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IR35 Success for Lorraine Kelly at tax tribunal 1

Regency factors: The importance of VAT record-keeping 3

Employee expenses 4

VAT Reverse charge construction...................... 7

MTD for VAT update 9

Government scheme to increase cyber resilience .. 10

Preventing abuse of the R&D tax relief of SMEs – Response by ICAS 12

What happens when a pension fund breaches the lifetime allowance 13

IAASB call for comments – applying ISAs in audits of less complex entities 14

Accounting and auditing query – due diligence costs 15

FRC confirms amendments to FRS 102 on accounting for multi-employer Defined Benefit pension schemes .. 16

IR35 SUCCESS FOR LORRAINE KELLY AT TAX TRIBUNAL

In 2018, Christa Ackroyd Media Ltd lost an IR35 appeal in a case involving the former BBC Look North Television Presenter Christa Ackroyd.

More recently, in the case of Albatel Ltd (TC7045) the personal service company owned by Lorraine Kelly and her husband Stephen Smith argued successfully that it was not subject to the IR35 rules.

HMRC argued that Lorraine Kelly was effectively an employee of ITV and, had Albatel Ltd not been interposed between her and ITV, then she would have had a contract of service with ITV, subject to PAYE and NIC.

Lorraine Kelly argued, successfully, that she was a freelance entertainer and, as well as presenting television breakfast shows, she also presented radio programmes and was a columnist for some national papers.

The appeals were against a Regulation 80 determination in the sum of £899,912.95 and a Notice of Decision in respect of Class 1 NIC of £312,615.54.

The Tribunal summarised the grounds of appeal as “the nature and range of Ms Kelly’s work mean that she should be treated as a self-employed star. Consequently, the IR35 legislation cannot be invoked so as to deem there to be any employment relationship”.

In reaching its decision, the Tribunal took the following principles into consideration:

1. Mutuality of obligation to perform personal work offered and to pay remuneration.
2. Whether the worker is subject to a sufficient degree of control in terms of what is to be done and where and when and how.
3. The existence of a right to substitute, irrespective of whether or not that right was exercised in practice.
4. Whether the worker was in business on his own account, including consideration of factors such as whether the worker had to provide at his own expense any necessary equipment; hires his own helpers; whether the worker bears financial risk; whether the worker has the opportunity to profit; and whether the worker was engaged himself to perform services in the course of an already established business of his own.
5. The duration of the contract, degree of continuity and whether the worker was “part and parcel” of the organisation.

The Tribunal, in applying these principles, found the terms of the hypothetical contract between Ms Kelly and ITV would be:

1. The contract was for a term of two years and six months. Ms Kelly was contractually obliged to perform the services of a first-class presenter to ITV, and ITV was contractually obliged to pay the fees. The fees would reduce proportionally if Ms Kelly did not

perform services for a minimum period. The contract could be terminated on giving six months written notice. However, if this occurred prior to the expiry of two years and six months, ITV would still be required to pay Ms Kelly for that minimum period.

2. ITV was not contractually bound to call on the services of Ms Kelly.
3. ITV had the right to call on the services of Ms Kelly but if she was not available for any reason, Ms Kelly may propose a substitute. ITV could determine whether to accept the substitute.
4. Ms Kelly was expected to present the live shows subject to being available. Beyond that there were no set working hours or days or location.
5. Ms Kelly must cooperate with ITV and take account of its directions, but she could at her discretion decide the manner, means and methods by which she performs the services.
6. Ms Kelly was entitled to undertake other paid or unpaid work outside ITV provided there was no conflict with the live programmes.
7. Ms Kelly was not subject to training days, formal appraisals nor did she have a team leader or line manager.
8. There was no express provision for holiday pay, sick pay, maternity leave or pension entitlement.
9. Ms Kelly was not required to attend production meetings, interviews, or other services ancillary to the programme.
10. ITV arranged and provided transport for the purposes of the services provided by Ms Kelly.
11. ITV would have final editorial control of the programme.

In applying the terms of the hypothetical contract, the Tribunal made the following findings in relation to whether the contract was a contract of service or a contract for services:

Mutuality of Obligation

1. Ms Kelly was obliged to perform personally the services; the company had no other employees it could send in her place and the agreement specifically named Ms Kelly as the person engaged to perform the services.
2. It was argued for the company that ITV was entitled to call on the services of Ms Kelly, but it wasn't obliged to do so, nor was there an obligation to call on the services of Ms Kelly.
3. ITV was obliged to pay Ms Kelly for the services performed and there was an expectation that there would be up to forty-two weeks of work per year. However, ITV was not obliged to call on Ms Kelly and the show could have been dropped, for instance if ratings fell.
4. The Tribunal considered there was mutuality of obligation but, what there was, amounted only to the irreducible minimum and was not determinative of the issue.

Control

1. The appellant's case relied on the absence of control as a significant indicator pointing away from a contract of services.
2. Case authorities recognise that the absence of control in the case of a skilled worker is not an automatic indicator away from employment.
3. Ms Kelly was engaged for her specific skill. The Tribunal accepted that in relation to the programme "Lorraine", and to a lesser extent "Daybreak", it was Ms Kelly's "brand" that was specifically engaged. The Tribunal considered it clear from the evidence that Ms Kelly had minimal or no supervision.
4. The Tribunal also accepted Ms Kelly's evidence that she decided on the running order of the programme, the items to feature and the angle to take in interviews. They accepted that contrary to being part of a jigsaw, Ms Kelly was the jigsaw. The fact that programmes were aired from a studio was in the Tribunal's view, no more than a practical requirement and had Ms Kelly decided to present the show from a different location then this would happen. They accepted that when ITV wanted to move the programme to Scotland or Manchester, this was vetoed by Ms Kelly. They also accepted that it was Ms Kelly's decision to stay on site after the show and lead meetings about the following day's show, reflecting the control which Ms Kelly had in determining what would or would not feature.
5. The Tribunal accepted that Ms Kelly's preparation or attendance at interviews were not matters in respect of which ITV had control but demonstrated why Ms Kelly was engaged; rather than relying on researchers Ms Kelly chooses to carry out her own preparation and why the programme has "Ms Kelly's DNA".
6. On the basis of evidence heard from Ms Kelly and other

witnesses, the Tribunal was in no doubt that Ms Kelly was not hired to be part of a team but rather to lead a team. ITV sought Ms Kelly's services to make the show a success and increase ratings. This further demonstrated Ms Kelly being engaged to use her skills as she saw fit with a free reign. The choice of a co-presenter was dictated by Ms Kelly and indeed, ITV had travelled to Dundee to cast for the co-presenter.

7. The Tribunal accepted that Ms Kelly was not under the control of Ms Walton of ITV, and that the two roles were entirely separate and distinct. Ms Walton's obligations were to ITV and Ms Kelly's were to present the show to a high quality, not overrun (as it was live), and to comply with industry regulations. Ms Kelly's role was to provide a programme in any manner she chose.

8. The Tribunal were satisfied that Ms Kelly was free to carry out other work and activities without any real restriction and in fact did so, including a four-week expedition to Antarctica which interfered with her ability to perform duties for ITV.

9. Based on all of the above, the Tribunal were satisfied that the level of control of her work lay with Ms Kelly.

Other Contractual Provisions

1. Ms Kelly was not entitled to sick pay, holiday pay or other benefits to which employees generally have an entitlement. She was not provided with training nor subject to appraisals.

2. Neither party intended to create a contract of service.

3. There was no scope for Ms Kelly to increase profits, but she was exposed to the type of risk found in self-employment such as the programme being dropped or long-term sickness.

4. In applying the test as to whether the appellant was providing services and in business on its own account, the Tribunal noted that while engaged with ITV, Ms Kelly carried out a variety of work from writing to designing and advertising a fashion line. She also appeared on other television shows. The picture emerged of considerable and varied activities of Ms Kelly that could not be considered to be part and parcel of ITV Breakfast. In the Tribunal's view, ITV was not employing a servant but rather purchasing a product, mainly the brand and individual personality of Lorraine Kelly. They concluded that this supported the conclusion that the appellant was in business on its own account.

In looking at the overall picture and making a considered and qualitative assessment of the evidence as a whole, the Tribunal reached the view that the relationship between Ms Kelly and ITV was a contract for services and not that of employer and employee.

There was a further issue as to whether agency fees were tax deductible and the Tribunal stated that "we have no hesitation in concluding that Ms Kelly is a "theatrical actress" and the legislation is satisfied such as to make the expenses deductible".

The appeal was allowed.

The Tribunal decision extends to forty-six pages and there is much case specific information, much of which could be applied in similar cases.

REGENCY FACTORS: THE IMPORTANCE OF VAT RECORD-KEEPING

As we enter MTD for VAT, we look at a recent case highlighting the importance of VAT record-keeping.

In Regency Factors (Regency Factors Ltd [2019] TC 07010), the company had claimed VAT bad debt relief, which HMRC disallowed. Changes to record keeping could have achieved a different outcome.

Factoring bad debts

Regency Factors (Regency) provides a factoring service, advancing up to 80% of the value of invoices assigned to it by its customer businesses. Regency offsets its fees against this advance, collects the debts and remits any additional amounts collected to its customers.

There are cases where the assigned debts are not collected in full. These may represent bad debts for Regency's customers, but only where Regency's own charges remain unpaid would Regency itself incur a bad debt.

Bookkeeping

Regency's primary ledger account for its customers was an overview, summarising the total advances, assigned invoices and its own fees and disbursements. This ledger account, called by Regency a Factoring Current Account (FCA) '*is a running*

account balance, accordingly there is an admixture of funds and it is impossible to apportion credits to particular invoices submitted by a client and receipts from their Customer'.

This FCA account is used by Regency to claim VAT Bad Debt Relief (BDR). BDR was claimed where amounts received in respect of assigned invoices fell short of advances to customers – as shown in the monthly FCA. The 'shortfall' was apportioned pari passu (pro-rata) across all headings, including VAT.

However this is not the method of claiming relief specified in the VAT Notice. HMRC expected to see the records outlined in the VAT Notice on bad debt relief. Would the Tribunal take a broader view?

Was there a debt for a bad debt relief claim?

The Tribunal first had to decide if there was actually a debt on which VAT bad debt relief could be claimed.

The unusual feature here is that Regency's customers didn't 'pay' the factoring bills. Rather, Regency's customers received a smaller advance from Regency to take account of the factoring charge.

For example, on £1,000 of invoices assigned from a business customer to Regency, Regency might advance 80%, ie £800, but Regency first deducted its charges of £36. Therefore, Regency's customer only received £764 as an advance on account of the £1,000 of assigned invoices. Did this amount to 'payment' for VAT purposes? The Tribunal considered that it did.

On this approach, there was no bad debt. Regency had been paid its fee, and the VAT on the fee, by offset when the advance was made by Regency to its customer. In addition, the tax point was the date that Regency raised the invoice on the basis that the fees were deducted from the advance.

If the fees were paid in full when the advance was made, there could not be a bad debt. In addition, according to the BDR rules, no claim can be made for BDR unless invoices have been unpaid for six months. Invoices paid immediately by offset cannot be six months old.

Accounting for VAT

How did Regency calculate its VAT Bad Debt Relief? Regency based its BDR claim on an accounting entry in the FCA, whereas in the Tribunal's view, BDR had to be claimed in respect of individual factoring invoices.

The lack of any audit trail from the invoice to the BDR claim meant, in Tribunal's view, that there was no claim possible.

BDR scheme arrangements

Another challenge to Regency's claim was that the VAT Notice at 2.2 specifies seven requirements for a successful BDR claim. Two of these were particularly relevant to Regency:

- You must have written off the debt in your day to day VAT accounts and transferred it to a separate bad debt account
- The debt must have remained unpaid for a period of 6 months after the later of the time payment was due and payable and the date of the supply

Regency did not maintain a separate VAT bad debts account, and this told heavily against it. In the Tribunal's view, '…in the absence of a refunds for bad debt account, as required by regulation 168, it is impossible to say whether the necessary conditions for BDR have been met'. Without knowing if the conditions have been met, BDR cannot be given.

Conclusion

VAT record-keeping requirements are specific and can go beyond what a business considers essential for its own purposes.

The Regency case shows the necessity of maintaining records in accordance with the VAT rules, not just business records that enable the firm to operate commercially. Regency may have experienced 'bad debts' to its own way of thinking, but it was not entitled to apportion book losses pro-rata against VAT and fees. Entitlement to VAT BDR requires creation of an audit trail from VAT invoice to bad debt account, and this had not been achieved.

EMPLOYEE EXPENSES

Introduction

The types of expenses payments being paid, and the associated tax implications for employment tax purposes, have evolved over the years. In this article, we go back to basics.

Private or business?

Making the initial decision as to whether an item of expenditure is 'business' or 'private' is fundamental to ascertaining the correct income tax and NICs treatment of that item. Usually, the expenses policy of the business stipulates what can and cannot be paid, and how this translates into either a taxable or non-taxable receipt for the employee. Anyone looking for guidance on this should first consult the HMRC booklet 480

which deals with expenses and benefits and 490 which deals with the treatment of travelling and subsistence expenses.

Who is taxable and who is exempt?

The Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) charges employment income to income tax. Employment income includes salary, wages, fees and other emoluments from an employment, including amounts which arise under what is known as "the benefits code". The benefits code takes account of amounts which are not 'earnings' but nevertheless count as employment income, such as expenses and benefits provided to directors and employees. Section 336 ITEPA 2003 details the general rule: certain expenses are eligible for tax deduction, making them partially or wholly free from income tax. In some cases, where the employee is not charged to tax on an expense, the value of the expense is instead taxed on the employer. More information on this is set out below.
Very few employees are exempt from the benefits code, although certain categories, such as lower paid ministers of religion are, as detailed in chapter 8 of ITEPA 2003.

What items of expenditure are exempt from employment taxation?

If any payment of expenses whatsoever is made to an employee by reason of their employment, this counts in the first instance towards their pay for employment tax purposes under s.70 ITEPA 2003, unless it is covered by an exemption or it has already been subject to tax elsewhere. There is a long list of exempt payments and the best place to find these is by reading the relevant section of HMRC's Booklet 480, which is updated annually. The 2019 version is available online now. Note that items which are normally regarded as taxable benefits can be classified as "trivial" if they cost less than £50 to provide, are not cash or cash vouchers, are not received under the employment contract, and are not a reward or in recognition for particular services.

Where the employer is a close company and the benefit is provided to an individual who is a director or other office holder of the company (or to a member of their family or household), the exemption is capped at a total cost of £300 in the tax year.

If any of these conditions is not satisfied then the benefit is not regarded as being "trivial" and must be taxed in the normal way, subject to any other available exemptions or deductions.

Individual Agreements with HMRC

It has been a long-held view of many businesses that only benefits in kind are reportable on form P11D, but business expenses such as travel, subsistence and entertaining do not need to be included. However, this is a misconception. Any items within the benefits code are reportable on a form P11D (expenses and benefits – the clue is in the name) unless the items have been agreed under an Approval Notice or, from 6 April 2019, are scale rate payments which are compliant with Section 289A ITEPA 2003.

Removal of checking requirement for benchmark scale rates from 6 April 2019

From 6 April 2019, employers will no longer be required to operate a system for checking an employee's expenditure in order to make payments free of tax in relation to expenses paid or reimbursed using benchmark scale rates. Instead, employers will only be required to ensure that employees are undertaking qualifying travel on occasions in respect of which a payment is made or reimbursed, and that neither the employer nor any other person knows or suspects or could reasonably be expected to know or suspect, that travel was not undertaken. See EIM30225 for further guidance.

Employers who pay any non-allowable expenses or provide non-exempt benefits will still need to put those through the payroll and deduct tax and NICs or put them on form P11D, in accordance with existing practice.

Expenses or benefits that are only partially exempted will need to be put through the payroll in full and employees will need to claim a deduction from HMRC on the part that is exempt.

Paying cash reimbursements, or meeting the cost of the expenses directly?

Neither of these methods are problematic as they both fall under the rules mentioned above and can be exempted or assessed to tax accordingly. However, care should be taken when the expense being reimbursed or paid directly is something which is in the employee's own name – such as a telephone bill or credit card bill. Meeting bills which are the employee's legal liability to pay is known as meeting a "pecuniary liability". Different rules exist here because the tax relief available under section 336 ITEPA 2003 is not available, unless it can be demonstrated that the amounts are "wholly, exclusively and necessarily" incurred in the proper performance of the employee's duties. If something contains even a small private element, it is not within the above definition.

Obtaining a tax deduction for business expenses payments

As mentioned above, sometimes, an expense payment is technically still taxable on an

employee or director, but tax relief can be obtained on it under sections 336-338 ITEPA 2003. Travel, subsistence and entertaining expenses are often confusing for employees and employers alike to categorise. To illustrate this point, I have set out a simple table which shows why the employee is not always taxed on the expense. Usually, if something is not taxable on the employee, it is taxed on the employer business instead by counting towards business profits instead of being deducted from them.

Table 1 (page 7) can be helpful when constructing an expense claim form for employees to complete or when creating expenses protocols for checking that expenses are being taxed on the employees or included in the accounting process which feeds into the business tax return. Once again, a comprehensive list of expenses payments can be found in HMRC's Booklet 480, as can definitions of business travel, subsistence and entertaining expenses.

Please note that in all the above scenarios, VAT receipts should be kept so that if appropriate any VAT element can be claimed back by the business, if VAT-registered.

The difference between cash and non-cash vouchers

A cash voucher is something which is redeemable for cash to approximately the same value as the cost to the business of providing the voucher. A non-cash voucher is only redeemable for goods and services. Cash vouchers should always be payrolled in the pay period in which they are given and subjected to PAYE and Class 1 NICs. However, non-cash vouchers are still liable to Class 1 NICs but should be declared on a P11D unless the business has agreed to payroll benefits in kind with HMRC. Some vouchers, such as those qualifying as "trivial benefits" are exempt, but must still be reported.

Company cars and vans

One of the most common and costly errors made by employers relates to the private use of company cars and vans by directors and employees. The term "company car" or "company van" relates to any vehicle provided by a business to its employee or a director. Errors can arise when vehicles available for private use are not identified, the wrong list price or CO2 multiplier is used, and where private fuel provided is not reported on P11Ds or payrolled. It is also important for the business to be able to reclaim VAT on the fuel purchases but to do this, the employee must retain all receipts to avoid the VAT element being disallowed, which can have an adverse effect on the employer's cash flow.

Bearing the cost of the income tax on certain benefits in kind (PAYE Settlement Agreements, or PSAs)

As long as items are classifiable as minor, irregular or not practicable to operate PAYE or value for P11D inclusion, they can be included in a PSA. Bear in mind though that, due to the grossing up calculation and the Class 1B employer's NICs due, this method can be costly to the employer – especially where higher and additional rate taxpayers are concerned – but it is up to every business to decide whether this is a cost it wishes to bear.

PSAs cannot be retrospective. For existing PSAs, the requirement to renew annually has been removed from 6 April 2018 and been replaced by 'enduring agreements', which are only renewed where there is a change or annulment. A brand new PSA should ideally be in place by the start of the new tax year - so applying to HMRC in February is probably a good idea. This also prevents items which may carry a Class 1 NICs liability (and which should otherwise be processed through payroll for the pay period in question) such as vouchers, to be included in the settlement instead of being taxed on the employee. For further information see PAYE Settlement Agreements and for further guidance see Overview of PAYE Settlement Agreements (PSA) PSA1000

Payrolling expenses and benefits

Has your business or client chosen to payroll benefits in kind? Currently there is a facility to payroll most benefits in kind but beneficial loans and living accommodation benefit cannot be payrolled.

Whilst payrolling benefits removes the need to complete forms P11D, it does not remove the need to complete a P11D(b), submit it to HMRC by 6 July following the tax year in which the benefits are provided, and pay over the Class 1A NICs due on the benefits by 19 July to avoid a penalty.

Further information can be found at GOV.UK as well as examples. Payrolling is generally a good idea, because it means that employees tend to be paying the tax on their benefits whilst enjoying them, rather than being assessed a year later.

Conclusion

The trickier aspects of expenses and benefits in kind can catch an employer out, but the key is to keep it simple. First, make an objective distinction between private and business, then decide which type of expense or benefit it is. From there it is possible to allocate the correct tax/NICs treatment, if indeed no exemptions or reliefs are due.

Table 1

Type of expense	Employee	Employer
Business travel – potentially taxable on the employee but not on the employer	Business travel is only eligible for tax relief where it is "wholly, exclusively and necessarily" incurred in the proper performance of the employee's duties under s.336 ITEPA 2003	The employer business can claim a deduction from profits in its accounts for travel expenses incurred by employees travelling wholly and exclusively on business.
Subsistence – potentially taxable on the employee but not on the employer	Subsistence is only eligible for tax relief where it is "wholly, exclusively and necessarily" incurred in the proper performance of the employee's duties under s.336 ITEPA 2003	The employer business can claim a deduction in its accounts for any subsistence incurred by employees whilst travelling wholly and exclusively on business.
Entertaining – taxable on the employer and not on the employee	The employee must demonstrate that entertaining was taking place to further the course of the business relationship	Client entertaining is "added back" to the business profit figure of the employer business
Staff entertaining – taxable on the staff unless the employer settles it under a PSA or it qualifies as an "annual function"	Staff entertaining which falls outside of the "annual functions" exemption at s.264 ITEPA 2003 is treated as a benefit in kind and should be declared on P11D unless the employer settles the liability using a PSA.	Staff entertaining is an allowable deduction from business profits under s.46 ITTOIA 2005 as long as it is wholly and exclusively for the purposes of the trade.

VAT REVERSE CHARGE CONSTRUCTION

A VAT revolution is happening in construction from 1 October 2019. It needs action now to be ready for the scale of the change.

Tax avoidance

A new plank in the Government's anti-avoidance repertoire is to be put in place in October. It applies to VAT registered businesses supplying construction services. To attack missing trader fraud in the construction sector, responsibility for accounting for output tax moves from subcontractor to the contractor for supplies covered by the Construction Industry Scheme (CIS).

A similar arrangement already applies to mobile phones and some other 'at risk' supplies. The construction reverse charge will be similar but with some significant differences.

Scope of the changes

The reverse charge will apply to:

- VAT registered businesses in a CIS supply chain
- supplies of 'specified services' – meaning construction services (but not, for example, property or land)
- supplies of labour and materials charged at standard or reduced rate VAT.

It does not apply to supplies outside CIS, to non-VAT registered businesses, or to zero-rated supplies. In these cases, normal VAT invoicing rules apply.

Reverse charge does not apply to 'end user' customers. These are VAT registered businesses who do not supply on construction services received. This would include, for example, a large retailer having a store built, or a construction business making a supply of property – such as a newly built office block or warehouse.

Where the reverse charge does not apply, supplies are invoiced under the normal rules.

Impact of VAT reverse charge

Businesses will need advice on record keeping requirements and impact on working capital.

Key impacts of the changes include:

- cashflow – subcontractors lose output tax which could be used as working capital
- subcontractors may become repayment cases, as input tax may now exceed output tax. They may be more under the HMRC spotlight as a result; they may also wish to

consider moving to monthly accounting

- subcontractor using the VAT flat-rate scheme may find that the changes mean the scheme is no longer appropriate for them
- invoicing – both subcontractors and contractors may need to change their invoicing procedures:

  - reverse charge invoices are issued by the subcontractor when reverse charge applies. They must include specific details – such as saying that the reverse charge applies / customer accounts for the VAT. The invoice should show the amount which would have been charged as VAT, but it must not be shown as VAT payable.
  - subcontractors will need to know more about their contractors to get invoicing right. They will need to know if the contractor is VAT registered, and if the supply is within CIS reporting, before making out the invoice.
  - contractors will need enough information and expertise to make out a VAT invoice correctly for the supplies they receive under the reverse charge.
  - the final contractor in the CIS supply chain will need to know if their customers are 'end users' – that is, VAT registered businesses which will not be making onward supplies of construction services.
  - in some cases, final customers may be 'deemed contractors' under CIS for some transactions. (Deemed contractors are those non-construction businesses with an average annual expenditure on construction operations of over £1 million in the last three years). The reverse charge will not normally apply to deemed contractors as they will normally be 'end users'.

VAT return entries

Where the reverse charge applies, the supplier's VAT returns shows the output, but not the output tax on the supply. While the customer's VAT return shows output tax on the supply, but not output, and it also shows the input and input tax on the supply, subject to normal input tax recovery rules.

Penalties

HMRC has noted that it understands the difficulties businesses may have in implementing the domestic reverse charge and will apply a light touch in dealing with related errors that occur in the first 6 months after introduction, where businesses are trying to comply with the new legislation. However, businesses that knowingly claim end user status when the domestic reverse charge should have applied will still be liable for the output tax that should have been paid and may be liable for penalties.

Further information

HMRC will be releasing additional guidance as October approaches. The following are available so far:

There is a useful flowchart in the annex to the HMRC guidance note – annexe 1

VAT reverse charge for building and construction services guidance note

Final draft of the Statutory Instrument

Explanatory memorandum

Policy paper - 7 Nov 18

Domestic reverse charge procedure (VAT Notice 735) – as it currently applies to other services.

MTD FOR VAT UPDATE

With MTD for VAT officially beginning from the first VAT period starting on or after 1 April 2019, all VAT registered businesses, unless exempt, or deferred, should be maintaining the prescribed VAT information digitally.

Some businesses have started making submissions – particularly monthly repayment cases, who decided to join early. There have been problems reported including returns shown as submitted according to the firm's software, but which later appear not to have been logged by HMRC. This may only become apparent when an expected refund fails to materialise.

Similar issues have been reported elsewhere.

Phoning HMRC

It is all too easy to end up going round in circles with phone calls to HMRC. The information we have received indicates that there are usually around 100 HMRC staff available for helplines. When lines are busy – caller numbers far exceed staff - then you will hear a 'busy' message and Intelligent Telephony may be activated.

The HMRC Intelligent Telephony has not been able to identify the word 'MTD' though it may recognise VAT. It is therefore unlikely that the voice recognition system will currently take you to the correct team within HMRC.

Unfortunately, when lines are busy, your call may be abruptly terminated. HMRC advises that their phone lines are usually less busy between 8am and 11am.

With MTD for VAT you may:

- Phone the VAT helpline (0300 200 3700). You may need to ask to be put through to the MTD VAT team in Glasgow, or
- Phone the Agent Dedicated Line and ask to be transferred to MTD VAT team in Glasgow

HMRC MTD for VAT updates

HMRC is aiming to issue fortnightly updates. To the end of April 2019, six editions have been issued. You can register to receive copies by emailing makingtaxdigital.mailbox@hmrc.gov.uk.

The updates can also be found on the ICAS website, under 'MTD - Latest updates from HMRC'. This section of the website also includes other information from HMRC:

- Making Tax Digital Update for Agents – Issues 1-6 (January to April 2019)
- Information required for client sign up (4 April 2019)
- How to sign up for an HMRC Agent Services Account (4 April 2019)
- Signing up to MTD for VAT at the right time (30 April 2019)

MTD for VAT notice

The MTD for VAT notice VAT Notice 700/22: Making Tax Digital for VAT is being continually updated. The latest set of revisions (3 May 2019) cover:

- Guidance on the turnover test
- Exemptions
- Digital links
- Supplies by third parties
- Supplies received
- Use of supplier statements
- Petty cash transactions
- Charity fund raising events

Much of this is clarification of rules we have known about for a while, but some information is newly made public. Key clarifications are:

Petty cash (para 4.3 .3.2 of the Notice)

This confirms that petty cash items do not have to be entered individually in the digital records. Instead:

The business can record the total value and the total input tax allowable. This applies to individual purchases with a VAT-inclusive value below £50 and the total value of petty cash transactions recorded in this way cannot exceed a VAT-inclusive value of £500 per entry.

Charity fund raising events (para 4.3 .4)

A similar easement applies here, where transactions for a charity event can be entered digitally as a single item.

Where supplies are made or received during a charity fundraising event run by volunteers you may treat all supplies made as covered by one invoice for the event, and all supplies received as covered by one invoice for the event, for the purposes of the digital record keeping requirements.

Turnover test (paras 2.1 and 2.1 .1)

New wording confirms that any business which, on or after 1 April 2019, exceeds the VAT threshold of £85,000 in taxable supplies and is registered for MTD for VAT will not be able to leave MTD for VAT if its turnover falls below the deregistration threshold. The business would need to deregister for VAT altogether.

By contrast, a business which is voluntarily registered for VAT and which joins MTD for VAT, may subsequently leave MTD for VAT without needing to de-register for VAT.

Exemption

Grounds of exemption (3.1-3.4) are restricted. Businesses in insolvency are not required to follow MTD. The 'not reasonably practicable' exemption is not an effort-free, let-out-clause: '*HMRC will not give you an exemption purely on the basis that reasonable effort, time and cost may be involved in making the transition to Making Tax Digital, for example choosing and buying any new hardware or software or learning to use them.'*

The 'religious society' exemption is similarly strict. All those involved in running the business would need to qualify and HMRC will not give you the exemption if '*you're currently filing online and use a computer or smart device for business or personal use*'.

Digital links (para 4.2 .1.1)

The update confirms that you do need digital links, even during the soft-landing period, '*where the data to be included in any of the boxes of the VAT Return has been prepared within a software program, product or application, and this data is then transferred to another program, product or application in order to submit the VAT Return data to HMRC via the API platform'.*

This covers the example of preparing a VAT return nine-box summary within a spreadsheet and then transferring this data into bridging software. The transfer from spreadsheet into bridging software must be digital e.g. linked cells.

Third party supplies (para 4.3 .2.1)

In a similar way to the petty cash and charity event easements, where sales are made via third parties, digital record keeping requirements are relaxed.

Where a third party agent makes supplies on your behalf, those supplies do not fall within the digital record keeping requirements until you receive the information from the agent. Where the information is received as a summary document you can treat this document as one invoice issued by you for the purpose of creating your digital record.

This relaxation only varies the requirements on maintaining records using functional compatible software. It does not change any other record keeping requirements set out in VAT legislation.

Supplier statements (para 4.3 .3.1)

Again digital record keeping requirements are relaxed where a business 'pays to statement' and records only the statement total in their records.

HMRC will permit that *'where a supplier issues a statement for a period you may record the totals from the supplier statement (rather than the individual invoices) provided all supplies on the statement are to be included on the same return and the total VAT charged at each rate is shown'.*

Agent journey and software choices

Agent update 6, includes more information on how to sign your clients up for MTD for VAT as well as links for setting up an Agent Services Account.

HMRC's software choices viewer is continually being updated, but it is worth reminding clients that this does not ensure that the software is appropriate for their business. The choice of book keeping software should be based on business requirements such as invoicing and reporting functionality, cashflow managements and compatibility with other systems, including those used by business advisers.

The requirements of MTD for VAT can be met entirely by using spreadsheets, or by using existing digital software and bridging software for submission. Don't let the tax tail wag the accounting dog: records are not just for VAT purposes. We are already hearing reports of smaller business clients, panicked into buying software through persuasive publicity. This can result in their purchasing systems which don't match their business requirements and which will need to be replaced later.

GOVERNMENT SCHEME TO INCREASE CYBER RESILIENCE

Cyber Essentials Certification for your business

Almost every week we are hearing reports of a major cyber incident, with many firms already being the victim of an attack. The number of businesses reporting cyber incidents has risen from 45% last year to 61% in 2019 (Cyber Readiness Report). The use of PDFs and Office files to hide malware is gradually taking over traditional delivery options like scripts, executables and other miscellaneous files types (2019 SonicWall Cyber Threat Report).

Due to the exponential growth in cyber crime, the government launched the Cyber Essentials Scheme to help you protect your organisation, whatever its size, against a whole range of the most common cyber attacks. Not everyone has the time or knowledge needed to develop a full-on cyber security system.

There are three levels of engagement:

1. The simplest is to familiarise yourself with cyber security terminology, gaining enough knowledge to begin securing your IT.

2. If you need more certainty in your cyber security, you can go for basic, or entry level Cyber Essentials certification.

3. For those who want to take cyber security further, you can go for Cyber Essentials Plus certification.

To make your business more secure, it's vital to think about your organisation as a whole, and how information is accessed. The following areas are included in the scope of Cyber Essentials.

Bring your own device (BYOD)

Traditionally, user devices were owned and managed centrally by the organisation. Allowing employees to bring their own devices to work can pose a cyber security threat but having a robust policy can minimise risks.

Updates

Always download the latest software and app updates on all devices used for work – whether it's a work mobile or a home computer. These contain vital security upgrades which protect devices from viruses and hackers.

Screen lock

This will give devices an extra layer of security, as each time it is unlocked, staff will need to use a PIN, pattern, password, fingerprint or face. This means if

someone gets hold of a device, they can't access the data without entering one of these credentials.

Email password

Create strong, separate passwords for email accounts, as hackers can use email as a gateway to gain valuable information.

Backup important data

If an employee's device is infected by a virus or accessed by a hacker, your data may be damaged, deleted or held to ransom. Make sure you backup important data to an external hard drive or a cloud-based storage system.

Encryption

Emails are an especially vulnerable access point for attackers looking to intercept messages and gain important information from them. Hackers can gain access to all of your most important personal information sent through email - like payroll details, bank account numbers or login information - but they also have access to any attachments or content that others have sent to you and have the ability to take complete control of your email account. Encryption is an important added security measure that makes sure that even if a message is intercepted its information cannot be accessed. By utilising the public/private key pair system, email encryption also helps verify the authenticity of the sender and recipient of the message.

Firewalls

The Cyber Essentials Scheme requires all devices connected to the internet to be protected with a firewall. A firewall is a device which can restrict the inbound and outbound network traffic to services on the network. It can help protect against cyber attacks by implementing restrictions, known as 'firewall rules', which can allow or block traffic according to its source, destination and type of communication.

It's important for the organisation to:

- change the default admin password
- prevent access to the admin interface from the internet
- block unauthenticated inbound connections
- ensure inbound firewall rules are approved and documented by an authorised individual
- remove or disable permissive firewall rules quickly, when they are no longer needed.

It's also recommended to use a host-based firewall on devices which are used on untrusted networks, such as public Wi-Fi hotspots.

Secure configuration

Default installations of computers and network devices can provide cyber attackers with a variety of opportunities to gain unauthorised access to an organisation's sensitive information. You can minimise inherent vulnerabilities and increase protection against common types of cyber attack by:

- removing or disabling unnecessary user accounts
- changing any default or guessable account passwords
- uninstalling unnecessary software
- disabling auto-run which allows file execution without user authorisation
- authenticating users before allowing internet-based access to commercially or personally sensitive data, or data which is critical to the running of the organisation

Your password policy should tell users:

- how to avoid choosing obvious or common passwords
- not to use the same password anywhere else, at work or at home
- if they may use password management software — if so, which software and how
- which passwords they really must memorise and not record anywhere

User access control

Users should only be granted as much access as they need to perform their role. When admin accounts with special access privileges are compromised, their greater freedoms can be exploited to facilitate large-scale corruption of information, disruption to business processes and unauthorised access to other devices in the organisation. Such accounts typically allow:

- execution of software with the ability to make significant and security relevant changes to the operating system
- changes to the operating system for some or all users
- creation of new accounts and allocation of their privileges

You must take special care over the allocation and use of privileged accounts. This means the organisation must:

- have a user account creation and approval process
- authenticate users before granting access to applications or devices, using unique credentials
- remove or disable user accounts when no longer required
- implement two-factor authentication, where available
- use administrative accounts to perform administrative activities only
- remove or disable special access privileges when no longer required

Malware protection

Running software downloaded from the internet can expose a device to malware infection, such as computer viruses, worms and spyware. Potential sources of malware infection include malicious email attachments, downloads and direct installation of unauthorised software.

If a system is infected with malware, your organisation is likely to suffer from problems like malfunctioning systems, data loss, or onward infection that goes unseen until it causes harm elsewhere.

You can largely avoid the potential for harm from malware by:

- detecting and disabling malware before it causes harm (anti-malware software)
- executing only software that you know to be worthy of trust (application whitelisting)
- executing untrusted software in an environment that controls access to other data (application sandboxing)

Patch management

Any device that runs software can contain security flaws, known as vulnerabilities. Once discovered, cyber criminals move quickly to exploit vulnerabilities to attack computers and networks in organisations with these weaknesses.

Product vendors provide fixes for vulnerabilities identified in products that they still support, in the form of software updates known as patches. Patches may be made available to customers immediately or on a regular release schedule. The organisation must keep all its software up to date. Software must be:

- licensed and supported
- removed from devices when no longer supported
- patched within 14 days of an update being released, where the patch fixes a vulnerability with a severity the product vendor describes as ‘critical’ or ‘high risk’.

Conclusion

The Scottish Government has allocated £500,000 to support businesses to increase their cyber resilience. Certain organisations in Scotland can apply for a Cyber Essentials voucher for up to £1000.

PREVENTING ABUSE OF THE R&D TAX RELIEF OF SMEs – RESPONSE BY ICAS

General comments

ICAS has contributed to the consultation “VAT registration threshold: call for evidence published on 13 March 2018.

Exemptions to any cap are vital if genuine R&D activity of SME companies is to be encouraged and supported. While targeted anti-avoidance measures are understandable in the context of misuse of the system, concerns have been expressed that the system is inadequately policed, and blanket restrictions are an inappropriate substitute for more rigorous examination of claims.

There is an inherent tension between encouraging SMEs to make R&D claims while imposing blanket restrictions. It is likely that many SMEs are not making full use of R&D claims; while some businesses are being approached directly by organisations marketing R&D schemes and are encouraged to claims in excess of their entitlement.

Comments on specific areas

Question 1

If the cap is only applied for payable tax credit claims above a defined “threshold“, at what level would this be useful at reducing any potential administrative burdens on genuine companies?

No comments

Question 2

If a group was only able to submit one payable tax credit claim at or below a certain threshold per year, how would this fit with the way that claims are currently made? How common is it for more than one company in a group or common control entity to make a claim for the payable R&D tax credit?

No comments

Question 3

If an element of the PAYE and NICs liabilities of another group or connected company were included as a part of the cap (where R&D has been subcontracted to it or EPWs provided by it), to what extent would this benefit companies? How much additional complexity would this add to claiming the payable tax credit?

No comments

Question 4

Would it be practical for claimant companies to obtain the PAYE and NICs information from other group or connected companies? Are there any limitations to their

doing so? Would the other company be willing to provide this information?

No comments

Question 5

How beneficial would surrendering carried forward losses, to claim a future payable tax credit when sufficient PAYE and NICs liability has been generated, be to a company affected by the cap? Would a time limit of 2 years be appropriate? How straightforward would it be to keep track of the origin year of the losses?

The carry forward option un-surrendered for losses is welcome. This would impose a cashflow disadvantage on SMEs, but if far preferable to a losing the right to surrender altogether. A two year time-frame seems adequate and recordkeeping burdens would be in line with normal requirements to track tax losses.

Question 6

Would carrying forward losses make companies consider taking on more staff in the future - to unlock some (or all) of the rest of their payable tax credit?

This appears unlikely except for exceptional circumstances.

Question 7

The government is interested in the characteristics of companies that could be affected by the cap. For example, if you are or represent a company likely to be affected by the cap, how large is the company in terms of employees? How many staff are primarily engaged in R&D activity? How old is the company? What sector does it operate in?

No comments

Question 8

What else could the government consider, regarding how the cap is applied to preventing abuse, to ensure genuine companies can continue access the payable tax credit? Are there any alternative measures that could prevent abuse of the payable tax credit.

There is a concern that R&D claims may receive only ‘light touch’ checking. This could encourage organisations who prepare R&D claims on fixed percentages, or any other simplified arbitrary basis, rather than examining specific costs. Enhanced review would help identify spurious claims.

Conclusion

This consultation ended on 24 May 2019. We will run an article on any changes resulting from it in due course.

WHAT HAPPENS WHEN A PENSION FUND BREACHES THE LIFETIME ALLOWANCE ?

You may be aware of the £40,000 annual allowance, which is tapered down to £10,000 where an individual’s income exceeds £150,000 in a year. What is less understood, however, is the effect of the lifetime allowance whereby:

- A tax charge of 55% can be levied following the payment of a relevant lump sum or relevant lump sum death benefit, or
- A tax charge of 25% can be levied for any part of the chargeable amount not derived from a lump sum payment.

What follows is not intended as investment advice. Such advice can only be given by a pensions adviser qualified to give advice. Instead, the intention of this article is to give the you an understanding of what happens, on some occasions, where a change can arise when an individual is in the fortunate position of having pension funds at or above the £1.055 million level of the lifetime allowance.

A lifetime allowance charge occurs where there is benefit crystalisation event (“BCE”) and the “amount tested” exceeds the individuals remaining lifetime allowance.

There are thirteen different BCEs but the main occasions on which this will need to be done for most individuals will be:

- When they put some, or all, of their pension into payment or draw tax free cash.
- On reaching age 75.
- On death, before age 75.

The lifetime allowance is currently £1,055,000. For many people, the lifetime allowance will not be an issue as the value of their pension funds will be nowhere near this level. For others, where the value of their pension funds is approaching, or exceeds the lifetime allowance, the question arises as to whether they should cease making contributions. In simple terms some may make the decision based on perhaps achieving 41% income tax relief (in Scotland) on a contribution but potentially suffering a 55% charge on part of their tax free lump sum and, (if by then a 21% tax payer), a 46% charge on part of their pension income.

A number of other factors should be borne in mind:

1. The value of the individual's pension fund may reduce or not keep up with increases in the lifetime allowance.

2. The law may change in the future. Much has changed since the 2006 pension simplification.

3. It is only the part of the fund above the lifetime allowance which is subject to the charge.

4. Even if an individual's pension fund is around or above the lifetime allowance, it is possible to continue contributing. There are inheritance tax advantages in having funds in a pension rather than for example ISAs.

Turning back to the title of this article, unless there is a BCE nothing happens just because the value of an individual's pension fund exceeds the lifetime allowance. Therefore, for example, if, as a result of ongoing contributions and fund growth, the pension fund of an individual age 60, and who is still working, rises to £1.2 million, then nothing happens in the sense that no tax has to be paid at this time.

The main occasions where a BCE may occur are:

1. If the individual decides to draw say £150,000 of his maximum tax free cash (25% of the LTA), and draws income from £450,000 of his remaining crystalised fund then the amounts utilised in doing this would be tested against the lifetime allowance. The amounts are below the lifetime allowance and there will be no lifetime allowance charge. A similar test would be carried out on each subsequent BCE, when the individual draws more tax free cash or puts further pension into payment. There is, however, only a lifetime allowance charge once the remaining part of the lifetime allowance has been utilised. £455,000 of the LTA remains of which £113,750, can be taken as tax free cash. Any lump sum in excess of this is taxed at 55% and, if taken as income is taxed at 25% plus the individual's marginal rate which can be as high as 46% in Scotland.

2. If the individual reaches age 75 and has either not crystalised any of his pension fund at all, or has only crystalised part of it, then the uncrystalised part is tested against the remaining lifetime allowance. If there is not enough lifetime allowance left then a charge of 25% is made on the excess. The 55% charge does not apply at age 75.

   It is not necessary to put the remaining funds into payment, despite having suffered the 25% charge.

3. If the individual dies before age 75, without having drawn any pension benefits, then the amount of his pension fund is tested against the allowance at date of death. Note that there is no BCE where the individual dies after age 75.

   If the pension benefits are taken by his beneficiaries entirely as a lump sum then a 55% charge will be payable on the excess of the fund value over the lifetime allowance.

   If a pension is taken by his beneficiaries, as an annuity or drawdown then a 25% lifetime allowance charge will apply on the excess over the LTA. This is in addition to income tax at the marginal rate payable by the recipient of the pension.

It could also be worth reviewing pension contracts to ensure that they provide the facility to nominate drawdown for beneficiaries as not all of them do. The impact of this is that if the individual dies over age 75 and there is no option for drawdown, then the lump sum is the only option which is taxable at 25% plus the marginal Income Tax rate of the beneficiary. However, this is less a lifetime allowance issue and more about the importance of reviewing the pension beneficiary.

IAASB CALL FOR COMMENTS – APPLYING ISAs IN AUDITS OF LESS COMPLEX ENTITIES

The International Auditing and Assurance Standards Board (IAASB) has published a Discussion Paper, Audits of Less Complex Entities: Exploring Possible Options to Address the Challenges in Applying the International Standards on Auditing (ISAs). The consultation will remain open until **September 12, 2019**.

The IAASB seeks to further understand the challenges of using ISAs in audits of less complex entities and to help them identify possible actions to address these challenges.
In many of the recent consultation responses, ICAS, along with other global accounting bodies, has been calling for a change in approach to address issues of complexity,

length, understandability, scalability, and proportionality related to using the ISAs. There is a sense that many of the revised ISAs are focused on the most complex of audits and therefore have become increasingly irrelevant and onerous for smaller audits.

Following this feedback, and to a large extent, prompted by a move from the Nordic Federation to develop their own Standard for Audits of Small Entities (SASE), the IAASB has issued a Discussion Paper to explore how they, and others, could further support auditors working in the smaller and less complex entity environments.

The IAASB is seeking input from all interested stakeholders to help them develop an appropriate solution. They are particularly keen to reach out to the smaller practices to understand the key obstacles and issues they face when applying the ISAs to smaller and less complex entities.

In addition to a request for responses to the formal discussion paper, the IAASB are currently considering a range of outreach activities including webinars and surveys. Round table meetings with some of the smaller firms have also been suggested.

ICAS will be promoting these outreach activities once the details are available and are keen to hear from any practitioners who would be interested in participating.

ACCOUNTING AND AUDITINT QUERY – DUE DILIGENCE COSTS

Query

Our organisation has incurred circa £300k in due diligence costs as result of recent acquisition. What would be the normal accounting treatment for such costs? Are they treated as part of the Cost of Investment (and consolidation part of the Goodwill calculation) or are they capitalised and amortised through the profit and loss account?

We are applying full FRS 102.

Response

For the purposes of this response, we assume that you are applying the purchase and not the merger method of acquisition.

Expenses included in the cost of acquisition should be limited to those incurred directly in making the acquisition. They may include incremental costs such as professional fees paid to investment banks, accountants, legal advisors, valuers and other consultants. The general principle is that the costs should be direct and incremental to the business combination and hence would not have been incurred if the combination had not occurred.

The cost of a due diligence report prepared by an external party on the acquiree can be capitalised as part of the cost of the combination. This will be acceptable even where the report relates to a management buy-out (MBO) provided that a new entity is formed to hold the shares of the existing business.

The steps to be followed when applying the purchase method of acquisition are as follows:

The purchase method in stages

FRS 102, paragraph 19.7 set out the following steps for applying the purchase method of acquisition:

- step 1 - identify the acquirer
- step 2 - determine the date of acquisition
- step 3 - measure the cost of the acquisition
- step 4 - allocate cost of the acquisition to identified assets, liabilities and contingent liabilities acquired
- step 5 - recognise and measure any non-controlling interest in the acquiree
- step 6 - account for any residual balance of goodwill or negative goodwill.

As far as the treatment of any residual goodwill is concerned, the acquirer shall, at the acquisition date:

(a) recognise goodwill acquired in a business combination as an asset; and

(b) initially measure that goodwill at its cost, being the excess of the cost of the business combination over the acquirer’s interest in the net amount of the identifiable assets, liabilities and contingent liabilities recognised and measured in accordance with paragraphs 19.15 to 19.15C of FRS 102.

After initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less accumulated amortisation and accumulated impairment losses:

(a) An entity shall follow the principles in paragraphs 18.19 to 18.24 of FRS 102 for amortisation of goodwill. Goodwill shall be considered to have a finite useful life, and

shall be amortised on a systematic basis over its life. If, in exceptional cases, an entity is unable to make a reliable estimate of the useful life of goodwill, the life shall not exceed 10 years.

(b) An entity shall follow Section 27, Impairment of Assets for recognising and measuring the impairment of goodwill.

If the acquirer's interest in the net amount of the identifiable assets, liabilities and provisions for contingent liabilities recognised in accordance with paragraph 19.14 exceeds the cost of the business combination (also referred to as 'negative goodwill'), the acquirer shall:

(a) Reassess the identification and measurement of the acquiree's assets, liabilities and provisions for contingent liabilities and the measurement of the cost of the combination.

(b) Recognise and separately disclose the resulting excess on the face of the statement of financial position on the acquisition date, immediately below goodwill, and followed by a subtotal of the net amount of goodwill and the excess.

(c) Recognise subsequently the excess up to the fair value of non-monetary assets acquired in profit or loss in the periods in which the non-monetary assets are recovered. Any excess exceeding the fair value of non-monetary assets acquired shall be recognised in profit or loss in the periods expected to be benefited.

FRC CONFIRMS AMENDMENTS TO FRS 102 ON ACCOUNTING FOR MULTI-EMPLOYER DEFINED BENEFIT PENSION SCHEMES

The Financial Reporting Council (FRC) has published amendments to FRS 102. These set out how employers participating in multi-employer defined benefit (DB) schemes should account for a change from defined contribution (DC) accounting to DB accounting, when sufficient information to recognise a net DB pension liability (or asset) becomes available for the first time. The amendments do not impact on accounting for DB schemes where an entity already recognises a net DB pension liability (or asset).

The amendments to FRS 102 are consistent with the proposals set out in Financial Reporting Exposure Draft (FRED) 71 and are effective for accounting periods beginning on or after 1 January 2020, with early application permitted. These amendments require any adjustments needed to account for a change from DC to DB accounting to be made in year with no restatement of comparatives.

Prior to this amendment, FRS 102 did not specifically deal with accounting for a change from DC to DB accounting. However, demand for clarification of the treatment arose from a development in the social housing sector.

Registered social housing providers participating in the Social Housing Pension Scheme (SHPS) or the Scottish Housing Associations' Pension Scheme (SHAPS) will have sufficient information to apply DB accounting for the first time for the preparation of accounts for periods ending on 31 March 2019.

The four UK Housing Federations jointly published technical accounting guidance in anticipation of the FRED 71 proposals being taken forward as amendments to FRS 102. This guidance accompanies but does not form part of the Statement of Recommended Practice (SORP) for social housing providers.

An impact assessment and feedback statement from the FRC accompanies the final amendments. ICAS responded to the proposed changes and while we are of the view that a change from DC to DB accounting meets the criteria for treatment as a change in accounting policy, we acknowledge that a consistent approach is desirable to address the immediate concerns of the social housing sector.

Wider application

These amendments are more widely applicable than the social housing sector and apply to any employer participating in a multi-employer DB scheme changing from DC to DB accounting, for example, charities, including charitable companies, applying the Charities SORP and further education colleges and universities applying the Education SORP: Accounting for further and higher education.

While there are no similar charity sector or education sector-wide developments in the offing, each entity in these sectors needs to consider its own particular circumstances.

The amendments

The amendments, made to Section 28 of FRS 102 on Employee Benefits, are summarised below. FRS 102 refers to pension schemes as post-employment benefit plans.

When an entity participates in a defined benefit plan, which is a multi-employer plan that is accounted for as if the plan were a defined contribution plan, and sufficient information to use defined benefit accounting becomes available, the entity shall:

- Apply defined benefit accounting from the relevant date; and
- Recognise the difference between:

  (i) its net defined benefit liability at the relevant date; and
  (ii) the carrying value at the relevant date of its liability for the contributions payable arising from an agreement to fund a deficit, if any, as a separate item in other comprehensive income.

The relevant date is the later of the first day for which sufficient information to use defined benefit accounting becomes available, and the first day of the current reporting period. Comparative information is not to be restated.

The calculation of the difference excludes the impact of any plan changes, curtailments or settlements occurring at the relevant date.

There is a consequential amendment to Section 1 of FRS 102 on Scope. If an entity applies this amendment to an accounting period beginning before 1 January 2020 it shall disclose that fact, unless it applies Section 1A of FRS 102, in which case it is encouraged to disclose that fact.

Social housing sector guidance

The social housing sector technical accounting guidance was published in March 2019 and it covers the following keys aspects of accounting for a change from DC to DB accounting.

- The anticipated changes to FRS 102.
- When the DB accounting information will be available – May 2019.
- A worked example, including key judgements and considerations, accompanying accounting entries and disclosures.

The guidance also includes commentary on Guaranteed Minimum Pensions (GMP) equalisation following the High Court ruling, on 26 October 2018, in the Lloyds Banking Group case.

Early adoption

The Scottish Charities Accounts and Reports (Scotland) Regulations 2006 (as amended) (the 2006 regulations) have, in recent years, impacted on the ability of charities to early adopt amendments to FRS 102.

Further education colleges and universities have charitable status and some, but not all, social housing providers have charitable status. In Scotland, such charities are known collectively as 'special case' charities. Special case charities must apply the 2006 regulations in addition to the sector specific SORPs referred to above.

Scottish charities, including, it appears, special case charities, are specifically prohibited by the Charities Accounts and Reports (Scotland) Regulations 2006 (as amended) from adopting early the changes to FRS 102 arising from the first triennial review conducted by the FRC. This suite of amendments applies to accounting periods beginning on or after 1 January 2019.

However, at the time of writing no changes have been made to the 2006 regulations prohibiting the early adoption of the amendments to FRS 102 arising from FRED 71.

Scottish charities, including special case charities, seeking to adopt these amendments early should consult their accountancy advisers. It is worth noting that FRS 102 is currently silent on how a change from DC to DB must be accounted for, therefore, it would not make sense for a Scottish charity accounting for such a change in an accounting period beginning before 1 January 2020 to adopt a different approach.

The law and regulations which form part of the accounting frameworks which apply to charities in England and Wales, including further education colleges, universities and social housing providers, do not prohibit the early adoption of amendments to FRS 102. However, cross-border charities, i.e. charities primarily based in England or Wales but registered as charities in Scotland with the Office of the Scottish Charity Regulator (OSCR), should similarly consult their accountancy advisers regarding the early adoption of changes to FRS 102.

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Jeanette Rorison, Practice administrator, ICAS

0131 347 0249

practicesupport@icas.com

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CA House 21 Haymarket Yards Edinburgh EH12 5BH

practicesupport@icas.com +44 (0)131 347 0249 icas.com