in many different circumstances – not just by a failure to meet National Minimum Wage obligations. However, because of the proliferation of NMW related cases which HMRC is pursuing, resulting in a quarterly naming and shaming list and telephone number sized arrears bills in some cases, little wonder that when the term "arrears of pay" are concerned, everyone thinks of NMW. This article examines how income tax and National Insurance contributions should be applied to pay arrears, potential interest and penalties, and looks at some related tax cases.

Pay arrears

Pay arrears most frequently occur when:

- An employer or employee discovers that wages or salary paid in an earlier period were less than what they should have been paid under the employee's contract
- Backdated pay awards
- The employer's payroll or HR systems make an error
- Equal pay legislation applies and the employer has to pay the arrears to the employee(s), or a court has ordered this.

What makes earnings from an employment liable to income tax?

Employment earnings are liable to PAYE under s.62 ITEPA 2003. It follows that any employment earnings paid in arrears such as National Minimum Wage (NMW) allowances, holiday pay etc. are thus liable to income tax. Note that arrears of pay are not compensation awards even if ordered to be paid by a tribunal and should never be treated as such – HMRC will not accept that argument.

The tax legislation behind pay arrears

In terms of basic principles, the timing of the charge to PAYE on taxable earnings is the earlier of when the payment was either received by the employee or worker, or when entitlement arose to it (s 686 ITEPA 2003). In the case of arrears of pay therefore the employer will need to consider when the entitlement arose.

To illustrate this, in a pay dispute, for example, the employees will receive a pay arrears award based on a contractual, or deemed contractual, entitlement to that pay, which entitles them to receive that money from a given point in past time.

Practical application of allocating pay to closed tax years

HMRC guidance https://www.gov.uk/hmrc-internal-manuals/paye-manual/paye70023 sets out how to allocate a payment of arrears through payroll in closed years. The guidance explains, in line with the regulations at sections 18 and 686 ITEPA 2003, that whilst legally, the *liability* to tax arises in the year the money is earned, lump sum arrears should be subject to PAYE at the time they are *actually paid.*

There are two settlement procedures, dependent on whether

employer is a ‘large employer’ or not.

Large employers (such as a local authority or NHS) wishing to settle income tax liabilities, and where large numbers of employees are involved, can settle directly with HMRC under s.141 PAYE Regulations 2003. If a large employer does not wish to use this settlement route, they must follow the same procedure as other employers, as discussed below.

For those employers who are not ‘large employers’, the employer should allocate the payments to week 53 of the closed year to which the arrears correspond. If this is not possible or the employer does not wish to do this, and the payment is taxed in full in the tax year in which the payment was received, this could result in an employee being taken into a higher tax bracket for that tax year. The employer has a duty to tell the employee this, thereby enabling them to contact HMRC. Employees who contact HMRC in such cases can have their arrears of pay reallocated at the end of the tax year in which the arrears were paid. In some cases, this will lead to cash flow issues for the employee.

Having established when the entitlement arose, the next most common difficulty most employers encounter is the disparate payroll treatment for income tax (PAYE) and NICs purposes (see below).

Software problems

I understand from discussions over the years with software providers that there are some software programmes which do not allow employers to process adjustments in closed tax years. If this happens, the HMRC Basic Tools can be used instead to cater for this one-off event. HMRC has placed written guidance on this topic on GOV.UK https://www.gov.uk/government/collections/guidance-for-employers-on-using-basic-paye-tools-bpt and there is also the employer’s helpline (0300 200 3200).

Scottish and Welsh taxpayers

The tax rates used must correspond to the rates applicable to Scottish and Welsh taxpayers in force at the time the employee became “entitled” to the payment. If no Scottish or Welsh rates were in force in the particular year in question, the rates used should be UK rates.

The NICs legislation behind pay arears

National Insurance Contributions (NICs) are calculated based on pay periods and any lump sums of pay arrears are deemed for NICs purposes to be received in that pay period. As such, no retrospection is required. Whilst a lump sum can result in a large one-off NICs charge for that pay period which may result in a cash flow issue, in some cases it can actually save the employee money because NICs are charged at 12% until pay reaches the Upper Earnings Limit (£50,000 for 2019/20). Thus, the NICs charged on anything over that drops to 2%. The regulations covering this can be found at s.6 SSCBA 1992 or **https://www.gov.uk/hmrc-internal-manuals/national-insurance-manual/nim02065**

Practical application of NICs on pay arrears through payroll

In some cases, the NICs will be the only thing processed through the current payroll run because the tax may have been settled directly or put through closed tax years. The employer should understand how to configure the payroll parameters to ensure the lump sum is chargeable to NICs but not to tax. The payment needs to be made on the FPS for that pay period.

Payments of arrears in instalments

Employees might agree to sign agreements to receive their arrears of pay in delayed stages if this helps the employer to fund the payments, which would lead to the date on which the monies are paid being delayed. However, just because employees have agreed to receive the arrears in instalments does not necessarily mean that PAYE is not still due:

Earnings are treated as ‘received’ for assessment purposes, and ‘paid’ for PAYE purposes, on the earliest of the following in accordance with s.18 ITEPA 2003:

- when a payment of earnings is actually made or when a payment on account of earnings is made
- the time when a person becomes entitled to payment of earnings or a payment on account of earnings

For directors:

- the date when earnings are credited in the company’s accounts or records
- where the amount of the earnings is determined before the end of the period to which they relate, the date that period ends
- where the amount of the earnings is determined after the end of the period to which they relate, the date the amount is determined.

HMRC guidance on this can be found at EIM 42360.

If an employer is experiencing any difficulty in paying the PAYE to HMRC, they should contact HMRC immediately to discuss time to pay arrangements.

What constitutes pay arrears - some interesting examples

Police housing payment arrears

The case of White v Inland Revenue Commissioners SpC357 concerns itself with arrears of police housing allowance. Mr White was a police officer who commenced working three days after a police housing allowance was abolished. However he had been given material about the allowance before joining the police and thought it would be a part of his remuneration. Mr White complained that he had only taken the role because he was anticipating this payment in addition to his earnings as an officer. He was initially awarded a payment but there was a dispute about how the payments should be allocated to which tax years. Eventually it was decided that he was not "entitled" to arrears for some of the years he claimed for, and that any earnings he had accrued an entitlement to should be attributed to the year in which they were deemed to have been earned, in accordance with what is now section 18 ITEPA 2003.

Tronc scheme leads to NMW arrears

The case of Annabel's (Berkeley Square) Ltd and others v Revenue and Customs Commissioners [2009] STC 1551 concerned itself with whether payments from a tronc scheme represented earnings for NMW purposes. In the case of each worker, the 'basic wage' was lower than the NMW and "topped up" by tips by way of a tronc scheme. HMRC took the view that the employers were not satisfying their obligations to pay the NMW, and issued enforcement notices under s.19 of the National Minimum Wage Act 1998. The employer appealed those notices. Were the payments from the tronc scheme "money payments paid by the employer" and thus counting towards pay for NMW purposes by virtue of reg 30[a] of the NMW Regs 1999 (SI 1999/584)? The Court of Appeal held that a payment to an employee by a tronc master was not a payment by the employer and HMRC won the right to claim NMW arrears of pay.

Unpaid holiday pay arrears

A number of cases of pay arrears are in connection with holiday pay and have been heard in the Employment Appeal Tribunal. Fulton v Bear Scotland Ltd and others; Woods and others v Hertel (UK) Ltd; Law and others v Amec Group Ltd all lost at the Employment Appeal Tribunal when they appealed against the earlier employment tribunal decision that payments for non-guaranteed overtime were part of normal remuneration and were to be included as such in the calculation of holiday leave taken under Regulation 13 of the Working Time Regulations 1998, SI 1998/1833. Hertel and Amec nevertheless subsequently succeeded in proving that the employees could not claim the consequent arrears of pay awarded to them were unlawful deductions from their pay under the Employment Rights Act 1996.

Pension contribution arrears – links to NMW

NMW arrears can also give rise to pension contribution arrears. Where these are identified, it may be necessary under auto-enrolment regulations to place the employee into a workplace pension scheme. Backdated contributions may need to be calculated. This may affect the 3 yearly re-enrolment window if this has already passed. The Pensions Regulator (TPR) has detailed guidance available on its website to help employers/ advisers dealing with pay arrears.

Interest and penalties

HMRC reserves the right to charge interest on late payments of PAYE under the Harmonised Interest Regime which was brought in by FA 2009 sections 101-104. Depending on the case, HMRC may or may not decide to take action using its charging powers. Interest is usually chargeable from the 19th April following the tax year in which the PAYE should have been paid.

As far as penalties goes, it is within HMRC's powers under FA2009 Sch.56 to issue penalties for late returns – under RTI, these are risk-assessed penalties covering PAYE, Class 1 NICs, CIS and Student Loan deductions based on the number of late payments in a tax year. Incorrect returns are dealt with under FA2009 Sch.55 and are based on the number of employees with a surcharge if the failure continues for more than three months.

No penalties would be likely to apply if the employer has declared and paid the PAYE/NICs in the periods corresponding to when the earnings arrears were treated as 'received' under RTI, as the employer will have complied with the requirements as set down in the PAYE Regulations 2003 (SI 2003/2682) as amended by SI2015/ 1927. However, if the employer subsequently fails to report or pay the PAYE on the arrears on time, penalties may apply under the above provisions.

Other implications

Finally, employers and advisers should be aware that making payments of arrears will be likely to have a knock-on effect in other areas of the employees' lives – to the extent that some may question why they received them in the first place. State welfare benefits and tax credits are particularly prominent and in

terms of these it is important that the employees understand they need to inform the DWP and HMRC that they have received a pay arrears award. If their benefits and tax credits are affected, they may find themselves subject to recovery proceedings, fines and penalties. Debt agencies and local authorities may also need to know if an employee received a pay award.

Conclusion

Payments of pay arrears are something of an administrative nuisance. The tax and NICs disparity of treatment does little to simplify the tasks which an employer has to overcome to correct pay retrospectively.

Unfortunately matters are made even more complicated because there is more than one Government department involved in the policy, management and collection of pay arrears due to the mix of legislation and regulations covering employment law and tax law. Sometimes this leads to confusion, duplication and certain aspects falling through the gaps between the two agencies.

Employers who have to pay arrears awards will need to prepare to utilise additional resources to ensure they tread carefully through the maze and come out smelling of roses.

VAT AND VOUCHERS: CHANGE OF TREATMENT FROM 1 JANUARY 2019

Recent years have seen a significant increase in the number of retailers offering gift vouchers for sale. Such vouchers are usually sold by the retailer in order that the vouchers may be exchanged, in the future, for goods or services of the same value as the voucher itself.

The VAT rules pertaining to the sale (and redemption) of vouchers has, in the past, been complicated. As a result of an EU Directive on the VAT treatment of vouchers, the treatment has been simplified from 1 January 2019. These changes will prevent either non-taxation or double taxation of goods or services which relate to vouchers.

This change only applies to vouchers issued on or after 1 January 2019 and only with respect to vouchers for which a payment has been made and which may be used to buy either goods or services. The changes do not apply to discount vouchers or money-off tokens.

Prior to this change on 1 January 2019, the purchaser of a voucher was deemed to be receiving two supplies, a voucher; and an underlying supply of goods or services. Since 1 January 2019, there is only one supply, being that of the underlying goods or services, which will be provided in exchange for the voucher at a later date.

Vouchers are now clearly defined as one of two types, single purpose or multi-purpose vouchers.

Single purpose vouchers may only be redeemed for goods or services that are liable to VAT at the same rate (at the time that the voucher is issued), for example, a book token or voucher issued by a hair dresser in return for beauty services. In addition, the place of supply of the underlying goods and/or services must be known at the time that the voucher is issued. Any VAT due on those underlying goods or services is paid at the point of issue of the voucher and at the point (if any) of each transfer of it for consideration. VAT is therefore not payable when the voucher is redeemed, but if the business redeeming the voucher in exchange for taxable goods or services is different from the business which issued it, there is also a supply of those goods or services from the former business to the latter.

A multi-purpose voucher is a voucher that is not a single purpose voucher. Thus, a multi-purpose voucher can be redeemed for a range of goods and/or services which have different VAT treatments and/or where the underlying goods and/or services have a different place of supply. Any VAT due should be accounted for as output tax to HMRC when the voucher is redeemed for goods or services. At this point, it will be possible to know how much (if any) output tax is due to HMRC, depending on the nature of the supply and the place of supply. The consideration for that supply will be amount last paid for the voucher or, in the absence of this information, its face value.

Retailers are likely to prefer to sell multi-purpose vouchers in order to avoid accounting for output tax until the voucher is redeemed as there will always be instances where vouchers are lost or forgotten about and may therefore extend their range of products and services in order to ensure that single purpose treatment does not apply. The rules are, however, now simpler, which is likely to be very welcome.

VAT AND NON-REFUNDABLE DEPOSITS

The VAT treatment of non-refundable deposits has changed as of 1 March 2019.

This change affects situations where a non-refundable deposit is paid for either goods or services and, following a failure to purchase the relevant goods or services by the customer, the deposit is retained by the (would-be) supplier. Prior to 1 March 2019, in such a situation, where the goods or services are liable to VAT at either the standard or reduced rate, VAT would have been initially accounted for by the supplier, on the deposit received. When the customer fails to purchase, the non-refundable deposit was deemed to become the supplier's compensation (for the failed sale) and thus the VAT accounted for on the deposit could be reclaimed by the supplier from HMRC assuming the two events, (that is, the payment of the deposit and the failure to purchase) happened in different VAT accounting periods).

On 13 December 2018, Revenue and Customs Brief 13/2018 was issued describing this change in policy. It was not deemed necessary to amend legislation as HMRC argue that this is simply a change in their policy, which has been justified by recent EU cases.

This revised policy applies to UK business that receives deposits from customers in advance of VAT bearing goods or services being supplied, and retains that deposit where there is non-collection of goods or cancellation or non-use of services. Thus, as before, when the deposit is received, this creates a tax point and VAT must be accounted for on that deposit when it is received. However, from 1 March, when the supply in question fails to be fulfilled (and the deposit retained by the supplier), it will no longer be possible to reclaim the VAT accounted for on that deposit. This is because, the payment of the deposit is deemed to be a payment for the right to receive a future supply, irrespective of whether that supply is actually fulfilled. What was purchased in return for the deposit, was a right to buy and therefore there is no adjustment to the VAT treatment of that supply at a future date, if the supply is unfulfilled.

One of the EU case law referred to above was an airline ticket case (Air France-KLM (Case C-250/14)) where the CJEU ruled that the consideration for the price of air tickets was not dependant on the presence of the passenger at boarding but that the relevant factor was the passenger's right to benefit from the transport service. Whether the passenger exercises that right is not relevant and the non-refundable advance payment for the ticket is not compensation, as the supply of the right had been properly made.
The Brief (13/2018) includes transitional rules for deposits received before 1 March 2019 and where cancellation takes place before this date. In these cases, the deposit retained by the supplier will not be subject to output tax if it has been the past policy of the supplier to adjust the original output tax that was accounted for on the deposit. But if this was not the policy of the business to make this change, HMRC says in 13/2018 that it cannot now change its policy (or adjust the output tax on past cancellations) because it has strictly applied the law correctly in the past. If a cancellation happens on or after 1 March 2019, the new policy will apply, that is, there should be adjustment to the original output tax accounted for.

THE STRANGE CASE OF MR YECHIEL

The first tier tribunal decision in Hezi Yechiel v HMRC (TC6829) produced a surprising and concerning result.

While an FTT decision does not set a precedent, it is worrying that HMRC took this case at all, and more concerning that it was lost by the tax payer.

The case concerns principal private residence relief.

Mr Yechiel bought a house in 2007 and rented it out while he sought planning permission for an extension. His fiancée did not like the house and they did not occupy it when they married in 2008. Divorce proceedings commenced in January 2011 and Mr Yechiel moved into the house in April 2011 with the intention of it becoming his home. He liked the area and his parents lived close by.

The house was large and in need of refurbishment. He had his bedroom refurbished and a new kitchen was fitted.

Mr Yechiel did not cook his own meals but ate takeaway food and also ate at his parents' house.

He took his washing to his parents' house too.

He did sleep in the property between at least April and July 2011 and this was accepted by the Tribunal.

In October 2011, Mr Yechiel sought to rent and then sell the property. He moved in with his parents in December 2011.

In the case of Goodwin v Curtis (1998) STC475 it was held that a degree of permanence and continuity had to be present for the principal private relief under Section 222 TCGA 1992 to be available.

The Tribunal decided against Mr Yechiel on the following grounds:

- Mr Yechiel would not have lived in the house with his wife as she did not like the area.
- When they separated, he could not afford to both maintain the house and also reach a settlement with his wife.
- He did not cook in the house and sometimes had his meals with his parents.
- His laundry was done at his parents' house.
- He did not have much furniture.
- Not much mail was received at the house.
- Significant periods of time were spent away from the house during the day at his parents' house.

The Tribunal stated that "to have a quality of residence, the occupation of the house should constitute not only sleeping but also periods of living, being, cooking, eating a meal sitting down and generally spending some periods of leisure there".

To those of us working in tax, this does seem a very strange decision and a surprising one for HMRC to have taken. After splitting from his wife, this was the only property available to Mr Yechiel short of moving in with his parents.

If you have clients, who live on their own, spend long hours working, eat junk food from takeaways and spend weekends away from home then it may be worth mentioning the strange case of Mr Yechiel to them.

AMORTISATION OF GOODWILL ON INCORPORATION OF A BUSINESS

The statutory provisions which cover the amortisation of intangible assets for Corporation tax purposes are contained in Sections 711 to 906 CTA 2009.

Where a sole trader or partnership incorporates, there is usually goodwill, giving rise to gains in the hands of the transferors and shown on the balance sheet of the acquiring company.

The acquiring company may decide to amortise the goodwill. From a corporation tax point of view, the general position is that tax relief is available in respect of the amortisation of intangible assets:

- Created by the company after 31 March 2002.
- Acquired from unrelated parties after 31 March 2002.
- Acquired from related parties after 31 March 2002 where the related party itself, or any other person, only created the asset after 31 March 2002.

The question which arises is, whether for example, a partnership has been trading since before 31 March 2002 and incorporates its business into a limited company, it is possible to obtain corporation tax relief for the amortisation of goodwill on incorporation.

Where the company is a close company, a related party includes a participator in the close company. This captures the situation where partners transfer their partnership business to a company which they own.

There are anti avoidance provisions preventing relief in respect of pre Finance Act 2002 assets. One of these is where a company acquires goodwill from a related party where:

- The asset was acquired on or after 1 April 2002, and
- The value of asset is derived in whole or in part from another asset which was a pre Finance Act 2002 asset in the hands of:

  (i) The transferor at the time when it was connected with the company; or

  (ii) Another person at the time when that other person was a related party in relation to the company or the transferor. This would catch pre Finance 2002 goodwill created by the partners who had retired by the time of the incorporation.

It may be that if part of the goodwill acquired on incorporation is derived from a pre Finance Act 2002 asset this will be a separate asset from the post Finance Act 2002 asset.

However, Section 884 CTA 2009 "goodwill: time of creation" states that:

"for the purposes of Section 882 (application of this part to assets created or acquired on or after 1 April 2002) goodwill is treated as created –

(a) Before (and not after) 1 April 2002 in a case in which the business in question was carried on at any time before that date by the company or a related party, and

(b) On or after 1 April 2002 in any other case".

It therefore appears that, where an unincorporated business was carried on prior to 1 April 2002 then none of its goodwill transferred on a subsequent incorporation is tax deductible if amortised, under part 8 of CTA 2009.

This is certainly HMRC's very strong view of the position. In Revenue & Customs Brief – 25/11 "HMRC has previously stated that they would challenge past claims with a view to litigation where there are arrangements to claim corporation tax relief for goodwill under the Corporate Intangible Fixed Assets Regime where a company has acquired a business that was carried on by a related party before commencement of the regime (1 April 2002)".

HMRC manuals at CIRD11680 ("when asset treated as created or acquired; exceptions to expenditure incurred rule: goodwill") then covers the situation where a business was carried on by a related party prior to 1 April 2002. It again makes the point that goodwill cannot be treated as created on or after 1 April 2002 if the related party carried on the business to which it relates, at any time prior to that date.

HMRC manuals at CIRD45265 ("partnership incorporation of a pre-FA 2002 business: technical arguments") is based on at least one of the partners being a related party at the time of incorporation and was carrying on the business in question prior to 1 April 2002 so that Section 884 applies and covers two points:

1. **Partner Leaves Prior to Transfer**

   A partner may retire or leave the partnership prior to the incorporation and relief for the amortisation claimed in respect of his goodwill on the basis that he is not a related party at the time of the incorporation. HMRC's position is that where it can be established that the goodwill of the business is partnership property then it is not capable of independent disposal by the outgoing partner. Either the outgoing partner's interests will have been transferred to the remaining partners or to a new partner, where he leaves prior to the transfer of the business to the company or where he leaves afterwards, he will still be a related party because he was an associate of a participator at the time of the acquisition.

2. **Partnership and Business Ceased Prior to Transfer**

   HMRC view as erroneous, any contention that a partnership business ceased prior to transfer with the company commencing business later. They say that it is a question of fact whether or not the business has ceased but it is important to distinguish between the partnership cessation (or dissolution) and an actual cessation of the business. A change in business ownership and the transfer of goodwill are strong indicators that the purchaser has succeeded to the trade and the trade has not ceased. Since goodwill is inseparable from the business and the partnership has disposed of the business as a going concern, it follows that the partnership must have existed at the time of acquisition by the company. In short, there is no moment in time when the business was not owned by either the partnership or the company.

The final point made is the statutory provision at Section 884, which deems the goodwill of the whole business to have been created before 1 April 2002 if any one of the related parties was carrying on that business prior to that date. There is nothing within the deeming rule at Section 884 that allows part of the goodwill of the business to have been created before 1 April 2002 and part thereafter.

If you feel that you can find a way through the statutory provisions, then you will find strong resistance from HMRC waiting for you.

AVOIDING INCOME TAX ON MVLs

Spotlight 47 is an HMRC pronouncement in which they say they are aware of schemes that claim to avoid the income tax charge on members' voluntary liquidations. This is apparently achieved by changing the way shareholders take value out of their companies.

Up until 6 April 2016, distributions in a winding up potentially gave rise to capital gains. Some individuals however undertook "phoenixism" where their company traded for a period, ceased and went into members' voluntary liquidation. The shareholders were able to extract funds from the liquidation by way of capital distributions most likely subject to Capital Gains Tax at the 10% entrepreneurs relief rate. They would then set up another company and basically carry on the same trade.

A new targeted anti avoidance rule (TAAR) was introduced from 6 April 2016 and could apply in certain circumstances to holders of more than 5% of the shares in a close company. If there was a tax avoidance motive, the liquidation proceeds could be subject to income tax, as an income distribution, rather than capital gains tax as a capital distribution.

Rather curiously, Spotlight 47 suggests that the TAAR legislation can be avoided by selling the shares in the company to a third party rather than winding it up! In fairness to HMRC, they refer to "scheme promoters" and "making an "artificial modification to the arrangements" and so the spotlight is not being shone upon a normal commercial transaction where shares in a company are sold in the ordinary course of events.

HMRC consider that these schemes do not work because, in many cases, the actual outcome is that the individual is receiving distributions in a winding up. As the individual carries on trading using a different vehicle, the schemes are within the scope and purpose of the TAAR legislation. Secondly, phoenixism arrangements that claim to involve payments to shareholders taxed as capital instead of income are caught by the TAAR, or other provisions.

HMRC go on to say that if it is claimed that the phoenixism TAAR does not cover the arrangements, they will consider whether the general anti abuse rule (GAAR) applies to these schemes. Transactions after 14 September 2016 where the TAAR applies will be subject to a 60% penalty.

If your clients are considering becoming involved in something that seems a bit odd, rather than winding up their company at the end of its useful life, then they should be warned of HMRC's likely position.

More worrying, is the prospect of HMRC looking at normal commercial sales of companies from the jaundiced perspective of the vendors seeking to avoid tax by not putting their company into members' voluntary liquidation! That said, in a commercial sale, it is normal for the vendor shareholders to have to sign an undertaking not to compete with the company which they have just sold for a period of perhaps three years and therefore there is no realistic prospect that the vendors are trying to circumvent the two year period prescribed in the TAAR.

The original consultative document on phoenixism did raise the question of whether capital gains tax should apply to the sale of shares in a company with a substantial cash surplus. Is Spotlight 47 shining in this direction?

SPRING BUDGET STATEMENT

When the Chancellor said that he would move the budget to the Autumn and the Autumn statement to the Spring, he also said that his plan was not to introduce anything dramatic in Spring statements.

He has pretty well adhered to this but he did take the opportunity to remind us all of some of his previous proposals.

- The income tax personal allowance is rising to £12,500 from 6 April 2009 and, if you are lucky enough to live in England (sic) you will not fall into the higher rate income tax bracket until your income from all sources reaches £50,000.

- If it is your life's ambition to be a higher rate tax payer then, in Scotland, you can achieve this after an income level of £43,430. Many will regard this as a good thing, particularly if they are only a lower rate tax payer.

  Curiously however, while the advantage in company owners receiving dividends rather than salary has reduced a bit, it is more advantageous if you are a Scottish tax payer as the thresholds and higher rates of Scottish tax do not apply to dividend income. Another incentive to incorporate in Scotland.

- The pensions lifetime allowance increases from £1.03 million to £1.055 million from 6 April 2019 also. Following pensions simplification in 2006 some fairly significant changes have been made, one of the most curious being to restrict the amount which higher earners can contribute to their pensions. Unless these individuals have already made significant contributions, anyone starting now is unlikely to get anywhere near the lifetime limit into their pension pot if they are restricted to a maximum annual contribution of £10,000.

- If your business has £1 million to spend, then it can already invest up to this amount on plant and machinery and obtain a 100% tax deduction as the annual investment allowance limit rose to this figure in respect of expenditure incurred from 1 January 2019. This is likely to affect a relatively modest number of businesses however.

So, what's new?

The results of a number of consultations will be published together with some new ones:

- A surprise was that the dogmatic introduction of Making Tax Digital seems to have at least slowed down. It is already coming in for VAT but is not to be extended to any other taxes, until at least

April 2021 and may not be mandatory.

- VAT partial exemption and the capital goods scheme is, not before time, to be the subject of a call for evidence on simplification. This is a very complicated area and one where traders frequently ignore it or get it wrong.
- Principal private residence relief is also to be subject to a consultation covering the proposed shortening of the exemption applying to the final period of ownership and also to the lettings relief.

While the Government and HMRC have been preoccupied with Brexit, there may just have been a silver lining in that they have not had more time to keep messing about with the tax system.

UPDATE TO LLP SORP

In issue 148, we highlighted updates to a number of Statements of Recommended Practice (SORPs). Since then, an updated version of the SORP for Limited Liability Partnerships (LLPs) has been published by the Consultative Committee of Accountancy Bodies (CCAB).

SORPS issued by CCAB apply to LLPs preparing accounts under UK GAAP to present a 'true and fair view'. CCAB has stated that "the underlying purpose of the SORP is to deal with issues that are specific to LLPs and ensure that, as far as possible, LLPs present financial statements that are comparable with those of other entities".

Updates have been made to the LLP SORP as a result of amendments to FRS 102 resulting from the first Triennial Review of the Standard in December 2017.

Updates are made to:

- the guidance on cash flow statement presentation to reflect the new requirement to disclose the changes in net debt between the beginning and end of the financial period;
- the guidance on accounting by small LLPs to reflect the simpler recognition and measurement requirements available to small entities when accounting for certain loans;
- provide additional guidance on the revised recognition rules for intangibles assets acquired in a business combination;
- the guidance on merger accounting to reflect the extended definition of a group reconstruction.

In addition other minor clarifications have been made to ensure consistency with FRS 102.

The updated SORP is effective for accounting periods beginning on or after 1 January 2019 with earlier adoption permitted subject to certain exceptions.

The SORP is available from: https://www.ccab.org.uk/documents/2018LLPsFinalSORP.pdf

FRC PROPOSE TO ENHANCE AUDITORS' WORK ON GOING CONCERN

The Financial Reporting Council (FRC) is consulting on proposed revisions to the auditing standard on going concern, International Standard on Auditing (ISA) UK 570. The proposed changes mean that the UK version of ISA 570 will go further than the current international auditing standard.
https://www.frc.org.uk/consultation-list/2019/exposure-draft-proposed-isa-(uk)-570-(revised)

Going concern basis of accounting

Going concern is one of the fundamental principles in the preparation of financial statements. The financial reporting frameworks applicable in the UK generally require the adoption of the going concern basis of accounting in financial statements in all cases except where management intends to liquidate the entity; to cease trading; or where it has no realistic alternative to either of these options.

Accounting frameworks do not normally specify a maximum period that should be reviewed as part of the assessment of going concern. However, both International Accounting Standard (IAS) 1 and FRS 102 require that management takes into account all available information about the future. IAS 1 defines this as a period that should be at least, but is not limited to, twelve months from the end of the reporting period. FRS 102 requires that this covers a period which is at least, but is not limited to, twelve months from the date when the financial statements are authorised for issue.

Rationale behind the revisions

The new proposals to increase the work effort by auditors when

assessing whether an entity is a going concern follow well-publicised corporate failures where the auditor's report failed to highlight concerns about the future prospects of entities which collapsed soon after. In addition, the findings identified in several of the FRC's enforcement cases highlight a need to revise the standard in an attempt to drive improvements in audit quality.

Some of the key features in the proposed revisions aimed at improving audit quality are as follows:

1. **Fostering an appropriately independent and challenging mindset in the auditor**

   Professional scepticism is a key requirement in a high-quality audit and the revisions introduce additional requirements and application material to encourage greater challenge over management's assessment of going concern. The need for the auditor to consider the potential for management bias in the preparation of the financial statements has also been included in proposed revisions to the standard. A requirement for the auditor to stand back and consider all the audit evidence obtained in relation to going concern, whether corroborative or contradictory, has also been inserted.

2. **Providing greater transparency and insight into the audit process through enhanced auditor reporting**

   Auditors have been required to report on going concern for all UK audited entities since 2016. Investors have welcomed the introduction of Key Audit Matters in relation to going concern for public interest and listed entities but have asked for more information to be reported. In response, the proposed revisions have added a new requirement for the auditor's report to include an explanation of how the auditor has evaluated management's assessment of the entity's concern status accompanied by a conclusion that management's use of the going concern status is appropriate. In circumstances where no material uncertainty has been identified a statement should be included in the auditor's report that the auditor has not identified a material uncertainty in relation to going concern.

3. **Enhancing documentation of the auditor's judgements**

   New requirements have been proposed around the necessary documentation required to support the auditor's evaluation of managements' going concern assessment. These include:

   - Key elements of the auditor's understanding of the entity and its environment, including the entity's internal control related to going concern;
   - Indicators of possible management bias related to going concern, if any, and the auditor's evaluation of the implications for the audit.
   - Significant judgments relating to the auditor's determination of:

   (i) Whether or not a material uncertainty related to going concern exists;

   (ii) The appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements; and

   (iii) The appropriateness of management's disclosures in the financial statements.

The ICAS Audit and Assurance Panel will be producing and submitting a response to the FRC Consultation by the deadline of 14 June 2016. If you would like to provide any input to the ICAS response, please contact accountingandauditing@icas.com

FRC GUIDANCE ON FRS 102 – NEW STAFF FACTSHEETS

In December 2018, the Financial Reporting Council (FRC) published a new suite of staff factsheets, providing additional guidance on certain aspects of FRS 102. These replace the existing Staff Education Notes (SENs) which were published when FRS 102 first came into effect in 2015.
The factsheets cover the following areas:

Factsheet 1 – Triennial Review 2017 amendments

This factsheet explains the amendments made to FRS 102 as a result of the 2017 triennial review process. These include:

- A new accounting policy choice in relation to investment properties rented to another group entity. These can now be measured at cost, thus removing the previous anomaly whereby such properties were accounted for at fair value in the individual balance sheet and at cost in the group balance sheet.
- A clarification regarding the recognition of separate intangible assets in a business combination, which

could result in fewer such assets being recognised.
- A new principles-based definition of a basic financial instrument to assist implementation.
- An exemption to allow small entities to measure loans from a director at transaction price rather than at present value.

Factsheet 2 – Triennial Review 2017 transition

This factsheet illustrates how some transactions may be dealt with on transition to the Triennial Review 2017 Amendments. Of particular relevance to smaller companies are the following:

- Simplified treatment of loans from directors for small entities - A small entity that wishes to take advantage of this relief should account for this retrospectively as a voluntary change in accounting policy, and insofar as it is practicable, comparative information needs to be presented as if the new policy has always been applied.
- Investment properties rented to a group entity – an entity that chooses to measure investment properties rented to another group entity under the cost model going forward has a choice of accounting treatment on transition:

    1. apply the transitional provision which allows an entity to take the fair value at the date of transition (i.e. not the current carrying amount) and use that as the property's deemed cost going forward; or

    2. use the historical cost of the property, and depreciate/impair the asset as if it had always been carried at cost.

    An entity has a free choice but the availability of information and the work required to determine the carrying value at the transition date, prior year end and current year end may lead an entity to take the transitional exemption for ease.

Factsheet 3 – Illustrative Statement of Cashflows

Whilst under FRS 102 section 1A, small entities are not required to prepare a cashflow statement, this illustrative example will be useful to companies using full FRS 102, or those adopting section 1A but choosing to prepare a cashflow statement.

Factsheet 4 – Financial Instruments

This factsheet summarises the requirements of FRS 102 on accounting for financial instruments, including the following areas:

- Accounting policy choice and scope
- Classification
- Initial and subsequent measurement, including detailed guidance on financing transactions.
- Impairment
- Derecognition
- Disclosures

In particular, this factsheet carries forward the guidance from the old Staff Education Note (SEN) 16 on financing transactions which covers accounting for loans at zero or below market rates of interest.

Factsheet 5 – Property: Fair Value Measurement

This covers remeasurement of property included under section 16 of FRS 102 – investment properties, and section 17 – property, plant and equipment. This includes some useful material carried forward from the previous SEN on the treatment of revaluations in reserves, and transfers from investment property to PPE.

Factsheet 6 – Business Combinations

This factsheet provides a high level overview to entities applying FRS 102 that undertake a business combination for the first time covering the following:

- An outline of the purchase method
- The separation of intangible assets from goodwill
- Illustrative disclosures.

Factsheet 7 – transition to FRS 102

The final factsheet replaces the previous SEN which dealt with first-time adoption of FRS 102. It provides guidance for entities transitioning to FRS 102 from another standard such as FRS 105, FRS 101 or IFRS. For example, an entity that qualifies for the micro-entity regime may have voluntarily chosen to apply FRS 102 initially but subsequently decided to move to FRS 105 for cost or simplicity reasons. However, if the entity grows and it no longer qualifies for the micro-entities regime, it has to move back up to FRS 102. In this situation, the entity must apply Section 35 on both transitions to FRS 102 (unless on the second occasion it chooses to apply FRS 102 as if it had never stopped applying it).

This factsheet outlines these requirements including:

- the general procedures for transitioning;
- the mandatory transitional exceptions and optional transitional exemptions to retrospective restatement; and
- the disclosure requirements on transition.

The factsheets are available from: https://www.frc.org.uk/accountants/accounting-and-reporting-policy/uk-accounting-standards/staff-factsheets

GUIDANCE FOR PENSION SCHEMES ON ACCOUNTING FOR GUARANTEED MINIMUM PENSION EQUALISATION

The Pensions Research Accounts Group (PRAG) has published new guidance on 'Accounting for Guaranteed Minimum Pension (GMP) equalisation by pension schemes following the Lloyds judgement' (March 2019). The guidance is available on the members' area of the PRAG website www.prag.org.uk.

The guidance has been prepared:

- To assist pension schemes assess the impact on their accounts of the High Court judgement, on 26 October 2018, in Lloyds Banking Group Pensions Trustees Limited v Lloyds Bank Plc GMP equalisation case.
- To make it clear that each pension scheme will need to exercise judgement and have regard to its scheme rules in determining the appropriate accounting treatment for obligations arising from the requirement to equalise the effect of unequal GMPs accrued between 1990 and 1997.

In summary, pension schemes should recognise a liability in respect of backdated benefits payable and related interest where these can be measured reliably, and the liability is expected to be material.

Current estimates of obligations relating to the equalisation of GMPs range from 1% of scheme liabilities to 4%. However, obligations could be outside of this range.

What is GMP?

The GMP is the minimum pension which a UK occupational pension scheme has to provide for those employees who were contracted out of the State Earnings Related Pensions Scheme (SERPS) between 6 April 1978 and 5 April 1997.

About the Lloyds judgement

In the Lloyds judgement, the High Court:

- Ruled that the Lloyds Schemes must equalise for the effect of unequal GMPs accrued between 17 May 1990 and 5 April 1997.
- Set out a range of methodologies that the trustees can use to calculate scheme obligations.
- Ruled that back payments are applicable subject to any limitations in the scheme rules, for example in relation to time limits on the back-dating of benefits, with interest applied at 1% of the Bank of England basic rate.

The judgement did not deal with the treatment of transfers out or de-minimis considerations which are expected to be dealt with in a second hearing later this year.

Most pension schemes were required to equalise benefits payable to male and female scheme members as a result of a judgement reached by the European Court of Justice on 17 May 1990 in Barber v Guardian Royal Exchange Assurance Group. The judgement was incorporated into the Pensions Act 1995.

However, subsequent to the Barber case, pension schemes have tended not to equalise differences in benefits as GMPs remained, and still remain unequal in the underlying legislation. The absence of changes to the underlying legislation or sufficient guidance from the UK Government on acceptable methodologies have resulted in this position.

While the October 2018 ruling relates specifically to Lloyds Pension Schemes, it applies to any scheme contracted out between May 1990 and April 1997 and providing GMPs.

Accounting for obligations arising from GMP equalisation

Under FRS 102:21:4, an entity shall recognise a provision only when:

(a) the entity has an obligation at the reporting date as a result of a past event;

(b) it is probable (i.e. more likely than not) that the entity will be required to transfer economic benefits in settlement; and

(c) the amount of the obligation can be estimated reliably. Schemes are likely to have to exercise judgement in determining the obligating event (FRS 102:21:4(a)) and the measurement of the obligation (FRS 102:21:4(c)).

The guidance points schemes towards the following considerations in arriving at a judgment about these requirements:

- If the liability is clearly going to be immaterial it will not be necessary to include it in the financial statements, although the trustees may do so if they wish, explaining their approach to dealing with the matter in their trustees' report and the financial statements.
- The determination of the required GMP equalisation at a member level is complex

and will involve detailed analysis of individual member records which current experience suggests will not be available for some time, possibly a number of years. Also whilst the rulings have provided clarification in practice, trustees may find further complications in applying the methodologies approved by the High Court. In these circumstances, it is not necessary to calculate the backdated benefits and related interest at a member level for accounting purposes if a reliable estimate can be determined by other methods *[meaning a provision can be recognised rather than an accrual].

- It is possible that, in certain circumstances, measurement difficulties could exist which mean trustees cannot reach a reliable estimate. For example if the trustees and employer had not yet agreed upon the appropriate methodology, significant data issues exist, or further significant clarifications are required.
- Non-recognition of liabilities due to measurement difficulties is normally expected to be rare and very exceptional, see paragraph 3.6.3 of the Pensions SORP. If the trustees conclude that it is too early in their deliberations and decision making process to determine a reliable estimate, and there are grounds to believe the amounts are likely to be material, this should be disclosed in the notes to the financial statements (FRS102:2:32) and it would fall to be treated as a contingent liability under FRS 102 (FRS 102:21:12) rather than an accrual or provision. The scheme auditor will consider the implications of this on their auditor's report.
- The question arises as from what date this obligation existed, as this is relevant to considering whether to treat the ruling as an adjusting or non-adjusting post balance sheet event. One view is that the effective date of the obligation is the date of the ruling *[the High Court's judgement in the Lloyds case]. Another view is that trustees always had this obligation which the ruling has confirmed. In either case the effective date is not when the trustees eventually amend scheme benefits to comply with the ruling. The balance of views emerging from accounting firms is that the effective date for recognising the obligation is the date of the ruling, which provides clear guidance as to the measurement methods available.
- Based on the views described above *[i.e. the obligating event occurred on 26 October 2018, the date of the Lloyds judgement] schemes with year ends before the judgement date where financial statements are approved after the judgement date will disclose the ruling as a non-adjusting post balance sheet event, with an estimate of its financial effect or an explanation that such an estimate cannot be made, where the amounts are material.
- Schemes with year ends after the judgement date will recognise the cost of backdated benefits and related interest in their financial statements where material and where a reliable estimate can be made.
- For schemes with year ends post 26 October 2018 the cost of backdating benefits and the related interest is recognised in the accounting period in which the date of the ruling falls *[meaning at the date of the obligating event either the date of the Lloyds judgement or an earlier date].

*Denotes a clarification of the guidance by ICAS.

Example disclosures

An appendix to the guide provides example narrative disclosures for scheme accounts on the following scenarios:

Pensions schemes with a year ending before 26 October 2018 (described in the guidance as pre-26 October 2018 year-ends)

- Non-adjusting post balance sheet event, possible to estimate the obligation
- Non-adjusting post balance sheet event, not possible to estimate the obligation
- Amount immaterial but disclosure of the issue included in the financial statements

Pension schemes with a year ending on or after 26 October 2018 (described in the guidance as post-26 October year-ends)

- Reliable estimate available, deemed an accrual
- Reliable estimate available, deemed a provision
- Not possible to obtain a reliable estimate

Not period specific

- Historic transfers out

NON-CHARITABLE TRADING SUBSIDIARIES: ACCOUNTING FOR CORPORATE GIFT AID

The Charities SORP Committee has published important new guidance for non-charitable trading subsidiaries on how to account for corporate gift aid. The guidance is set out in Information Sheet 2: Accounting for gift aid payments made by a subsidiary to its parent charity where no legal obligation to make the payment exists (January 2019).

Purpose and authority

Information Sheet 2 provides guidance on how to:

- Implement amendments to the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102) arising from Financial Reporting Exposure Draft 68 (FRED 68): payments by subsidiaries to their charitable parents that qualify for gift aid.
- Address the consequences of clarification that corporate gift aid payments are distributions under company law rather than expenses, following a legal opinion obtained by ICAEW. ICAS commentary on this topic collates guidance applicable across the UK from the Charity Commission for England and Wales, HMRC and ICAEW.
- Reflect a clarification in the Charities SORP (FRS 102) as to when payments by subsidiaries to their charitable parents that qualify for gift aid are adjusting events occurring after the end of the reporting period. The clarification is made via an amendment to Module 13 of the Charities SORP on events after the reporting period.

Information sheets are advisory only. However, they are authoritative in that they set out the views of the Charities SORP-making Body and its advisory SORP Committee.

FRED 68 amendments

FRED 68 inserts two paragraphs into Section 29 of FRS 102 on income tax: paragraphs 29.14A and 29.22A. These are set out below, along with paragraph 29.14 which is required to make sense of paragraph 29.14A.

29.14. In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In other jurisdictions, income taxes may be refundable or payable if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In both of those circumstances, an entity shall measure current and deferred taxes at the tax rate applicable to undistributed profits until the entity recognises a liability to pay a dividend. When the entity recognises a liability to pay a dividend, it shall recognise the resulting current or deferred tax liability (asset), and the related tax expense (income).

29.14A. As an exception, when:

(a) an entity is wholly-owned by one or more charitable entities;

(b) it is probable that a gift aid payment will be made to a member of the same charitable group, or a charitable venturer, within nine months of the reporting date; and

(c) that payment will qualify to be set against profits for tax purposes, the income tax effects of that gift aid payment shall be recognised at the reporting date. The income tax effects shall be measured consistently with the tax treatment planned to be used in the entity's income tax filings. A deferred tax liability shall not be recognised in relation to such a gift aid payment.

29.22A. An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:

(a) the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and

(b) the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

Effective date

Amendments to FRS 102 arising from FRED 68 apply to accounting periods beginning on or after 1 January 2019. Early adoption is permitted without any requirement to early adopt other amendments to FRS 102 arising from the triennial review.

Early adoption is permitted in paragraph 1.18(b) of FRS 102 and must be disclosed as part of the information about the basis of preparation in the notes to the accounts.

Scope of Information Sheet 2

Information sheet 2 provides guidance on the accounting and related disclosures required

where there is no legal obligation for a non-charitable trading subsidiary to make a gift aid payment to its parent charity.

The Information Sheet does not:

- Provide specific guidance for non-charitable trading subsidiaries applying Section 1A of FRS 102. However, aspects of the guidance will, nevertheless, be relevant.
- Cover the accounting and related disclosure requirements where there is a legal obligation for a non-charitable trading subsidiary to make a gift aid payment to its parent charity, i.e. where a Deed of Covenant is in place.
- Provide guidance for non-charitable trading subsidiaries preparing accounts under the Financial Reporting Standard applicable to the micro-entities regime (FRS 105).
- Provide guidance on the accounting implications for a parent charity's individual accounts or its group accounts. However, some limited commentary is available.

Illustrative examples

The guidance contains the following illustrative examples of accounting for gift aid payments and the associated tax relief on first-time adoption of amendments to FRS 102 arising from FRED 68:

- Example 1: Previously accounted for the gift aid payment as an expense in the income statement when profits arose.
- Example 2: Previously accounted for the gift aid payment in equity when profits arose.
- Example 3: Previously accounted for the gift aid payment in equity when paid.
- Example 4: Previously accounted for the gift aid payments as an expense in the income statement when profits arose: an interim gift aid payment made during the reporting period.

Assumptions

The illustrative examples are based on the following assumptions:

- There is no legal obligation to make the gift aid payment at the reporting date.
- The reporting entity is wholly-owned by its parent charity.
- The subsidiary entity is a private company limited by shares which prepares accounts in accordance with FRS 102.
- Taxable profits are equal to accounting profits and accounting reserves are equal to the subsidiary entity's distributable profits.
- The tax rate has been assumed as 20% for years ending 31 December 2017 and 31 December 2018.
- All taxable profits will be paid by the subsidiary entity to its parent charity via a gift aid payment made within nine months of the reporting date. The payment is made after the accounts have been approved.
- The subsidiary entity has elected to apply paragraphs 29.14A and 29.22A of FRS 102 in its accounts for the year ended 31 December 2018.

Information Sheet 2 is available from the following link: http://www.charitysorp.org/about-the-sorp/helpsheets

COMPROMISED CREDENTIALS ON THE DARK WEB

Thieves are working overtime to steal your valuable business data. Are your credentials on the dark web?

Not familiar with the term "Dark Web"? That's okay, even some of the most sophisticated individuals in the tech industry have no idea what the dark web is and how it's accessed. To understand what the dark web is, you must first understand that there is a large portion of the internet that is not indexed by common search engines like Google, Bing and Yahoo. This is the "Deep Web."

Because the traffic flowing through the deep web was encrypted, it quickly became a preferred communication channel for privacy-conscious individuals, organisations and governments to share data, without detection. It did not take long for corrupt individuals and organisations to begin using the deep web as a platform for exploit. The term "Dark Web" was coined to describe the pockets of the deep web that are used to buy, trade and exploit illegally acquired data or illegal items.

Why should you be aware of the threat from the dark web?

The volume of data breaches has reached epidemic proportions and shows no signs of slowing down. These data breaches lead to the sensitive information of your employees ending up in the hands of criminals who use this information to hack into your system or phish your employees for money or other data. On an average day, hundreds of thousands of login credentials (email addresses and passwords), along with national insurance numbers, dates of

birth, financial information and other personally identifiable information are added for exploitation. Once hackers have this information, they use it to target your business with social engineering campaigns and ransomware attacks.

80% of your employees will use the same or a derivation of the same password across all of the systems they access at work and personally. Therefore if a site they use personally is hacked and their username and password exposed, it is likely that this information will be sold to a hacker who may then try and use it to access your system.

Awareness Raising

Raising awareness around compromised credentials is paramount. Employees can have exposed credentials and be completely unaware. They therefore continue to use the same standard password, leaving company systems extremely vulnerable to attack. All staff within your organisation should be reminded of your company password policy and remain vigilant to phishing emails attempting to extract their passwords. This information can be a little frightening for business owners; however, it is important to be aware and take steps to secure your network.

It remains human nature to reuse passwords and this will continue to be a vulnerability for your network. When it comes to a data breach it's not a matter or “if” but “when”. The current cyber landscape is evolving quickly and small businesses need to ensure they have enhanced security in place to protect against damaging data breaches.

TAX STATUS OF CONSULTANCY PAYMENTS

The recent case of Petrol Services Ltd v CRC (TC06907) concerned a company which operated two petrol filling stations.

HMRC assessed the company to PAYE and NIC totalling £116,771 and £70,625 respectively which covered a period of six years.

The directors, Mr Odedra and Mr Badiani were not remunerated by the company. They, and their spouses, each owned 25% of the issued share capital. There were two consultancy agreements in place with the company for the provision of their services:

- Mr Odedra and his wife had a consultancy partnership where they shared profits 50/50.
- Mr Badiani and his wife had a company called Jadeprime Ltd the shares of which were owned 50/50 by Mr & Mrs Badiani.

The two contracts were almost identical providing for the two businesses to provide consultancy services, which were not defined, to the company. It was not in dispute that both Mr Odedra and Mr Badiani held the office of director of the company. What was in dispute was the appellants assertion that the payments to their consultancy businesses were not earnings, but payment for consultancy services, whereas HMRC's position was that the consultancy payments were earnings from Mr Odedra's and Mr Badiani's offices as directors.

The first tier Tribunal did not find the appellant's argument convincing that they were non-executive directors; did not have contracts providing for remuneration; and accordingly, the payments could not be attributed to the office held by them.

The appellants argued that unless there was an avoidance motive, the payments made to consultancy vehicles cannot be taxed as earnings. The FTT held that this was incorrect and that an individual is liable to income tax on earnings even if paid to a third person and this is so irrespective of whether there is a tax avoidance motive. Reference was made to Lord Hodge in the Rangers case where he made the point that the legislative provision imposing tax on earnings “is silent as to the identity of the recipient”.

The appellants argued that the contracts were contracts for services and not contracts of service. Having reviewed the contracts, the FTT considered that they should properly be regarded as contracts of service.

The appellants argued that the services provided under the contracts were not the sort provided by non-executive directors. The FTT found this a particularly unattractive argument. Firstly it is normal, in the case of closely held companies for the directors, to perform all tasks however lofty or lowly they may be. Secondly, whereas they fully accept that it is legally possible for an individual to have his own independent business (for example an accountant or solicitor) while also having the office of director of a company, and that in such a case the person's professional fees are not earnings from his office as director, though they observed in passing that in their experience this does not normally occur where the individual is a competitor of, or in the same line of business as, the company, as appears to have been the case here.

The Judge went on to say that the provisions of ITEPA and SSCBA 1992 are intended to impose a liability to income tax and NICs on earnings from an

office or employment, and to provide for the collection of that income tax and NICs by the employer. The obligation ought not to be side stepped by the appellant putting in place contracts that purport to be consultancy contracts pursuant to which the directors of the appellant (contracting alongside a vehicle owned by the director) exclusively conduct the entire business of the appellant.

When viewed realistically, as no services were provided by the consultants other than those provided by the directors of the appellants, the payments should be regarded as having been an award for the services as director of the appellant.

It followed that the appeal must be dismissed. However, the Judge went on to consider the appellant's point that, as there was no written contract of service and only a written contract for services, the terms of which were such that three factors necessary to establish employment set out in Ready Mix Concrete were not satisfied.

The appellant had said that there was no control over the performance of services. The three factors in Ready Mix Concrete were:

1. The servant agrees that, in consideration of a wage or other remuneration, he will provide his own work and skill in the performance of some service for his master.

   The contracts required performance of services by each of Mr Odedra and Mr Badiani for which remuneration was to be paid. They were each named as a consultant and both signed the contracts. It was held that the contracts provided for services to be performed by the appellants for which there is an express right be remunerated. The test was satisfied.

2. He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in sufficient degree to make that other master.

   The terms of the contracts implicitly provide for services supplied to be subject to scrutiny by the appellant, because the appellant had to determine whether to extend the term of the contract at the expiry of the first five years; whether to terminate the contract by giving notice; whether the consultant had performed the services to the required standard; whether any assistance was required in the branches of its business; whether the consultant had performed services for the required fifteen hours per week; whether to give directions to the consultant; whether the consultant had complied with directions given; and whether to increase the fee payable which had to be undertaken annually. The fact that the appellant could only operate through the two directors, whose services were being scrutinised, did not mean that the performance of each one was not scrutinised by the other. To allow the contract to run, the directors had to be satisfied that the services were being performed to the required standard. This seemed to suggest that Mr Odedra, as director, scrutinised the activities of Mr Badiani; and Mr Badiani, as director, scrutinised the services of Mr Odedra. The standard of each was scrutinised and controlled by the appellant. This test was also satisfied.

3. The other provisions of the contract are consistent with it being a contract of service.

   Although the contractor in the contracts in each case, Mr Badiani and Mr Odedra, had their consultancy vehicle, there is no express right to substitute another individual in the performance of the services. Further that the individual is named is indicative that substitution is not permitted. This test was also satisfied.

The Tribunal considered four other factors:

1. Whether considering the facts as a whole are indicative of employment, following Lorrimer v Hall and Walls v Sinnett.

2. Whether the individuals are part and parcel of the organisation (Future Online Ltd v Foulds).

3. Whether there is sufficient framework to control the activities of the individual, rather than whether the manner or performance was subject to oversight (Montgomery v Johnson).

4. In the case of highly skilled individuals, an employment relationship will exist if what the individual does is subject to control and not how it is done (Catholic Welfare).

Taking all of the factors into account the FTT considered the relationship to be that of employer and employee. They also considered that Mr Odedra and Mr Badiani were part and parcel of the appellant's business. No one else performed any activities of the business apart from the two directors. Consultancy contracts required oversight by the appellant. There was a framework to control the activities of each of the directors. The directors were under the control of the appellant.

The Judge understood that some tax had been paid by the consultancy vehicles and also by Mrs Odedra and Mrs Badiani and the FTT stated that it "would

hope and expect HMRC to avoid any double taxation that might arise if there are no extant enquiries into any relative returns for the periods in question".

It sometimes happens that an external consultant is asked to come on to the Board of a client company as a non-executive director. The latter should be the subject of a separate contract in respect of these duties with the remuneration therefrom being subject to PAYE and NIC.

PREPARING FOR CHANGES AT THE UK BORDER IF THERE'S A NO DEAL EU EXIT

Clients need to take five key actions to keep their goods moving across the border:

- Register for an EORI number
- Decide whether they will handle Customs Declarations in house or through a third party
- Check if they are eligible for simplified customs procedures
- Check for updates on tariffs that apply to their goods, and consider using duty relief schemes
- Confirm if they need licences or certificates to bring their goods across the border. (For example, if they are exporting food, animals or fish to the EU they will need an Export Health Certificate.)

For latest information visit the Government's 'Prepare for EU Exit' page.

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