TECHNICAL BULLETIN

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MTD ITSA - WHAT TO DO NOW

Back to the beginning

Starting life as Making Tax Easier in 2015, MTD ITSA has been on the agenda for a long while. It was due to come in before MTD for VAT but was pulled at the last minute. So where are we now?

A new timetable

The latest update and delay to the MTD for ITSA timetable is very welcome. It follows representations to the Financial Secretary to the Treasury by ICAS and other Professional Bodies.

In August ICAS was a joint signatory, along with CIOT, ATT and ICAEW to a letter raising concerns over the timescale and resourcing for MTD ITSA and Basis Period Reform. The new Financial Secretary to the Treasury recent replied to the letter and the concerns were mentioned in the ministerial written statement on 23rd September.

The new timescale sees Making Tax Digital for Income Tax Self-Assessment delayed until 6 April 2024 for trading and property income for sole trader businesses. General partnerships are now scheduled to join from April 2025, with more complex partnerships due to join at a later, as yet unannounced, date.

The outcome of the consultation on Basis Period Reform has not been confirmed. It is likely to feature in the Budget. But it has been announced that any changes will not come into effect before April 2024, with the transition year not earlier than 2023/24 tax year.

The timeframe for extension of MTD for VAT is unaffected, with all VAT registered businesses joining from April 2022, unless qualifying for an exemption. The new points-based penalty system will apply to MTD for VAT from this date too.

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Legislative basis and key changes

Alongside the announcement on 23 September, The Income Tax (Digital Requirements) Regulations 2021 were published. These come into force on 6 April 2024 and need to be read alongside Schedule A1 of the Taxes Management Act 1970.

Key new developments are that MTD ITSA quarterly reporting will now be to standard quarter ends to match the tax year. There will be an associated election for businesses to report to calendar quarter ends (30 June / 30 September / 31 December / 31 March) rather than to the 5th of the month (5 July/ 5 October/ 5 January / 5 April).

It is also confirmed that MTD ITSA will start on 6 April 2024 for all mandated businesses. It will not follow the pattern of MTD for VAT where business entered in staggers depending on their accounting year end. Everyone will need to submit their first quarterly update within one month of the end of quarter one, so by 5 August 2024. This fifth of the month deadline apples even where calendar month ends are used, so effectively giving an extra 5 days in which to file.

Basis Period Reform would, logically, precede quarterly reporting under MTD ITSA. Otherwise calculating tax bills will be exceedingly complex for many represented taxpayers. An announcement is expected on or by Budget Day. Legislation for this would be expected in the next Finance Act.

The HMRC Developer Hub is a useful source of reference.

But this isn't the end of the story. There is software to consider. And the ITSA pilot.

Software and the ITSA Pilot

At the time of writing, there are just seven software firms listed as having software compatible with MTD ITSA. Many of the software firms used by accounting firms aren't on the list yet. No doubt the key players will get there in due course.

So, for many firms, even apart from the exclusions list - such as businesses who claimed coronavirus support under SEISS or CJRS during 2021/22, those with multiple businesses, those with tax debts - signing clients up right away isn't an option.

It is still worth looking at the published guidelines for the ITSA pilot, and the information on Signing clients up for MTD ITSA. Solutions are changing all the time, and it is likely that it may be possible to sign clients up in advance. But it is unlikely that a bulk sign-up solution will be available.

What to do now

While some of the detail is still unclear, the direction of travel is pretty much assured.

By 6 April 2024, unincorporated businesses with trading turnover or property income of over £10,000, subject to minimal exceptions, will need to submit quarterly returns of income and expenses.

They will need to keep digital records and seamlessly make submissions without manual intervention. In due course, it is very likely that they will also need to make quarterly payments of income tax.

Are your clients ready? As a very first step, is their record keeping a completely digital journey, and how do they intend to make quarterly submissions? Will they need your help?

Basis Period Reform

The other key question relates to Basis Period Reform. If this goes ahead, having a year-end other than 31 March or 5 April will mean additional administration for tax on an ongoing basis. On the revised timetable this would not be before 2024/25.

At the very least, this additional work will involve apportionment of accounts to match the tax year for the End of Period Statement.

What will this mean for you? Will clients shift to 31 March year ends? What could the impact be for workflow? Contingency planning is needed here.

If change comes, 2023/24 is now expected to be a transitional year. Tax year basis assessment would replace current year basis of assessment. Clients with non-31 March or 5 April year ends are likely to be hit with additional tax bills.

The other side of the coin is that overlap relief would disappear on 5 April 2024, so changing a businesses' accounting date from 6 April 2023 onwards comes with fewer tax complications.

Even if the main Basis Period Reform is delayed, there is a separate consideration of reporting under MTD ITSA to standard quarters. So, 31 March is still looking like a good choice of year end for MTD ITSA. The consequences for workflow management need to be assessed.

Conclusion

MTD ITSA has been under discussion for a long while and we are entering a period where critical decisions are being made. Greater clarity should come over the next few months, but it is unlikely that every 'i' will be dotted, and every 't' crossed until much nearer the go-live date.

At the moment, it is time to make sure that businesses and professional firms assess likely outcomes and take the basic planning steps to be as ready as possible when change comes. ICAS tax and practice staff will continue to liaise with HMRC about the implementation of MTD for ITSA and the associated measures – please let us know if there are points of concern, or suggestions to make this work better, and we will continue to raise members' representations at the appropriate level.

SEISS UPDATE

With the claims window for SEISS 5 closing on 30 September, what do we still need to look out for?

SEISS 5 turnover test

SEISS 5 was arguably the most challenging for claimants, with the level of the grant depending on a comparison of turnover between the pandemic year and the reference year.

One significant question is, has the client reported turnover correctly?

SEISS 5 has a twist - not only are there two levels of grant, but also the claimant has to put in turnover figures and may need to calculate these. This is unlike the previous grants where HMRC did all the number crunching.

The application and processing of SEISS 5 seems to have run fairly smoothly, but this is no guarantee that clients have used the correct figures. This is an issue which could be picked up on by later HMRC compliance, so it may be as well to check now, especially as it could affect the level of grant at 80% of three months average historic profits or at 20%.

HMRC has issued some detailed guidance on how to calculate turnover. It is worth noting one particular issue - that while most of HMRC's guidance has been accurate, unfortunately during most of the claims' window, an HMRC YouTube video (now corrected), was saying 'use the figure from your 2020/21 tax return'. But this is only true if the claimant has 31 March or 5 April year end – a significant factor which was not initially highlighted.

If clients have made errors due to watching the YouTube video, it would be worth noting the impact and consider raising this as a reasonable excuse.

To clarify the rules - in summary, for SEISS 5, the pandemic year turnover is always the 12 months to 31 March 2021 or 5 April 2021, whatever the usual accounting date. So it will need a bespoke calculation where the normal accounting date does not fall within the period 31 March to 5 April 2021. Where a business uses accruals accounting under GAAP, then the turnover should be calculated using GAAP. Where a business has elected to use cash basis rules for income tax, then turnover should be on a cash basis.

Can you get a second bite of cherry?

Some clients may have put the wrong figures into the HMRC and received an unexpected answer. For example, if a client accidentally put in profit rather than turnover by mistake. For clear errors like this, it is advisable to contact HMRC and ask for a review. The claim can be reinstated or corrected.

HMRC is wary of people trying to fix the figures to get a higher grant, so normally once the claims process has been followed, that's it, and changes to the figures entered can't be made later.

How will HMRC compliance land?

HMRC will check tax return turnover to SEISS grant turnover for 2020/21; but it is unclear how this will work for those not using a 31 March or 5 April accounting reference date.

For example, how would HMRC spot the error if client with a 31 December year end put the 31 December 2020 turnover on the SEISS claim as the pandemic year? In such a case, the SEISS claim should have turnover for the 12 months to 31 March 2021.

But it is currently unclear if HMRC systems will be able to identify both the accounting year end on the tax return and the related turnover. If the compliance comparison is simply between turnover reported in the 2020/21 tax return and the SEISS 5 claim, then on HMRC's systems the figures would match. But, in the case of 31 December year ends as outlined above, the apparent match, would actually conceal an error.

Mismatches between 31 March 2021 or 5 April 2021 year end turnover should be more easily flagged.

Reference year issues:

For partnerships, there was a last-minute change to the regulations. It only affects those moving from sole trader to partnership status between reference year and pandemic year.

Normally the options are: use a partner's share of turnover based on the profit-sharing ratio, where the individual is also trading as a sole trader, or as a partner in another partnership; or use the turnover of entire partnership, where this is their only trade. The amendment to the regulations covers the situation where someone is a sole trader in one year, but a partner in the other year. It this case, it is now the profit-sharing ratio of turnover for the partnership which is used.

Auto correction of tax returns and backlog for early filers

Earlier in the year, HMRC spotted a mismatch between the figures it had on file for SEISS 1-3 paid out and amounts entered on many early-filed tax returns for 2020-21.

This was unexpected and created a processing backlog for both online and paper returns. HMRC has been working through this backlog and auto-correcting the tax returns by putting in the figure HMRC has for SEISS into the tax return box in which HMRC expected SEISS to be shown.

It has taken some time to clear the backlog. This has been causing issues where lending institutions want an SA320 tax calculation to support a mortgage application. Returns submitted since about the start of June are being processed and auto-corrected on receipt, so paradoxically, may be cleared sooner than some early filers.

Apart from the mortgage application issue, there is an additional point to watch - is HMRC's correction correct? If it isn't, then the client could pay double the tax on SEISS claimed.

HMRC will send out an SA302 tax calculation to the client when it corrects a tax return, but will the agent know?

HMRC's correction may not be correct if the SEISS grant has been entered in a different box on the tax return from the one HMRC expects, or if SEISS was included in business turnover.

As agents were not directly involved in the claims process, the possibility of client error is multiplied.

HMRC's view on where to include SEISS can be found on the check-if-you-need-to-change-your-self-assessment-return-for-seiss page.

Examples

1) A client included SEISS in turnover and did not alert their accountant that they had claimed SEISS. HMRC's correction will mean the client paying tax twice on the SEISS, once as part of turnover, and once as a standalone charge on SEISS. The solution is to amend the tax return to take SEISS out of turnover.

2) Client provided an incorrect figure for SEISS, but the SEISS was shown in the correct box on the tax return. This includes the possibility (which has happened in some cases) of a SEISS clamant putting SEISS 4 on the 2020/21 return (it should go on 2021/22 return). HMRC's correction may be correct in such cases. But it would be sensible to double check the reason for the mismatch.

One known error, now corrected, was that the HMRC API released some SEISS data to tax filing software with the decimal point in the wrong place. Examples include a £15,000 claim becoming a £1.5 million claim. Hopefully errors of this magnitude will be obvious, but there is a possibility that some very small claims might escape the radar.

Compliance areas going forward

HMRC compliance on SEISS will only increase over the next two years as tax returns are filed. One area to watch is 'ceased traders' cases. Watch for clients who ceased trading, or where no tax return is submitted for a year in which SEISS was claimed. For example, for SEISS 5 the business must trade in 2019/20 and 2020/21, and so HMRC would expect a return to be filed from both years, showing trading income.

There have been cases where HMRC has challenged incorrectly, for example where one trade has ceased, but another started in the same tax year, or if there are multiple trades in a tax year and at least one has continued.

Note also that the conditions have changed across SEISS 1-5. For example, SEISS 5 requires a fall in turnover (SEISS 5) and that the claimant reasonably believes there will be a significant reduction in trading profits due to the impact of Covid-19. This is more stringent that the 'adversely affected' condition, for example, applying to SEISS 1. Archived guidance can be used to check requirements in detail for each phase. This is not about applying hindsight: but rather, was it reasonable at the point of claim?

TAXATION OF SEISS – POTENTIAL FOR AN INCREASED TAX CHARGE

The special rules for taxation of SEISS grants can bring additional tax bills. It can become a case of Government giving with one hand and taking back with the other. How does this arise and what can be done about it?

Background

Schedule 16 FA 2020 para 3 (3) Finance Act 2020 requires SEISS grants 1-3 to be taxed in the tax year 2020-21, irrespective of accounting treatment. This can result in a mismatch for businesses which do not have a 31 March or 5 April accounting year end. Trading profits for a year unaffected by coronavirus can, under the statutory rules, be matched with SEISS grants relating to a different (later) period. The situation may be particularly significant where the accounting year ends early in 2020-21, such as the year to 30 April 2020.

This may result in the tax payable being more than expected, as SEISS pushes total taxable income above customary levels and into a higher tax band. A taxpayer who is normally basic rate, or Scottish intermediate rate, could find that adding SEISS grants on top of their normal level of pre-covid trading profits means that they become a higher rate taxpayer for 2020-21.

Why has this happened and what has been done about it?

ICAS and other professional bodies have raised this issue with HMRC from the start. But the sticking point seems to be that taxing SEISS on a receipts basis simplifies compliance. It means that the amount shown on the tax return as SEISS income in 2020-21 should match HMRC's records exactly for the amount recorded by HMRC as paid out.

One 'remedy' which has been suggested is a change in accounting date. It is possible that by extending the accounting period, some of the later, lower, pandemic-affected trading results would be included in the calculation of assessable profit. However, the outcome is somewhat uncertain. It would depend on the specific circumstances, including any overlap relief which might be available. There are also wider considerations here. The incidence of higher tax rates could also affect decisions around loss relief claims.

Partnership treatment

It is also anomalous that the rules for partnerships differ. The treatment of SEISS received and retained in full by an individual partner mirrors that for sole traders. But where SEISS grants claimed by a partner are 'distributed amongst the partners', the tax treatment changes. In this latter scenario, per schedule 16 FA 2020 para 3 (4), SEISS is taxed according to the partnership basis period. This approach is outlined on page 1 of the SA 850 partnership return notes, though, unfortunately, HMRC guidance does not mirror the exact wording of the legislation. The guidance uses the phrase any partner 'was required by the partners to account' for SEISS to the partnership.

In this particular partnership scenario, the issue of 'doubling up' does not arise as SEISS will be taxed in the accounting basis period of receipt and included as part of the partnership trading profit.

Conclusion

In summary, it is worth alerting clients to the possibility that, in the circumstances outlined, SEISS grants could push them into a higher tax bracket in 2020/21. There is no simple remedy. It will be necessary to consider each case on its own in terms of options available.

R&D CLAIMS - WHAT GOES ON THE CT600 – IT'S UP TO YOU

Search the web for "R&D claims" and you will find a range of businesses which claim to be able to prepare R&D claims. This is unsurprising given the amount of money potentially claimable under the Research and Development expenditure credit (RDEC) and the SME Research and Development tax relief for small and medium-sized enterprises schemes.

But what if your client has been approached by a firm claiming to do R&D and you are expected to include a claim prepared by them on the CT600? How far should you stray into R&D advice, and what responsibility have you to check figures supplied by a third party?

Staying within competencies

Law firms, who are used to contentious litigation came up with the adage 'if you don't do it, don't do it'. You are asking for trouble once you step outside the work you feel confident doing. Don't be persuaded to 'do it just this once'. All too often it will unravel.

Professional competence and due care are fundamental principles of Professional Conduct in Relation to Taxation (PCRT), and all members of the seven professional bodies (AAT, ACCA, ATT, CIOT, ICAS, ICAEW, and STEP) who drew up PRCT should adhere to it.

This means that unless you are a specialist R&D adviser, you would not normally be undertaking work on preparing R&D claims, but you could, willingly or otherwise, be involved in other ways.

For example, you might be asked to supply figures to someone else who is preparing an R&D claim, or you might be asked to include an R&D claim on a CT 600 Corporation tax return, where the figures have been prepared by someone else. What are your responsibilities here?

Responsibility for tax return data

Where an agent has not been directly involved in preparing an R&D claim, they will need to consider PCRT if they include the R&D claim on a tax submission. There is also a responsibility where you know that the figures you supply will be used as the basis for a tax submission by someone else.

In line with PCRT, agents should take care that items included on the return are not misleading, and that they are not associated with any submission to HMRC which they consider unreliable.

The agent's duty in terms of tax submissions, are covered in the PCRT help sheet Submission of tax information.

This guidance includes a number of helpful points, including (at paras 13 and 14) the comments that:

13 …. 'a member should take care not to be associated with the presentation of facts they know or believe to be incorrect or misleading, not to assert tax positions in a tax filing which they consider to have no sustainable basis.

14. When a member is communicating with HMRC, they should consider whether they need to make it clear to what extent they are relying on information which has been supplied by the client or a third party.

While the help sheets, unlike the fundamental principles, are not mandatory, they do provide evidence of best practice.

This means that you will want some assurance that the R&D claim included on a return you submit has been prepared by a reputable firm and to an acceptable standard. If you are unable to obtain such assurance, you make need to take additional steps.

This might include discussing with your client your misgivings about the R&D claim. In this context it is worth noting that HMRC compliance activity has tended to focus on high value claims. It is not an uncommon scenario to find that a company makes an initial low value R&D claim, based on incomplete or inaccurate information, which is unchallenged, only to find, three years later when a subsequent much larger claim is challenged, that much or all of the R&D previously claimed is repayable.

Hence the rationale that 'X claimed and received a refund, so why shouldn't I?' needs to be seen in the context that receipt of a refund is no proof that the claim is accurate. The challenge may come years later.

Discussion with the client is likely to result in two types of cases: ones where client and agent are now in agreement; or ones where they disagree.

The PCRT Dealing with errors help sheet outlines appropriate responses where there is disagreement, including AML issues. Claiming R&D relief where there is no reasonable basis for the claim could be reportable under the AML rules.

ICAS is not able to direct how members in practice should act in such cases, it is up to the professional judgement of each member, with knowledge of the client and the full circumstances, to make a balanced decision. However, it will support a firm's position if they have considered the appropriate PCRT guidance and there is an appropriate audit trail.

Unregulated firms in the R&D market

ICAS and the other professional bodies have concerns about largely unregulated advisers within the R&D market. These concerns have been raised with HMRC and there is ongoing dialogue. HMRC's initial response has been to look at mandatory Professional Indemnity Insurance for anyone providing 'tax advice'.

While it is encouraging that HMRC is willing to consider action, it seems unlikely that PII alone would bring sufficient regulation to the market.

Special guidance PCRT and R&D

In view of the potential complexity around R&D submissions, a separate 'topical guidance' sheet has been prepared to complement PCRT (Topical Guidance covering the application of professional standards to the provision of R&D tax credit services).

This guidance is laid out as twelve FAQs covering issues such as: does PCRT apply to R&D claims? Can all accountancy and tax adviser firms provide R&D tax advice? Does AML apply to R&D? Is PCRT guidance applicable to a specialist contributing directly or indirectly to a tax submission? If we use a specialist to prepare R&D claims for our clients but we submit the return, can we just accept the claim provided by the specialist?

The FAQs are aimed at members of the PCRT bodies, but it also offers a guide should members' clients ask about what should and shouldn't be claimed.

Conclusion

In conclusion, if your firm submits a CT 600, it's your responsibility to ensure that no entries are misleading. PCRT and associated guidance can help you decide on the appropriate actions to achieve this and support your discussions with clients and other firms on the topic.

NO DISCOVERY WHERE TAXPAYER WASN'T CARELESS

In the first tier tribunal decision in Loughrey (2021) TC 08198, the taxpayer's appeal against 2013/14 discovery assessments succeeded.

Mr Loughrey had been made redundant and, in completing his tax return for the year to 5 April 2014, he used figures from his P45 and his redundancy agreement. He also referred to HMRC's online guidance in preparing his return.

In line with many large employers, Mr Loughrey's did not issued paper payslips each month but instead, they were provided electronically. He could not access these payslips after he had been made redundant.

The point at issue, and in respect of which HMRC raised discovery assessments was that, in effect, Mr Loughrey had obtained the benefit of the £30,000 termination payment exemption twice. This was not in dispute, but the appeal concerned whether HMRC had met the conditions necessary to raise discovery assessments under section 29 TMA 1970.

The tribunal found that the taxpayer had taken reasonable care when completing his return and, in particular:

- He had followed HMRC's online guidance, and the instructions given in the "help function" on their tax return system.
- The fact that Mr Loughrey was not able to look at his payslips would not have altered anything, and he would have prepared his return in the manner which he had, in any event.
- He had no requirement to seek advice from either the HMRC helpline or a tax practitioner.

The tribunal therefore held that the requirements of section 29(4) TMA 1970 were not satisfied and that underpayment arose through the taxpayer acting carelessly.

Mr Loughrey's tax return included UK employment income. The tribunal held that the error in his return would have been obvious to the hypothetical Inspector, as HMRC had all of the Real Time Information on which Mr Loughrey's return was based.

Some may say that the taxpayer "got away with one", as it was clear that there was a 2013/14 underpayment of income tax as a result of double the amount of termination payment exemptions being given. However, the purpose of time limits is to enable taxpayers who have not been careless, negligent, nor fraudulent to have finality in their affairs while, at the same time, allowing HMRC time to review and if necessary, amend their self-assessment within these statutory time limits.

4 WAYS TO TRANSFORM YOUR FIRM'S HIGH-LEVEL IT STRATEGY

Every business needs an accountant, so the role of the accountant is safe...? Well, that may depend on what the client is looking for, and what the accountant can bring to the table.

With firms in the midst of planning for new hybrid ways of working, now's a great time to look at the overall business strategy of your organisation, and not just from a logistical perspective. Your clients' businesses are changing too, and so are their needs from their trusted advisors.

In this month's article, we'll share insights from our research and our own experience to give you four key areas to consider when reviewing the high-level strategy of your own organisation.

Survey your clients

You may think you know your clients really well, but when was the last time you put the ball in their court and asked them what they are really looking for from you, as their accountant? Conducting market research by surveying both existing and prospective clients provides great insight into what business owners' pain points really are. The results give you confidence that your high-level strategy focuses on offering services that support the needs of businesses during these challenging times.

The goal of your research is to understand your clients in all dimensions: rationally, emotionally, economically, socially, culturally, and more. It gives you the opportunity to walk in your clients' shoes and gain a holistic understanding of your clients as people. In turn, the solutions you offer will perfectly fit their needs, which is a win-win situation for both you and your clients, building that strong foundation to empower both your own and their businesses to go from strength to strength.

Add Value

Now you have insight from a client perspective, you'll be able to provide a more personalised, tailored approach to all your client relationships. It's been a tough few years for a lot of businesses, which has resulted in them scrutinising their outgoings and shopping around for better deals. From our research, we know that clients expect more added value than ever before, so being an accountant who only interacts with their client on an annual basis to look at historic records, isn't likely to cut it in this new competitive era.

The strategy for your firm should be centred around how best to help clients in their own business, by being visible to them, supporting them to become more efficient, and giving them great service. You must remain relevant to your clients by offering added value services such as a virtual finance function, a part-time finance director, and training in areas such as cloud bookkeeping and automation, along with any other ways you can support their businesses that you gleaned from your surveys.

You may need to recruit, or your existing team may need to upskill, to fulfil these roles. However, this is an opportunity to grow your revenue and build long-lasting client relationships as their trusted advisor.

Embrace Digital Transformation

To fully adopt your new operating model, you also have to welcome technology into the mix. We know from our research that if you don't automate, you risk clients moving to other firms who are more invested in technology. Younger clients can run their businesses only on apps, so if you don't have systems to deal with that, you will be left behind.

With more organisations moving to 'Making Tax Digital', never have there been more television adverts for cloud bookkeeping, resulting in clients being influenced to choose a solution by the media, rather than by their accountant. We see emerging digital-first firms choosing a cloud-based software stack and sticking to it. They become specialists in integrated cloud programs, which means they can deliver an efficient solution to their clients. Becoming certified in these packages is also a great way for firms to generate new business on these software vendors' 'Find an accountant' web searches, with the most highly trained at the top of the search list, examples being:

Xero: Look for an Accountant or Bookkeeper

QuickBooks: Find an Accountant or Bookkeeper near you

Sage: Find an Accountant, Bookkeeper or Accountant Partner near you

FreeAgent: Find an Accountant in the UK

Another great strategy is to attend events you know your potential clients attend, such as webinars or workshops run by cloud software vendors. This will keep you abreast of new developments in the technology sector as well as giving you the chance to make new connections.

Automation and artificial intelligence are some of the biggest digital transformations to ever emerge in the accounting sector. Invest in choosing your solutions wisely, learn how to use them and share your learnings with your clients. Your firm will become the authority on your chosen software stack, which will allow you to increase your client base without having to increase staff resourcing.

This change to cloud has other great advantages such as being able to have live access to your clients' bookkeeping, so you can help them on a day-to-day basis, rather than working on historic data. This gives you access to query real-time data and support your clients to make much more relevant and rational decisions. And don't forget the practical benefits of not having to send data backup files back and forth!

It's clear with remote working that if you don't embrace new technology, you will be left behind.

Think Global, Act Small

With the recent advances in communication platforms, the world now seems an even smaller place than ever before…without leaving your home! When discussing the strategic direction of your firm, think globally to open up new opportunities for your firm, such as being able to engage with clients on the other side of the world, and being able to employ staff from anywhere. On the flip side, this also means you are now in competition with accountancy firms from all over the world.

For many firms, this is a completely new model of operating, but with the adoption of technology such as Microsoft Teams, becoming a firm that engages with clients globally is completely within the realms of possibility. As firms will be working more flexibly and digitally, so will your clients, which will demand better broadband, so it's important to ensure you invest in the best connections available. We partner with CityFibre who are investing in full-fibre gigabit speed networks in areas such as Aberdeen, Ayr, Dundee, Edinburgh, Fort William, Glasgow, Inverness, Renfrewshire, Stirling, and Thurso.

To the outside world, whether it's a prospective client or employee looking in, it's important you share what sets your firm apart, such as being a member of ICAS and being forward thinking, while delivering excellent client service. Review your listing on ICAS: Find a Chartered Accountant (CA) to ensure your contact details and website are up to date.

There's still no better way to build a relationship than for accountants to meet with their clients face-to-face and lots of businesses love to support other local businesses, so if your firm's strategy can mix new with traditional ways of working, then you're on the right path.

Strategy Support

Taking a fresh look at your firm's high-level strategy is vital during this period of transition to ensure growth and success. The accountants that aren't willing to change will simply leave more for the rest!

If you are looking for some independent strategy advice, please email Liz.Smith@LugoIT.co.uk or click here to book an appointment at a time to suit you with ICAS IT Partner, Lugo

LONG ASSOCIATION – FRC ETHICAL STANDARD

The revised Financial Reporting Council (FRC) Ethical Standard 2019 (ES) became applicable for accounting periods commencing on or after 15 March 2020.

In paragraph 3.6 of the revised ES, the FRC made a subtle but significant change to requirements in relation to long association for non- Public Interest Entity (PIE) audit entities.

Where the auditor of a non-PIE / other listed entity has been in position for ten or more years, careful consideration needs to be given as to whether it is probable that an objective, reasonable, and informed third party would conclude the integrity, objectivity, or independence of the firm or covered persons are compromised.

If that consideration determines that these have not been comprised, and that individual is not rotated after ten years, it is necessary that the:

(a) safeguards, such as those noted in paragraph 3.5 of the ES 2019, are applied; <u>and</u>

(b) the reasoning as to why the individual continues to participate in the engagement is documented, and the facts are communicated to those charged with governance of the entity in accordance with paragraphs 1.54 – 1.62 of the ES.

The “and” as underlined above, replaces what was previously an “or” in the same paragraph of the FRC ES 2016.

The “or” in the 2016 FRC ES meant that satisfying the conditions of (b) in the paragraph above, alone, was deemed sufficient i.e., documenting consideration of the threat and why this was at an acceptable level and formally communicating these facts with those changed with governance on an annual basis. Under the revised standard, this cannot be applied in isolation, and must be in addition to a safeguard contained in paragraph 3.5.

Therefore, under ES 2019, where an audit engagement partner has held that role for a continuous period of ten years, appropriate safeguards (referring to paragraph 3.5 of FRC ES 2019), have to be applied; along with documenting the reasoning as to why the individual continues to participate in the engagement, and the facts are communicated to those charged with governance of the entity. It is no longer sufficient just to have regard to satisfying the requirements of paragraph 3.6 (b).

Paragraph 3.5 sets out that appropriate safeguards may include:

- appointing a partner who has no previous involvement with the entity as the engagement partner;
- removing (‘rotating’) the partners and the other senior members of the engagement team after a pre-determined number of years;
- involving an additional partner, who is not, and has not recently been, a member of the engagement team, to review the work done by the partners and the other senior members of the engagement team and to advise as necessary;
- arranging an engagement quality control review of the engagement in question.

This was a significant change and one in which ICAS sought clarification from the FRC as to its intended purpose. It was made clear by the FRC that the change from the use of “or” to “and” was deliberate and intended to strengthen the applicable requirements covering long association. While larger firms may be able to cope with safeguarding long association through RI rotation or engagement quality control review, this will not be so easy for smaller firms where:

- there may only be one RI; and/or
- there is less likely to be a change in audit team composition and/or a change in management of a small client.

Consequently, smaller firms may have to consider whether an appropriate safeguard can be applied following the guidance in para 3.5 of the ES. This may include instructing an external quality review on such engagements to ensure that the requirements of the ES are met, which will have a cost impact on the audit. Firms are reminded that, where a suitable safeguard cannot be implemented, that the firm must resign from the audit.

The glossary to the FRC ES makes clear that an engagement quality control review is a process undertaken prior to the signing of the audit report. It is defined as:

"A process designed to provide an objective evaluation, on or before the date of the report, of the significant judgments the engagement team made and the conclusions it reached in formulating the report. The engagement quality control review process is for audits of financial statements of listed entities and those other engagements, if any, for which the firm has determined an engagement quality control review is required."

Compliance with the 2019 Ethical Standard is subject to review as part of the audit monitoring visit process and firms should therefore ensure that they are not only aware of the requirements of the standard, but that identified ethical threats and safeguards implemented by the firm are sufficiently documented to demonstrate compliance.

IAASB ISSUES EXPOSURE DRAFT OF INTERNATIONAL STANDARD ON AUDITING FOR LESS COMPLEX ENTITIES

In July 2021, the International Auditing and Assurance Standards Board (IAASB) issued an Exposure Draft (ED) of a proposed International Standard on Auditing (ISA) for audits of financial statements of less complex Entities (LCEs). The consultation closes on 31 January 2022. It would of course ultimately be a decision for the Financial Reporting Council to decide whether any future finalised standard would be introduced in the UK.

In recent years there has been a spotlight on the quality of audits through the results of audit inspections and recent high profile corporate failures, more commonly associated with more complex entities. This has contributed to the recent revision of ISAs such as ISA 540 (Revised) 'Auditing Accounting Estimates and Related Disclosures' and ISA 315 (Revised 2019) 'Identifying and Assessing the Risks of Material Misstatement', as well as revisions to the IAASB's quality control standards, International Standard on Quality Management (ISQM) 1 'Quality Management For Firms That Perform Audits Or Reviews Of Financial Statements, Or Other Assurance Or Related Services Engagements' and ISA 220 (Revised) 'Quality Management for an Audit of Financial Statements', and the development of new ISQM 2 'Engagement Quality Reviews'. The FRC has subsequently issued almost identical standards in the UK.

These revisions had the objective of making the ISAs more relevant in the evolving environment and are intended to support the consistent performance of quality audits. However, with these revisions there has been growing concern about the length, complexity, and understandability of these standards and their application to audits of LCEs. Some stakeholders have therefore questioned whether the ISAs remain relevant and can be applied in a cost-effective manner to all audits. In response to these and other similar concerns, various jurisdictions or regions have undertaken initiatives targeted at audits of less complex (or smaller) entities. Furthermore, some jurisdictions have announced the intention to develop a standard(s) or solutions for audits of LCEs within their jurisdictions or have already developed a pronouncement. These developments increase the probability of fragmentation in standards for a large section of the audit market. The ED-ISA for LCE has therefore been developed as a separate, standalone standard, designed to be proportionate to the typical nature and circumstances of an LCE. The proposed standard contains requirements for the auditor to obtain sufficient appropriate audit evidence that is intended to enable the auditor to provide reasonable assurance in the circumstances of an audit of the financial statements of an LCE (i.e., an LCE as contemplated in the proposed standard.

The proposed standard is separate from the ISAs with no intended need to directly reference back to the requirements or application material in the ISAs in its application. This means that if there is a circumstance that has not been contemplated in the design of the ED-ISA for LCE as addressed in the Authority of the proposed standard, relevant ISA requirements cannot be used to "top-up" the ED-ISA for LCE in order to address the circumstance. Accordingly, the overall decision for the audit engagement is whether the ED-ISA for LCE is appropriate for use given the nature and circumstances of the entity; the proposed standard does not address complex matters or circumstances, and is not permitted to be used for audits that are not audits of financial statements of LCEs. For example, consider the circumstance where an entity has an accounting estimate calculated using a bespoke, complex model that is not contemplated by the proposed standard, but is otherwise an LCE. In this instance, an auditor may not use ED-ISA for LCE together with requirements from ISA 540 (Revised) to supplement what may not be addressed in ED-ISA for LCE when planning and performing the audit. Consequently, an auditor would then need to apply the ISAs because ED-ISA for LCE, in its design, does not address complex matters or circumstances.

If ED-ISA for LCE is used for engagements for which it has not been designed the requirements of the proposed standard will not be sufficient for the auditor to obtain sufficient appropriate audit evidence to support a reasonable assurance opinion. Therefore, a clear description of the types of entities for which the ISA for LCE is not intended is set out in the Authority of the Standard and these are split into two categories:

1 Specific classes of entities for which the use of the standard is prohibited.

2 Entities which exhibit qualitative characteristics which preclude the use of the standard for the audit of the financial statements of that entity because they are indicators of, or proxies for, matters or circumstances for which the standard has not been designed.

1 Specific classes of entities

The IAASB has provisionally prohibited use of the proposed standard where:

(a) Law or regulation:

(i) Explicitly prohibits the use of the proposed ISA for LCE (i.e., the standard is not authorized for use in a particular jurisdiction); or

(ii) Specifies the use of auditing standards, other than the proposed ISA for LCE, for an audit of financial statements in that jurisdiction.

(b) The entity is a listed entity.

(c) An entity meets one of the following criteria:

(i) An entity one of whose main functions is to take deposits from the public;

(ii) An entity one of whose main functions is to provide insurance to the public;

(iii) An entity whose function is to provide post-employment benefits;

(iv) An entity whose function is to act as a collective investment vehicle and which issues redeemable financial instruments to the public; or

(v) A class of entities where use of the proposed ISA for LCE is prohibited for that specific class of entity by a legislative or regulatory authority or relevant local body with standard setting authority in the jurisdiction.

(d) The audit is an audit of group financial statements.

The IAASB recognizes that there may be different circumstances in some jurisdictions that need to be taken into account. For example, there may be entities within a local context that are scoped into the prohibitions (because the broad class is prohibited) when they, in fact, do not exhibit public interest characteristics (they may be a ‘sub-set’ within the broad class described). There may also be additional classes of entities within a jurisdiction that also exhibits public interest characteristics. Therefore, the proposed standard allows for the ability to ‘modify’ these classes of prohibited entities through:

(a) Explicitly permitting a specific sub-set within a class to be able to use the proposed standard (however, still having regard to the qualitative characteristics relevant to the appropriate use of the standard)

(b) Introducing further classes of entities prohibited from using the proposed standard.

Such changes can only be made at a jurisdictional level and modifications can only be made within specific class – a whole class cannot be removed.

2 Qualitative characteristics

It is inappropriate for an audit of the financial statements of an entity to be undertaken using ED-ISA for LCE if the entity exhibits the following:

- Complex matters or circumstances relating to the nature and extent of the entity's business activities, operations and related transactions and events relevant to the preparation of the financial statements.
- Topics, themes and matters that increase, or indicate the presence of, complexity, such as those relating to ownership, corporate governance arrangements, policies, procedures, or processes established by the entity.

These are intended to be indicators of, or proxies for, matters or circumstances that are deemed complex for the purpose of the proposed standard (i.e., ED-ISA for LCE does not include requirements to address such matters or circumstances).

Consistent with an audit conducted in accordance with the ISAs, the intended outcome from using the ED-ISA for LCE is an audit opinion resulting from a quality audit engagement that would enhance the credibility of the financial statements for the users thereof. The basis for the design of the ED-ISA for LCE to achieve this outcome is a separate standard for an audit of the financial statements of an LCE that:

(a) Is proportionate to the nature and circumstances that would be typical of an audit of a less complex entity (as contemplated in the Authority).

(b) Can be used effectively and efficiently in those typical circumstances to obtain sufficient appropriate audit evidence to support a reasonable assurance audit opinion.

(c) Utilizes a risk-based approach to an audit, with requirements that are principles-based, so that the proposed standard can be applied to less complex entities with a wide range of circumstances and across sectors or industries.

Accordingly, many of the basic concepts used in the ISAs to support a risk-based approach have also been incorporated in the ED-ISA for LCE, including:

- The use of objectives;
- Using the core ISA requirements and concepts (such as professional scepticism and professional judgment) as a base for establishing the work effort of the auditor when performing an audit of an LCE;
- The need to obtain sufficient appropriate audit evidence to support the audit opinion;
- The use of materiality to focus the auditor's efforts and to evaluate misstatements; and
- Using the audit risk model, i.e., applying the concepts of inherent risk, control risk and detection risk.

As such, the ED-ISA for LCE would have the same overall objectives of an audit for the auditor, as well as the same inherent limitations, as an ISA audit. Similar to the ISAs, the ED-ISA for LCE sets out requirements that, taken together, would fulfil the overall objective of the auditor (i.e., to express an opinion based on the audit evidence obtained). Compliance with these requirements is intended to support how the auditor obtains sufficient appropriate audit evidence as the basis for the auditor's reasonable assurance opinion.

Therefore, to develop a standard that will achieve reasonable assurance, the IAASB has used the requirements in the ISAs as the basis for the requirements within the ED-ISA for LCE. This was accomplished by replicating and adapting requirements from the ISAs that are considered core to an audit for the nature and circumstances of less complex entities as contemplated by the proposed standard. Audit procedures that are not relevant to an LCE, as contemplated by the proposed standard (e.g., procedures specific to listed entities), are not included within ED-ISA for LCE.

The auditor is required to comply with all relevant requirements in ED-ISA for LCE unless it is judged to be necessary to depart (and only in exceptional circumstances) to be able to achieve reasonable assurance.

The IAASB has undertaken an analysis of how the requirements in the ED-ISA for LCE 'map' against the equivalent ISA requirements. This mapping, which includes commentary to explain any differences, can be accessed at: https://www.iaasb.org/publications/mapping-documents-isas-proposed-isa-lce

The ED-ISA for LCE has been developed on the basis that the auditor performing the engagement is a member of a firm that is subject to the IAASB's Quality Management Standards (ISQMs), or national requirements that are at least as demanding.

A key objective of the design of the proposed standard was to keep the standard concise and succinct (as much as possible); therefore, the approach to application or explanatory material was extensively deliberated. The ED-ISA for LCE includes "essential explanatory material" (EEM) where it has been considered that explanatory material is crucial to support the requirements or concepts used. The EEM serves a similar purpose to application and other explanatory material in the ISAs, but is much more limited than what is presented within the ISAs, and is targeted at a higher level (i.e., a conceptual and contextual level), taking into account the typical nature and circumstances of audits for which the proposed standard has been designed. EEM does not in itself impose a requirement or expand any requirement. Rather it is used when the explanation or guidance it provides is considered to be so important that including it in the proposed standard and positioning it alongside the requirement(s) is deemed necessary and informative for a proper understanding of the requirement(s).

The content (i.e., the requirements and related EEM) of ED-ISA for LCE have been grouped into nine "Parts" that follow the flow of an audit engagement (rather than by subject matter or topic like the ISAs) as follows:

Part 1: Fundamental Concepts, General Principles and Overarching Requirements

Part 2: Audit Evidence and Documentation

Part 3: Engagement Quality Management

Part 4: Acceptance or Continuance of an Audit Engagement and Initial Audit Engagements

Part 5: Planning

Part 6: Risk Identification and Assessment

Part 7: Responding to Assessed Risks of Material Misstatement

Part 8: Concluding

Part 9: Forming an Opinion and Reporting

Next Step

The IAASB will determine the next step following an analysis of the responses received to the consultation.

HOW SHOULD CHARITIES ACCOUNT FOR THE CJRS?

As the Coronavirus Job Retention Scheme (CJRS) comes to an end, charities which have received funding from the scheme will be reporting how much they have received in their financial statements.

Charity employers like other employers have not received funding like this before, and while charities are used to accounting for funding from third parties, the nature and purpose of CJRS funding requires specific consideration.

The Charities SORP Committee has published updated model trustees' annual reports and financial statements to assist charities address the impact of the coronavirus pandemic. The accounting guidance set out in this article is based on the requirements and guidance of Accounting and reporting by charities: A statement of recommended practice (FRS102) (the Charities SORP) and the Charities SORP Committee's illustrative examples.

The Charities SORP has not been amended to include requirements or guidance on how to account for CJRS funding. However, the illustrative examples are treated as authoritative for the purposes of this guidance, which creates consistency across the charity sector.

This guidance specifically refers to the Arts Theatre Trust model financial statements. The scenario is that the Arts Theatre Trust is a company limited by guarantee, operating a theatre and related activities with one trading subsidiary. The pandemic has affected its ability to operate, and the charity faces a challenging financial position and has taken up government financial assistance. The Arts Theatre Trust is registered with the Charity Commission for England and Wales. However, for the purposes of accounting for CJRS funding, it is relevant to any UK charity applying the Charities SORP.

Ultimately, professional judgement may be required to arrive at the correct treatment based on the specific facts and circumstances of individual charities.

What is the nature of CJRS funding?

CJRS funding is grant income.

What recognition and measurement requirements apply?

Under the Charities SORP, charities must apply the 'performance model' when accounting for government and non-government grants. They do not have the option of applying the 'accrual model', which is available to non-charitable companies.

The 'performance model' does not distinguish between revenue and capital grants for measurement and recognition purposes. It also applies to grants regardless of whether the funder has imposed performance related conditions, other types of condition or no conditions at all.

Income must only be recognised when all of the following criteria are met:

- Entitlement – control over the rights or other access to the economic benefit has passed to the charity.
- Probable – it is more likely than not that the economic benefits associated with the transaction or gift will flow to the charity.
- Measurement – the monetary value or amount of the income can be measured reliably, and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably. (Charities SORP, paragraph 5.8)

For a charity to have entitlement to CJRS funding, it must have fulfilled all the conditions attached to the grant by HMRC.

A charity must recognise grant income on a gross basis in the Statement of Financial Activities (SoFA).

How should CJRS funding be presented in the SoFA?

Under the Charities SORP 'larger' charities are required to present their income and expenditure on an activity basis and 'smaller' charities are encouraged to do so. This guidance follows the activity basis of presentation.

The Charities SORP defines 'larger' charities as those charities with a gross income of more than £500,000 in the reporting period. 'Smaller' charities are all other charities applying the SORP.

Under the activity basis, grant income is classified in the SoFA as either 'income from donations and legacies' or 'income from charitable activities'.

Grants with no performance related conditions attached are classified as 'income from donations and legacies'. However, grants which have performance related conditions attached are classified as 'income from charitable activities'.

CJRS funding is considered by the Charities SORP Committee to have performance related conditions and therefore it should normally be presented in the SoFA within 'income from charitable activities'.

In the Arts Theatre Trust illustrative example, CJRS funding is treated as a separate activity and is therefore presented as a separate line item on the face of the SoFA. This treatment is further reflected in the notes to the financial statements.

In the example, the CJRS is treated as a material component of income.

Restricted or unrestricted?

Charities applying the Charities SORP use fund accounting to distinguish between restricted and unrestricted funds.

In the Arts Theatre Trust example, CJRS funding is treated as unrestricted. Why should this be the case given that the funding must be used to pay salaries and wages?

The funding is treated as unrestricted as the grant conditions do not require that it must be used to fund a specific purpose or project. Instead, the funding can be used to pay the salaries and wages of any staff, subject to the general terms and conditions of the CJRS.

VAT ON DILAPIDATIONS

Commercial property contracts usually contain a clause to cover the requirement for a tenant to return the property to the landlord in the same condition it was at the beginning of the lease. Instead of the tenant actually doing the repairs it is often covered by a payment to the landlord known as a dilapidation payment.

Until recently, dilapidation payments were normally treated as outside the scope of VAT. However, in September 2020, HMRC issued a Customs brief providing guidance on the VAT treatment of charges described as compensation, or early termination fees, in a contract. This proposed new guidance suggests that the position could also be extended to dilapidations which would then become subject to VAT where the landlord had opted to tax the property and exempt from VAT, if not.

There have been extensive representations made by professional bodies on the VAT treatment of dilapidations and HMRC's last update (25 January 2021) noted that they would issue revised guidance to explain what businesses would need to do. Any such changes will only have effect from a date in the future, however HMRC advised that this was to include guidance on what to do if businesses had already changed how they treated such payments because of HMRC's Customs Brief in September 2020. This guidance has still not been issued and so, until then, HMRC have suggested that businesses can either:

- continue to treat such payments as further consideration for the contracted supply
- go back to treating them as outside the scope of VAT, if that is how they treated them before this brief was issued

This has therefore left the position currently wide open, and landlords and tenants need to be aware that, when arranging new commercial leasing agreements, the VAT position could change going forward. The wording in new contracts therefore needs to take account of the potential change coming.

Accordingly, as the VAT liability of dilapidations payments would follow the VAT treatment of the lease itself, if the landlord has opted to tax, VAT will be due on the dilapidation payment at 20% and otherwise it will be exempt.

Landlords who have opted to tax the property should therefore ensure that the lease agreement allows them to add VAT to any dilapidation payment to be made by the tenant if HMRC's position changes.

Tenants also need to be aware of the potential additional cost to them, depending on the terms of the lease and if they are not VAT registered or able to recover VAT.

VAT on works carried out by the landlord following receipt of a dilapidation payment will therefore be recoverable where they have opted to tax that property. However, where they have not opted to tax, the VAT on refurbishment will likely be a cost for the landlord, and so they may look for any irrecoverable VAT from the tenant as part of the dilapidation payment.

Further HMRC guidance will likely be issued by HMRC in due course, and we will provide an update once available.

NOW IS THE MOMENT IN THE FIGHT AGAINST CLIMATE CHANGE

With COP26 less than one month away, the eyes of the world will be on Glasgow and the commitments and actions the various heads of state sign up to during their 12-day conference.

Regardless of the format, be it a hybrid or physical event, it is the substance of what COP26 achieves that really matters, and that will determine its success. Worryingly, it has to be highlighted that, despite all the initiatives and activity in the last 30 years, global emissions are still increasing. There is no doubt that the decisions coming out of the November conference are likely to signal a need for greater urgency in the climate crisis and will impact all of us, in both our working and personal lives.

What is COP?

COP, or the Conference of the Parties, dates back to 1994 when the United Nations Framework Convention on Climate Change (UNFCCC) came into force. The 197 countries that have ratified the Convention are called Parties to the Convention.

There have been two landmark moments in its history. In 1997, the Kyoto Protocol was agreed, which committed industrialised countries and economies to limit and reduce greenhouse gases emissions in accordance with agreed individual targets. A further milestone agreement was reached during COP21 in 2015, when the Paris Agreement was adopted by 192 countries committing them to limit global warming to well below 2 degrees Celsius, preferably to 1.5 degrees Celsius, compared with pre-industrial levels.

As well as the formal government negotiations and talks, there will be plenty happening on the periphery of COP26 as businesses, NGOs etc promote their cases for what they are doing to save the planet. Ultimately, though, it will require a cohesive global strategy to achieve the aim of reducing global warming.

What can we expect from COP26?

COP 26 may benefit from the year's delay due to the change in administration and stance in the USA on the importance of sustainability. On taking office, President Biden signed an Executive Order to initiate the USA's re-signing the Paris Agreement. The importance of China also cannot be understated, and it will need to develop plans as to how it will reduce its current reliance on fossil fuels. These two countries remain the top two global greenhouse gas emitters.

Currently, those countries with plans to seek to achieve net zero are nowhere near reaching their respective targets.

This was evidenced in a report published by the Public Accounts Committee (the Committee) earlier this month which raised some doubts about the UK's own ability to achieve its net zero ambition, and highlighted the absence of a clear and cohesive plan, with targets and milestones, to measure our progress. As COP President this year, the eyes of the world will be on the UK in November, as the various delegates descend on Glasgow for what is being billed as the most significant COP since Paris in 2015.

This lack of visibility over the progress made towards achieving our ambition makes it profoundly difficult for the government to engage with the public on this issue. Public engagement is crucial, since 62% of the required reduction in emissions will rely on changes in individual behaviour and lifestyle choices.

COP26 presents an opportunity to keep the spotlight on what governments are doing or, possibly more importantly, are not doing. The key will be to ensure that governments are reminded of the urgent need for action. Businesses will also need to take note, and they are coming under increasing pressure from stakeholders, including investors, to do more.

What form could international agreements take? Many have been mentioned, but there is a need to reach agreement on these on an international basis, whether they be carbon trading and pricing, or eco taxes, to name but two.

How is COP26 relevant to the accountancy profession?

The IFRS Foundation has announced its intention to establish a new Board to be responsible for the development of globally accepted sustainability reporting standards. An announcement on the progress of the establishment of this new Board is expected to coincide with COP26. At the same time, the European Union has issued proposals for the development of sustainability reporting standards across the EU member states. We anticipate that both bodies will issue these standards in the second quarter of 2022. The accountancy and finance profession need to be ready to respond to the requirements of these standards when they take effect.

Conclusion

COP26 needs to be a landmark moment that results in real change – that must be its legacy. Governments, including the UK's, need to set out ambitious national plans, including timelines on how they will achieve their stated goals. The recent UN's Intergovernmental Panel on Climate Change (IPCC) report gave us all a stark warning about the extent to which climate change has already taken hold and the time we have left to take decisive and meaningful action.

It is important to emphasise that climate change is not just a problem for governments, it is a problem for all of us. But we need leadership, and a sense that we can and should be part of the solution, through changes in the way we work and do business, and our lifestyle choices.

As highlighted in The Power of One, each individual, including CAs, has their part to play. We need to determine how we will change our respective behaviours to create a more sustainable planet. That is not just in the business sense but in our everyday lives.

What can we as individuals do to help reduce the effects of climate change?

ICAS produced this article that suggests how we can all play our part start to take action to address climate change.

TAX & HMRC UPDATES

VAT Updates

VAT road fuel scale charges from 1 May 2021 to 30 April 2022

https://www.gov.uk/guidance/vat-road-fuel-scale-charges-from-1-may-2021-to-30-april-2022

VAT Notice 706 on partial exemption updated

https://www.gov.uk/guidance/partial-exemption-vat-notice-706

Information about how to complete a VAT return if a business is having problems with monthly statements when the business is authorised to use simplified declarations for imports, has been added.

https://www.gov.uk/guidance/complete-your-vat-return-to-account-for-import-vat

HMRC have updated their guidance covering VAT on movements of goods between Northern Ireland (NI) and the EU. The guidance has been updated to reflect changes to the VAT treatment of distance selling between Northern Ireland and the EU with effect from 1 July 2021.

https://www.gov.uk/guidance/vat-on-movements-of-goods-between-northern-ireland-and-the-eu

HMRC update genuine contact guidance

HMRC have updated their guidance on checking whether an e-mail received from HMRC is genuine. Phishing attacks are on the rise, so this is a must read.

https://www.gov.uk/guidance/check-if-an-email-youve-received-from-hmrc-is-genuine#annual-tax-summary

Agent Update: issue 88

HMRC's latest Agent Update can be found at

https://www.gov.uk/government/publications/agent-update-issue-88/agent-update-issue-88

HMRC update guidance on penalties

HMRC have updated new points-based late submission penalties to reflect the postponement of the start date for Making Tax Digital (MTD) for Income Tax Self-Assessment (ITSA) until April 2024.

https://www.gov.uk/government/publications/penalties-for-late-submission/penalties-for-late-submission

They have also updated their guidance on identifying tax avoidance enabler penalties and when to appeal. Information about assessments, inspection powers, modifications, and restrictions on power to publish information, has been updated.

HMRC update company tax return guidance

HMRC have updated their guidance on completing company tax returns. The guide to help complete form CT600 (2021) version 3 has been updated.

https://www.gov.uk/government/publications/corporation-tax-company-tax-return-guide

Health and Social Care Levy

From April 2022, the government will introduce a new, UK-wide 1.25% Health and Social Care Levy, ringfenced for health and social care, based on National Insurance contributions. HMRC have updated employer rates and thresholds for 2021/22 to reflect this.

https://www.gov.uk/guidance/rates-and-thresholds-for-employers-2021-to-2022

HMRC CLARIFIES HOW THE EMPLOYMENT ALLOWANCE IS TO INTERACT WITH CJRS CLAIMS AND PAYROLL DURING 2020-21 AND 2021-22

Background

Ever since the Coronavirus Job Retention Scheme (CJRS) was announced in March 2020, employers have been confused about how to claim the Employment Allowance (EA) where they qualify for it, where they were making furlough payments to staff.

Most of the professional tax bodies in the UK have been asking for clarification since March 2020 so that they could issue suitable guidance to their members. HMRC recently responded to this by providing some much-needed clarity on the subject.

Employment Allowance

EA is an allowance which is granted to businesses, charities (including community based amateur sports clubs) and individuals employing care and support workers, whose total secondary NICs liabilities amounted to less than £100,000 per annum in the previous tax year, whether this is a standalone employer, a group of connected employers or an employer with numerous payrolls. The EA has the effect of lowering the NICs bill of the employer by up to £4,000 per annum.

State aid

EA counts as *de minimis* state aid for businesses that make or sell goods, but not for individuals paying care and support workers, charities, amateur sports clubs, or businesses that do not make or sell goods. As such, when an employer is eligible to claim EA, it must make sure that the claim does not push the business over the relevant state aid threshold – some businesses claim other state aid amounts, and these claims must therefore all be added together.

State aid is calculated in three-year periods in Euros – so the claims must be worked out in Euros at the time of the claim.

Sector	**De minimis state aid threshold over 3 years**
Agriculture products sector	€20,000
Fisheries and aquaculture sector	€30,000
Road freight transport sector	€100,000
Industrial sector / other	€200,000

Source: HMRC

HMRC has set out clarification in specific common scenarios in a note to the Professional Bodies, which it is hoped will be incorporated into guidance:

Question: What happens in the case of employers whose total secondary (employer) NIC liability for the year will be less than £4,000?

HMRC says: "These employers should claim EA only and not claim NIC via CJRS. This will ensure that the employer gets the full amount of EA and avoids any risk of an incorrect CJRS claim."

Question: What happens in the case of employers who, taking the year as a whole, will pay more than £4,000 secondary NIC on top of the NIC covered by CJRS grants?

HMRC says: "Paragraph 2.3 of the first CJRS Direction sets out that for any CJRS grant claim:

> *"8.4 The total amount to be paid to reimburse any employer national insurance contributions must not exceed the total amount of employer's contributions actually paid by the employer for the period of the claim."*

Our view is that this means, in CJRS claim periods where the EA is also claimed in respect of furloughed employees, the CJRS claim for the corresponding period should be reduced by the amount of EA claimed, as NICs covered by the EA will not be "actually paid", otherwise the liability will effectively be relieved twice.

The guidance further notes that EA claims made later in the year will relate to NIC liabilities from earlier periods. We consider the legislation to be clear that EA deductions may only be made in periods after the claimant has given notice to HMRC in the required manner.

The process of how and when eligible employers can receive the EA is covered by s.4 NICA 2014, and in particular the arrangements made by HMRC under s.4(1) of the Act.

S.4(4) provides that the arrangements may make provision in particular to:

> (a)require deductions to be made at the earliest opportunity in a tax year;
>
> […]
>
> (d) provide that a person is not permitted to make deductions unless the person has first given notice to HMRC in such form and manner, and containing such information, as HMRC may require.

These two issues are then covered by paragraphs 5 and 10 respectively of the arrangements:

> 5. Before making any deduction of an employment allowance a person must give
>
> notice to HMRC of the PAYE scheme from which deductions will be made in
>
> accordance with paragraph 7, 8 or 9.
>
> […]
>
> *10. Once notice has been given deductions for an employment allowance must be*
>
> *made from qualifying payments as they occur in the tax year. [emphasis added]*

The combined effect of these two paragraphs is clear in that a person cannot make a deduction for the EA until they have given the required notice to HMRC; and once they have given that notice, they must make the deductions from payments as they occur (and from no other payments).

Additionally, ss4(5) to 4(10) of the Act make further provision for claiming a refund of overpaid NICs if the employer has not deducted the full EA amount over the course of the year, which gives further support to the view that the deductions cannot be treated as if made in a previous month if the claim is made "late", but rather must be reclaimed using the statutory process."

Question: What happens in the case of employers with a secondary NIC liability of less than £4,000 on top of the NIC covered by CJRS grants but more than £4,000 in total?

To ensure that the amount of EA claimed plus grants claimed for NIC under CJRS do not exceed their total secondary NIC liability for the year, will these employers need to reduce:

- their EA claim, or
- their claim for NIC under CJRS?

HMRC says: "Per our comments under scenario (2), in those periods where both the EA and NICs element of the CJRS grant have been claimed in respect of furloughed employees, the EA claim takes precedence and so the CJRS grant should be reduced."

HMRC comment on their compliance approach to CJRS claims

"The CJRS guidance should be considered prescriptive, but we will accept that a claim is correct if the grant was calculated in accordance with the guidance available at the point of claim, or in accordance with a reasonable interpretation of the guidance available at the time of the claim, even if this would result in an overpayment or underpayment compared to our preferred interpretation of guidance.

If an employer has claimed the wrong amount and this is not based on a reasonable interpretation of the guidance available at the time of that claim, the employer must take steps to correct the error.

No one who has tried to do the right thing has any need to be concerned, as long as they work with us to put it right, but we are taking tough action to tackle fraudulent behaviour.

Everyone who has claimed has a responsibility to ensure their claims are accurate and repay any money they were not entitled to. Our priorities are supporting our customers and tackling deliberate non-compliance and criminal attacks. We'll not be actively looking for innocent errors in our compliance approach. We'll assess overclaims and charge penalties to support these priorities."

HYBRID WORKING – WHAT YOUR CLIENTS NEED TO KNOW

Background

According to data from the Office of National Statistics, prior to COVID-19 only around 5% of the workforce worked mainly from home. Research recently undertaken, including a YouGov survey and CIPD research, indicates that a majority of workers now wish to spend at least part of the week working from home, after having experienced it during the pandemic. This trend can be used positively by employers to reconfigure the workplace and recruit talent from much further afield. The introduction of hybrid working practices is nothing new, but employers could benefit from the arrangement if they consider the opportunities and potential pitfalls in the round and adopt a holistic approach.

ICAS members can take the opportunity to discuss these arrangements with clients to ensure they are aware of what may be possible and where to obtain expert advice. Due to the cocktail of workforce planning, payroll and taxes aspects, remuneration planning, logistics, finance, and production all come into it – and due care and attention should be paid to each area – taking advice from the appropriate experts such as employment law and HR management where these are not available in-house.

Hybrid working – the new normal

The available research mentioned above tells us that most employees would prefer a hybrid working arrangement, where they work part of the week in the office and part from home. Hence the increased proliferation of the term "Hybrid working" which is not a new term, but it has never been taken so seriously as it is right now.

After having successfully and productively worked at home for the best part of 18 months, many employees previously based in offices and call centres have a compelling case in asking for more flexible working arrangements.

As such, many employers are now considering how they can accommodate this to maintain goodwill, engagement, and productivity. and retain staff without losing knowledge and to maintain continuity of service. The shift to hybrid working is possible, but it will entail a change of culture, a less hierarchical outlook, and refocused workplace protocols including homeworking, data protection, IT, and performance management.

Going hybrid

Hybrid working provides opportunities for employers to reduce accommodation and business travel-related overheads and, at the same time, enhances employee wellbeing and engagement, to provide a better work-life balance and likely fewer sick days. Employees can also benefit from a significant reduction in commuting costs, and with fewer people travelling twice a day and fewer business trips, there are also environmental benefits, which businesses can count into their carbon neutral calculations.

What to do?

It is likely that organisations will need to develop a process map of short, medium, and long-term strategic decisions, starting with bringing people back into the office safely and communicating reassuring messages to employees about this – not necessarily expecting the same from everyone depending on people's own individual health & wellbeing needs. The CIPD has produced a helpful guide on this. It may be the case that as hybrid working arrangements evolve in each workplace, the policies and protocols in each working environment will also need to develop gradually too.

Myriad employers: myriad arrangements

No two organisations are the same, and therefore there is no standard approach to implementing hybrid working. However, it does make sense for employers to cover off the legal implications adequately, as well as configuring a strategic plan and protocols which feed into that. Training managers, managing performance, and ensuring that data integrity is maintained are also key to success.

Communication

Communications are key to successfully bringing people back to work, and most employers should consider consulting their employees about their thoughts and preferences in advance. If a Trade Union is recognised by the employer, they should be included in this process also. It goes without saying that workplaces should always follow UK government guidance and legislative requirements relating to health and safety.

Protocols

If employers already have a flexible working policy in place, they can consider adapting this to extend it to hybrid working for all those employees who it considers are eligible for it. Otherwise, a new policy will be needed.

Consideration could be given to some or all of the following aspects:

- Which role types/teams are eligible for hybrid working;
- Unless it is being rolled out to all workers automatically, instructions on how to request hybrid working and the considerations that will apply;
- Roles and responsibilities for hybrid workers and people managers;
- How hybrid working dovetails with general flexible working arrangements;

Legal implications of hybrid working

Where an employee formally requests and is granted hybrid working arrangements, this will amount to a change to the terms and conditions of their employment. However, note that Hybrid working (and indeed other forms of flexible working) can also be undertaken on an informal or temporary basis without a contractual change taking place. It is important that everyone involved understands the difference. To date many employees working arrangements have changed due to the obligations on employers during a global pandemic. This would not lead to any permanent change to employees' contractual terms. In agreeing hybrid working arrangements going forward employers will need to be clear on whether any agreed changes are on a temporary trial basis or are intended to be a permanent contractual change.

Employment contracts should also state a contractual location. This does not necessarily change as a result of hybrid working, but employees who work permanently from home normally have their home address as their workplace. This is also important for tax purposes (see below).

Organisations should take legal advice where appropriate on their particular legal implications of hybrid working.

Tax implications of hybrid working – use of home as office, travel costs, benefits in kind

Employees should be advised to discuss any implications of homeworking with their landlord/ mortgage provider/ house insurer/local authority, especially if a room in the home is specifically set aside for work purposes and is not used for any other purpose.

There may also be tax implications for employer and employee if an employee wishes to work some of their remote time outside of the UK.

Depending on whether the employee is contractually based at home for all or part of the time, or there is a pattern to their hybrid working arrangements, the travel costs incurred to go to the office or on business trips may still be treated as taxable or as ordinary commuting costs – HMRC is warning us that the usual arrangements apply, and nothing has changed in that respect – although policy discussions are taking place on this.

The employer is still able to provide equipment and technology for the employee to use at home to tie in with workplace health and safety requirements – and this equipment/furniture etc remains an asset of the employer. If it is transferred to the employee, the usual transfer of assets rules apply.

Technology and equipment

In addition to technology, considering what other equipment will support effective and healthy remote working, including the provision of office furniture or mobile devices. Data integrity is also vital, and due consideration must be given to ensuring a seamless operation for hybrid working practices which does not compromise data integrity, and which is GDPR compliant.

Performance management

Managers will need to adjust their management of individuals from observation of time spent in the office and person to person integration/behaviours to assessment of productivity, outcomes, value, and levels of contribution if they do not already measure performance in this way. This will tend to lead to a more trusting professional relationship between workers and line managers.

WHY THE CONTRACTOR IN THE NORTHERN LIGHTS CASE WAS DEEMED TO BE WITHIN IR35

On 8 June 2021, the Upper Tax Tribunal handed down its judgement in the case of Northern Light Solutions Ltd v Revenue and Customs Commissioners [2021] UKUT 134 (TCC).

The case involved an IT contractor (Mr Lee) who provided his services to Nationwide Building Society through an intermediary company, Northern Light Solutions Ltd, over a seven-year period (2007 – 2014). HMRC challenged a series of contracts which were deemed to fall outside of IR35 between 2012 and 2015. The First-Tier Tribunal found for HMRC, deciding that were it not for the presence of the intermediary, Mr Lee would have been an employee of the Nationwide, as determined by Section 49 Income Tax (Earnings and Pensions) Act 2003 Section 1(c).

As both parties agreed that both Sections 49 (1)(a) and (b) were already in place in this case, the issue which the Upper Tribunal had to resolve was whether Section 49 (1)(c) applied – i.e.:

“the circumstances are such that—

(i)if the services were provided under a contract directly between the client and the worker, the worker would be regarded for income tax purposes as an employee of the client or the holder of an office under the client; or

(ii)the worker is an office-holder who holds that office under the client and the services relate to the office.”

To determine this, it was agreed that a similar approach should be adopted as took place in two other recent IR35 cases (*Kickabout*, *Atholl House*). This three-step approach was set out as follows by Herrington J and Brannan J in their decision:

1. “Find the terms of the actual contractual arrangements… and relevant circumstances within which Mr Lee worked”.
2. “Ascertain the terms of the 'hypothetical contract' (between Mr Lee and NBS) postulated by s 49(1)(c)(i) of ITEPA 2003 and the counterpart legislation as applicable for the purposes of NICs”.
3. “Consider whether the hypothetical contract would be a contract of employment”.

Four Grounds for appeal?

Although it was agreed to allow the appeal on four grounds in July 2020, there was a certain controversy about how the four grounds were then framed by the appellants in their submission to the Upper Tribunal. The respondents argued that the grounds for appeal had been set out wider that they were permitted to be, especially in respect of the question of substitution. Nevertheless, as the judges considered that the additional scope of three of the appeal grounds presented no detriment to HMRC, these three grounds were admitted. The fourth appeal ground relating to the “part and parcel” element was deemed to be too wide-ranging and contain irrelevancies and was refused.

The outcomes at the Upper Tribunal in respect of each Ground were as follows:

1. **Control**

The First Tier Tribunal had examined a typical project for Mr Lee to work on under his contract with Nationwide.

Some key facts established were:

- Mr Lee worked on a series of separate contracts, which were not carried over or “rolling” from the last assignment. The FTT considered that each contract nevertheless represented a hypothetical contract of employment.
- Each project was overseen by a Nationwide governance board – but day to day tasks and project management, including estimating project outlays, were Mr Lee’s responsibility.

- Mr Lee would determine who would make up the project team for each assignment. The governance board could review Mr Lee's plans and had an overarching power to adjust the plans, scope of the work, timing, and cost where this was deemed to be necessary.

- The appellants claimed the FTT was wrong to have excluded the evidence which indicated the Nationwide was not at liberty to move Mr Lee from one work project to another, and this pointed away from an employment contract. The UT judges disagreed.

- The fact that Mr Lee was not the ultimate arbiter of where, when, and how the work was carried out increased the case for him being under a hypothetical contract of employment, and therefore within IR35.

- For this Ground to be examined, reliance was placed on two cases: *Ready Mixed Concrete* (1967) and *Kickabout* (2020). The need to establish a "sufficient framework of control" and that the individual is "subject to the other's control in a sufficient degree to make that other master". The judges found both conditions to exist and dismissed the first Ground for these reasons.

2. **Mutuality of Obligation**

The appellants claimed the FTT was incorrect to determine that there was sufficient presence of mutuality of obligation in the hypothetical contract to formulate a contract of employment between the parties. They stated that the position was rather, that Nationwide was not obliged to provide further work to Mr Lee – even if he has completed the work set out in the contract before its anticipated termination date. Neither was Mr Lee obliged to continue beyond the completion of the proscribed work regardless of the end date. Moreover, the FTT's reference to Quashie was flawed.

In examining the work undertaken by the FTT, the UT judges concluded that they should adopt the approach taken by McKenna J in the *Ready Mixed Concrete* case, which is still considered to be the "go to" case for examining mutuality of obligation. They considered that the establishment of mutuality has two strands to it: The first being that a form of contract must exist between the parties, and second, that contract must contain sufficient elements of control and personal service to represent a contract of service.

Furthermore, the "irreducible minimum" of mutuality is that there must be an obligation on one party to offer work, and for the other party to carry it out as part of a "wage/work bargain" as described by in *Cotswold Developments* by Langstaff J. This long-established factor was noted by the UT to have arisen in the recent case of *PGMOL* where it was set out that … "it is insufficient to constitute an employment contract if the only obligation on the employer is to pay for work if and when it is actually done" – in other words, the employer should provide the work initially to enable the employee to carry it out and be paid for it.

Consequently, the Judges found that in this case, mutuality had in fact existed in each of the hypothetical contracts and as such, the second Ground was dismissed.

3. **Substitution**

The appellants claimed the FTT had erred in its reasoning when concluding that whilst the hypothetical contract would have been likely to contain a substitution clause, that clause would be likely to be classified as "almost hypothetical". The appellants claimed there was no basis evidence for applying this reasoning.

The main outcome for employment tax practitioners to note in terms of the substitution point is that the judge held up *Pimlico Plumbers* to be the leading authority on substitution – in that case, it was held that merely *being in possession* of a contractual right of substitution is not enough to determine the status of the worker – substitution actually *has to happen* - and the correct way to test this is to examine how dominant the personal service clause is in practice.

In this case, the evidence showed that … 'it would not be viable for Lee to substitute himself for the work as the substitute would not be able to get through security, they would not have a laptop nor knowledge of the work. The reality was that it was not going to happen'.

Using the Supreme Court's approach to substitution in Pimlico Plumbers as the yardstick enabled the Upper Tribunal to conclude that providing personal service was a key feature of the contract between Northern Light and the Nationwide – rendering Mr Lee within IR35 and dismissing the third Ground.

Note that this approach on substitution clauses contrasts sharply with the recent case decision in June 2021 by the Court of Appeal in the *Deliveroo* employment case, where on that occasion, the judiciary decided that it was sufficient to have a substitution clause in the contract even though it was rarely, if ever, utilized – and in that case, the Deliveroo riders were deemed to be self-employed due to this factor.

4. **Part and Parcel of the organisation**

The appellants claimed the FTT had not demonstrated a robust case for determining that Mr Lee fell to be part and parcel of the Nationwide. This fourth Ground relating to the "part and parcel" element was deemed to be too wide-ranging and to contain irrelevancies and was refused admission – which meat that the judges refused to consider it at all.

Outcome of the Upper Tribunal decision

The Upper Tribunal agreed that the First-Tier Tribunal, who first heard the case in February 2020, had not erred in law and its decision was sound. It is not clear whether HMRC will rely on the judiciary's reasoning on the mutuality of obligation point in future – as it differs slightly from their currently published interpretation of the *Ready Mixed Concrete* definition – HMRC currently believe that Mutuality of Obligation is present in *any* contract, which is contrary to what McKenna J set out in his summing up of that case, but is consistent with Langstaff J's comments in the Cotswold Developments Construction Ltd v Williams [2006] IRLR 181 Employment Appeal Tribunal case (" Speaking for myself I would prefer to use the concept of mutuality only in relation to the question whether a contract existed between the parties.")

Seeing the light?

Whilst this decision appears sensible due to the approach taken in terms of the tax and employment law cases chosen as referral points, it highlights the perennial difficulties in employment status decision-making for employers and tax advisers who are seeking to reach a sensible and robust conclusion outside of the courts

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