TECHNICAL BULLETIN

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A LAST LAUGH FROM THE CHANCELLOR

The Chancellor's budget which was delivered on 29 October 2018 was a longish one, but delivered with humour in what some commentators are predicting may be Philip Hammond's last as Chancellor. For a change, there was a number of interesting points for tax practitioners, some very welcome.

On the capital allowances front, the annual investment allowance is to be £1 million per annum in respect of the two-year periods ended 31 December 2020, rather than the current £200,000. This will not impact most businesses but those with large capital expenditure will welcome this, and it may assist some of our bigger businesses during the Brexit period.

Who remembers industrial buildings allowances? A structure and buildings allowance for new buildings where qualifying expenditure is incurred on or after 29 October 2018 is to be given. The rate of allowance is 2% per annum and it is to apply to buildings other than residential properties. The relief will not, however, apply to construction contracts entered into before 29 October 2018. Whereas the old industrial buildings allowance was mainly given in respect of buildings utilised in manufacturing, the new allowance will be given in respect of offices, shops, warehouses and other structures.

Against this, the enhanced capital allowances for energy efficient plant will end in April 2020, while the rate of allowances on the special pool, which includes integral features, is to be reduced to 6% from a present 8% with effect from April 2019.

A most welcome change is one of a number to the intangible assets regime and relates to the de-grouping charge. There has been an anomaly where assets have been transferred from one company to another group company, which subsequently leaves the group within six years. Where a capital gain would have crystalized, but the sale of the shares qualifies for substantial shareholding exemption, the de-grouping charge could also be covered by substantial shareholding exemption. The intangible assets regime did not, however, mirror the capital gains regime, and a de-grouping charge would crystalize in respect of intangible assets. The intangible assets de-grouping charge is to be brought in line with the capital gains rules, which is a very sensible and welcome change for those involved in corporate restructuring.

While the increase in the personal allowance to £12,500 will have grabbed the headlines, there were two significant proposals for tax practitioners:

1. In order to qualify for entrepreneurs relief, it will be necessary for vendors to own

the interest in the business or shares for at least two years rather than the current twelve months. This will probably not affect many people, as most will have owned their business for a considerably longer period, but could have an impact on last minute planning. It is one thing to perhaps delay a sale for a year in order to transfer shares to family members, but it is another to delay it for two years. The moral of the story is to think about succession and carry out planning in good time. The two-year period will also apply to EMI options.

The definition of a personal company is also being extended, with effect from budget day, so that, apart from holding at least 5% of the ordinary share capital and voting rights, it will also be necessary to have an entitlement to 5% of the distributable profits and 5% of assets available on a winding up. This change could have a significant effect in particular on companies backed by private equity, where there are several classes of shares; and companies where there are alphabet shares where the Articles provide that dividends can be paid on some classes of shares to the exclusion of others. While changes may be made on the passage of the Finance Bill, a detailed review should be carried out of companies where there are more than one class of share.

2. A further reduction to nine months is proposed, from the current eighteen months, in respect of principal private residence relief. Where an individual acquires another house and ceases to occupy the first house then the final nine months of ownership of the first house will be deemed to be a period of occupation for principal private residence relief, rather than the currently more generous eighteen months. A couple of years ago, the period was reduced from thirty-six months and there may now be little advantage in the relief at all.

   The lettings relief of £40,000 which has been available up to now, where an individual has not lived in a house which has been his principal private residence for part of the period of ownership, but has instead let it out, will only be available after 5 April 2020 where the owner of the property has shared occupancy with the tenant. This will be a very unusual circumstance but will apply in multiple occupancy situations.

The off-payroll provisions which currently apply to the public sector only are to be extended to the private sector. This relates to the IR35 provisions which have been with us for many years now and it is probably fair to say that, while they have deterred some of the more extreme cases, have caused more confusion and uncertainty than they have solved. It is proposed that the extension to the private sector is to take effect from 6 April 2020. From then, where a private sector company takes on workers through a personal service company, it will be up to the "employer" to decide whether the relationship is one which falls within IR35, with liability for accounting for PAYE and NIC falling on the client company rather than the intermediary company. This change was widely expected, and it is likely that businesses will be less likely to use the services of individuals through their own service companies due to the increased risk.

An interesting announcement was in relation to termination payments. From 6 April 2019, employer's NIC was to be chargeable on termination payments over £30,000 but this is now to be delayed until 6 April 2020. Presumably there is some technical problem similar to that which has delayed the abolition of Class II NIC for self-employed individuals, and may be further evidence of too many changes.

In summary, this budget has provided a number of points of interest to discuss with clients, including a number of surprises. There will be those who will, with the benefit of hindsight, wished they had delayed the construction of a building or incurring a lot of expenditure on plant and machinery until the new or enhanced capital allowances become available. Of more concern, however, is completely unexpected proposals with regard to entrepreneurs relief which could have a huge impact for shareholders of companies and who now may not qualify for entrepreneurs relief. For example, where there are different classes of shares, an individual may hold 5% of the ordinary share capital and voting rights but may not have an entitlement to 5% of the dividends where dividends can be declared at differing rates on differing classes of shares. Is this what the Government intended or, was their intended target private equity investments with interesting structures allowing individual investors to exit at a 10% rate of tax. Unless the proposals are modified, individuals who have been shareholders in companies for many many years may find that they are not entitled to entrepreneurs relief. Is this fair? Perhaps the Government and HMRC should get back to consulting with interested parties, including the professional bodies, before making announcements which, on the face of it, have unintended consequences for innocent tax payers.

EMPLOYMENT CORNER – WHAT ARE THE MAIN TAX AND PENSIONS RELATED PENALTIES AN EMPLOYER HAS TO FACE?

Pensions

Significant additional burdens were placed on the employer's doorstep a decade ago with the introduction of the Pensions Act 2008, which obliges employers to enrol certain employees into a pension scheme and then make employer contributions into that scheme.

Employers who fail to comply can be issued with criminal proceedings, fixed penalty notices of £400 a time, and escalating penalties from £50 to £10,000 per day depending on the size of the employer for failing to pay pension contributions. Fines can be issued to the employing business as well as to the Responsible Individuals within that business deemed responsible for breaches.

It is a criminal offence to attempt to induce or coerce an employee to opt out of their pension, and it is therefore vitally important that employers do not become involved in any pension-related conversations with employees other than to provide them with the Pensions information at the outset, and if the employee decides to opt out, the employer must renew the offer to join the pension scheme every three years on a rolling basis.
If criminal prosecution is successful, the maximum tariff for sentencing is two years' imprisonment.

Employment taxes

Payroll – real time information including CIS

As all of you who run payrolls will know, RTI penalties can be charged when the Full Payment Submission (FPS) was not sent in on time, or HMRC was expecting a different number of FPSs, or the Employer Payment Summary (EPS) was not submitted even where there are no employees.

The due dates for payments of PAYE and NICs are governed by The PAYE Regulations 2003; The Social Security (Contributions & Benefits) Act 1992 and the Social Security (Contributions) Regulations 2001. The due date is 19^{th} month (22 if paying electronically) following the tax month when the salary or wages payment was made to the employees.

Failure to pay PAYE, NICs or CIS on time incurs penalties under the provisions set out at FA2009 and FA 2010, as follows:

Number of late payments in a year –

- 1 late payment – Nil
- 2-4 late payments – 1%
- 5-7 late payments – 2%
- 8-10 late payments – 3%
- 11-12 late payments – 4%
- Any amount paid 6 months late – 5%
- Any amount paid 12 months late – 5%

Penalties for late submission are based on the number of employees. The first failure is overlooked, as is the late receipt (as long as within 30 days) of the first FPS by a new employer.

Second and subsequent failures are penalised as follows:

- 1-9 employees - £100
- 10-49 employees - £200
- 50-249 employees - £300
- 250+ employees - £400
- Failure continues for more than 3 months – 5% of the tax due.

Penalties for inaccurate RTI submissions are generally discussed as part of the employer compliance reviews – see below.

In addition, failure to submit mandatory e-filing returns of any kind are punishable with a penalty in accordance with SI2003/2682 as amended by SI2009/2029 Reg 14.

CIS – late returns

Late returns for those employers who are also contractors or subcontractors in the Construction Industry Scheme are completely separate to late return penalties for other employer related issues.

An initial penalty of £100 doubles after 2 months and if it is over 6 months late, a penalty of the greater of 5% of the tax due and £300 is due.

Benefits in kind

The penalty for not submitting forms P11D, the return of expenses payments and benefits to HMRC, by the 6 July deadline following the tax year in which the benefits were received is £300 initially, followed by a continuing failure penalty of up to £60 per day. Class 1A NICs which become due on the benefits is payable by 19 July (22 July for electronic payment) following the 6 July deadline. If this is not paid, penalties and interest can become payable, starting with a penalty of £100 per 50 employees or part thereof for the first 12 months. This penalty is capped at the value of Class 1A NICs outstanding. If the return is still outstanding more than 12 months after it initially became due, a further penalty not exceeding the total Class 1A NICs becomes due. A surcharge of 5% of the NICs due can be applied after 31 days, 6 months and 12 months respectively under SI2001/1004 Reg 67B.

If an employer enters into a PAYE Settlement Agreement (PSA), then the figure payable is normally computed and agreed over the summer following the tax year in question, and any grossed-up PAYE and Class 1B NICs settled by the employer by 19 October (22 for electronic payment). Penalties for not complying are the same as the other PAYE penalties and for the Class 1B NICs, the 5% surcharge as described in the previous paragraph can be imposed.

Employer compliance reviews

If, during an employer compliance review, HMRC determines that a RTI or other return such as P11D, P11D(b) or CIS is inaccurate, the penalties which apply are based on the loss of Revenue to the Exchequer and are governed by the provisions set down in FA2007 et seq. as follows:

- Careless inaccuracy – 30%
- Deliberate but not concealed inaccuracy – 70%
- Deliberate and concealed – 100%

It is possible to mitigate these penalties by way of either a prompted or unprompted disclosure:

- Prompted – 15%, 35% and 50%
- Unprompted – 0%, 20% and 30%

National minimum wage

In the latest Budget delivered by the Chancellor on 29 October 2018, we found out that the national minimum and living wage hourly rates were to rise. (see Table 1).

Penalties for failing to pay the national minimum/living wage are extremely punitive at 200% of any arrears owed to the worker and a maximum penalty of £20,000 per worker. Note that any penalty is reduced by 50% if the unpaid wages <u>and</u> the penalty are both paid within 14 days. An employer's brand and reputation can also suffer if there is a national minimum wage breach: HMRC "names and shames" employers who are penalised.

Table 1

Category	Rate from 1 April 2019 £	Rate from 1 April 2018 £
NLW for workers aged 25 and over (introduced and applies from 1 April 2016)	8.21	7.83
the main NMW rate for workers aged 21-24	7.70	7.38
the 18-20 NMW rate	6.15	5.90
the 16-17 NMW rate for workers above school leaving age but under 18	4.35	4.20
the apprentice rate, for apprentices under 19 or 19 or over and in the first year of their apprenticeship	3.90	3.70

HMRC, who administer the national minimum wage on behalf of BEIS, set out the most common national minimum wage errors in its December 2016 Employer Bulletin 63. These reasons remain the same two years later, and payroll professionals should be vigilant of them:

- Not paying the right rate, perhaps by missing an employee's birthday.
- Making deductions from wages which results in reducing the employee's pay below the correct national minimum wage/national living wage rate.
- Including top ups to pay that do not qualify for national minimum wage/national living wage.
- Failure to classify workers correctly, perhaps by treating them as self-employed or volunteers.
- Failure to include all the time a worker is working — perhaps by shutting up shop, waiting to clear security or travelling between customer appointments.

Perhaps the most difficult one of these to flag to an employer is the fourth one – classification of workers. Payroll professionals will not necessarily be aware that an employer has decided to treat someone as self-employed, for example. Practitioners should have at least one "due diligence" conversation with the employer each year (but preferably more often than that) to ensure that they have covered this point off – especially in small and growing private businesses and charities, but also in public sector entities.

Reward: GAAR and the DOTAS regime

Employers should also be aware that special provisions have been put in place to counter avoidance from 16 September 2016 under FA2003 s 212A. A penalty of 60% of the value of the counteracted advantage if a taxpayer submits a return, claim or other document on the basis that a tax advantage arises from the arrangements, and all or part of that tax advantage is later counteracted under the GAAR. Specific provisions apply to employers under the Declaration of Tax Avoidance Schemes (DOTAS) under the direct taxes disclosure regime. The legislation (FA 2016 Sch.18 Part 2 as amended) imposes a number of tests to determine if disclosure is required. Briefly these are:

1. Are there arrangements which are expected to provide a tax advantage?
2. Is getting a tax advantage expected to be one of the main benefits?
3. Does the scheme fall within one of a number of descriptions, called 'hallmarks'?

There are 8 hallmarks aimed at new and innovative schemes, marketed schemes and targeting specific schemes, for example, loss schemes. Some or all of these hallmarks apply in relation to certain taxes, including Income tax, NICs, and the Apprenticeship Levy.

Certain people must provide information to HMRC about avoidance schemes within 5 days of the schemes being made available or implemented. Usually the person providing that information will be the *promoter* of the scheme – i.e. the person who designs or markets the scheme. However, users of such schemes (i.e. employers) must also notify HMRC within 30 days using form AAG7 and quoting the Scheme Reference Number. Failure to do so can incur significant penalties.
Employers can become liable for penalties of up to £5,000 per employee, with further penalties of up to £600 per employee per day if the failure continues after the initial penalty has been imposed.

Serial tax avoiders and falsification of documents

Special provisions also apply under FA2016 Sch. 18 such that anyone who serially attempts to utilise a defeated tax avoidance scheme during the "Warning Period" after 15 September 2016 will suffer a penalty, as follows:

- Value of tax understated or overclaimed for the first defeat of a scheme used during the warning period – 20%
- Value of tax understated in the second such defeat – 40%
- Value of tax understated in any subsequent defeats – 60%

If any documents which are required by HMRC under TMA 1970 ss20BA or BB are deliberately falsified, concealed or destroyed, a fine of up to £5,000 can be imposed on summary conviction; or imprisonment for up to two years, a fine, or both on conviction on indictment.

Conclusion

Need I say more than…it's a jungle out there! Legislation is more convoluted, complex and opaque than it has ever been – meaning employers need to be ever more vigilant about their HR and taxation processes and policies.

IS HMRC GUIDANCE AND ADVICE UP TO THE MARK?

A practitioner recently remarked on 'down skilling' at HMRC. Phones answered by less qualified staff, lack of access to tax-qualified inspectors, online tools and guidance which don't always follow the law.

Is this a reflection of general experience and what are the implications in practice?

Reliance on HMRC guidance

The OTS recently published a report [Guidance for taxpayers: a vision for the future](). This identifies a number of key concerns including the different levels of information available online – some being designed as specialised guidance while some is generalised information.

But one key concern is how far HMRC guidance can be relied upon. The OTS states the position like this:

In the UK, the question whether HMRC is bound by its guidance relies on the twin public law doctrines of 'conspicuous unfairness' and 'legitimate expectation'. These have been developed by the Courts and do not apply to taxation alone. [4.8]

HMRC published its own view [When you can rely on information or advice provided by HM Revenue and Customs](). This says

HMRC will be bound by incorrect information or advice it gives, provided that it's clear and you can demonstrate that:

- *you reasonably relied on the advice*
- *you made full disclosure of all the relevant facts*
- *applying the law would result in your financial detriment*

This assurance needs careful consideration. The courts have held that -

The promise or practice...must constitute a specific undertaking, directed at a particular individual or group - R (Bhatt Murphy) v The Independent Assessor [2008] EWCA Civ 755; quoted in R (on the application of Gaines-Cooper) [2011] UKSC 47.

Hence guidance written specifically for Seafarers was held binding on HMRC (Cameron v HMRC [2012] EWHC 1174 (Admin)). But a claim to loss relief based on generally available guidance which was later withdrawn, was not binding on HMRC (R (on the application of Hely-Hutchinson [2017] EWCA Civ 1075).

It is clear that some information on Gov UK is too generalised to be reliable in all circumstances. This would include information on the Marriage Allowance; and when company directors must file a self-assessment tax return. HMRC may suggest that such information was intended for the average taxpayer, and not for tax advisers.

But when considering the HMRC Manuals, which are providing detailed guidance, there is a significant issue with updating. There is also the question of law and guidance – information in HMRC's manual is sometimes a statement of the law, at other times it represents HMRC's opinion or administrative procedures.

Legislation or guidance

'It seems to me that HMRC's compiler of the statement of case ….. cannot ever have read s 7 [Taxes Management Act 1970]'. So reported the Tribunal in the case of Alexander Steele (Alexander Steele TC06717 TC/2018/02782).

This could be a feature of 'down skilling' and lack of resourcing, but practitioners would be well advised not to take HMRC's word for it, and this is not an isolated incident.

In Christine Perrin ([[2018] UKUT 0156 (TCC)]()), the Upper Tribunal commented:

'It is regrettably still the case that HMRC sometimes continue to argue that the law requires any reasonable excuse to be based on some "unforeseeable or inescapable" event …. It is quite clear that the concept of "reasonable excuse" is far wider than those remarks implied might be the case.'

The position becomes even more difficult when it comes to HMRC concessions. In McHugh (McHugh [2018] UKFTT 0403 (TC) TC06605) the Tribunal commented:

It follows that it is our judgement that the example set out in the Capital Gains Manual [https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg65009] (published 12 March 2016 and updated 09 May 2018) is simply wrong and should not be applied or followed.

Does HMRC give advice?

Another angle is the role of HMRC in providing advice to taxpayers. The dangers here would be worth highlighting to clients. Unless the request to HMRC is couched in very specific terms, HMRC may say that it was not intended as guidance or advice.
The recent case of Mr Sprake highlights the need to be specific. Mr Sprake couldn't pay all his tax in time so he phoned HMRC (A P Sprake TC06676 [2018] UKFTT 0507 (TC)).

He was told there would be interest on late payment, but no-one at HMRC mentioned the 5% late payment penalty. The Tribunal decided that Mr Sprake had not phoned HMRC for advice, but only to give HMRC the information that he was going to pay late.

So '*Whilst it may have been helpful for HMRC to volunteer the information that a penalty would be payable when Mr Sprake contacted them to tell them that a payment would be made late, we do not consider that Mr Sprake had in fact requested advice from HMRC in this call as to the consequences of late payment'.*

But he was advised that there would be interest payable.

'*Mr Sprake noted that if he had been advised that there would be a penalty, he would have taken steps to borrow the money'.*

Conclusion

It will pay dividends to check HMRC guidance and administrative policy back to the underlying legislation. In a world of rapid change, the risks of mismatch become greater as circumstances arise which may not have been envisaged when the legislation was written.

The truth is that there is increasing need for professional tax advice in an age of digital approximation and self-serve.

TAX PRACTICE AND OWNER MANAGED BUSINESS TAXES

Class 2 was due to be abolished in April 2019. Now it has been reprieved, but this latest change is unlikely to be trouble free. What do practitioners and clients need to watch out for?

Not abolition, but ongoing change

The Written Ministerial Statement on 6 September 2018 by the Exchequer Secretary to the Treasury that Class 2 National Insurance will not now be axed, is the latest reversal in a long line of policy statements and discussions. From a practical point of view, it still leaves a number of issues unresolved.

Class 2 NICs has been changing since 2015 in line with the Government's aim to have a single class of voluntary NICs, to align it with the new State Pension regime from 2016, and following recommendations from the Office of Tax Simplification in 2011. The idea of abolishing Class 2 NICs has not turned out to be as simple as it first seemed.

It was also in view that Class 4 contributions would replace Class 2 contributions as the means of accessing contributory social security benefits. ICAS responded to the Government's consultation in February 2016.

Some of the changes made since 2015 are still causing problems and to be aware of the ongoing issues, we need to review what has already happened.

Change in collection

From the 2014-15 tax year, Class 2 NICs ceased to be collected by monthly / six monthly direct debit. Instead, from 2015-16, collection of Class 2 was made via the self-assessment return.

The change in collection method has not been trouble free.

Bumpy transition

Transition from 2015 to now has not been a smooth process for advisers and their clients. There are three main reasons for this:

- Confusion over the process for cessation of Class 2 payment direct debits;
- HMRC's expectation that all newly self-employed would use form CFW1 to register for self-assessment and Class 2 National Insurance;
- HMRC's decision to make the National Insurance and PAYE Service (NPS) computer system the primary National Insurance database. NPS 'overwrote' self-assessment return information without notifying either the taxpayer or agent.

Issues such as these are likely to continue to surface. When abolition of Class 2 was within sight, HMRC was unlikely to make expensive changes to the system, so how are matters to be dealt with now?

Live issues – newly self-employed

The CWF1 form for the newly self-employed covers registration for both income tax self-assessment and Class 2 National Insurance. However, what is the likelihood that someone already in self-assessment, perhaps due to having investment or rental income, will know they must complete a CWF1 form if they subsequently become self-employed for the first time?

The snag is that if the self-employed income is simply added to the self-assessment return, the individual will not be included on the NPS system as self-employed.
HMRC need to be informed that the individual is now liable to pay Class 2, and that NPS should be updated. HMRC advises that the CWF1 form is the recommended method. How many taxpayers are aware they need to do this, especially if they are unrepresented?

The action point for advisers is that all newly self-employed individuals should be registered for Class 2 using CWF1 even if they are already in self-assessment or where they make a 'voluntary' return (that is, one not prompted by HMRC issuing a notice to file).

Legacy issues – self-employment not showing on NPS

Where a self-employed individual is not recorded on NPS, HMRC will not accept payment of Class 2 through self-assessment.

Example: An individual who was in continuing self-employment in 2014-15 cancels their Class 2 NICs direct debit. HMRC considers this to be a declaration of cessation of self-employment. NPS is updated so they are no longer shown as self-employed.

The individual's tax return for 2015-16 is submitted, showing a Class 2 liability. The NPS system would not permit payment of that Class 2 – a refund of Class 2 contributions already made is instigated.

Sorting out the confusion results in many wasted hours for agents, clients and HMRC. The problem carries over into 2016-17 but should now be resolved.

Voluntary payments

Some change has already been legislated and the position of those making voluntary Class 2 contributions will need to be monitored.

People paying voluntary Class 2 payments include, but are not limited to:

- Examiners, exam moderators, invigilators and those who set exam questions;
- Anyone running a property business which is not taxed as a trade (before the 2015 changes, some property-related activities qualified as 'business activities' for Class 2 NICs purposes);
- Ministers of religion who are not liable to Class 1 NICs;
- Self-employed individuals with income below the small profits threshold;
- Expatriates currently paying voluntary Class 2 to maintain their UK state pension entitlement;
- Women intending to claim Maternity Allowance based on Class 2 contributions, who may wish to consider making voluntary payments in advance.

Not all these individuals will be in self-assessment and they may need to make separate arrangements to pay class 2.

Conclusion

The changes to Class 2 highlight a potentially costly gap between broad policy statements and the practicalities of implementation. Further change is needed, and vigilance will be required to avoid unwanted complications.

If you have come across ongoing problems in this area, please contact us at icas-tax@icas.com.

SORP UPDATES

In the previous edition of Technical Bulletin, changes to the Pensions Statement of Recommended Practice (SORP) were highlighted. Since then, the three SORP-making bodies for not-for profit sector SORPs have published updates too:

- The Charities SORP
- The Housing SORP
- The Further and Higher Education SORP

Changes arising from the Financial Reporting Council's (FRC) 2017 triennial review of Financial Reporting Standard (FRS) 102 are the main, but not the only reason, for the updates. Amendments which clarify existing requirements are also a notable feature of the updated SORPs.

All three updated SORPs are applicable for periods commencing on or after 1 January 2019. However, clarification amendments to the Charities SORP (FRS 102) are applicable to periods ending on or after 5 October 2018.

Entities registered as charities in Scotland with the Office of the Scottish Charities Regulator (OSCR) and early adoption

For charities registered in Scotland with OSCR, including cross-border charities, the early adoption of amendments to the Charities SORP (FRS 102) arising from the FRC's triennial review of the standard are not permitted.

Likewise, early adoption of the Housing SORP and the Education SORP is not permitted by entities registered as charities in Scotland with OSCR.
The prohibition on early adoption arises from the Charities Accounts (Scotland) Amendment Regulations 2018 (SSI 344 of 2018).

The Charities SORP

The Charities SORP-making body has not republished the Charities SORP (FRS 102) in full. Amendments to the SORP are made through Update Bulletin 2. This means that in order to comply with the Charities SORP (FRS 102), charities must comply with the following for periods commencing on or after 1 January 2019:

- Charites SORP (FRS 102) (effective 1 January 2015);
- Update Bulletin 1; and
- Update Bulletin 2.

These documents are available on the Charities SORP microsite at www.charitysorp.org

The amendments are set out in three sections:

- Clarifying amendments applicable to periods beginning on or after the date of this publication (October 2018);
- Significant amendments; and
- Minor amendments.

Clarifying amendments are made to the following SORP modules:

- Module 3: Accounting standards, policies, concepts and principles, including adjustment of estimates and errors. There is clarification of the existing requirement to provide comparative information.
- Module 5: Recognition of income, including legacies, grants and contract income. There is clarification about when payments by subsidiaries to their charitable parents that qualify for gift aid should be accrued in the individual accounts of the parent charity.
- Module 10: Balance Sheet. The undue cost or effort exemption for depreciating assets comprising of two or more major components which have substantially different useful economic lives is removed.
- Module 13: Events after the end of the reporting period. Clarification of when payments by subsidiaries to their charitable parents that qualify for gift aid are adjusting events occurring after the end of the reporting period.

Unless a Deed of Covenant is in place, corporate gift aid should be accounted for after the end of the reporting period. The Charities SORP-making body is developing an Information Sheet on accounting for corporate gift aid to assist charities and their subsidiaries deal with some of the complexities of this topic.

Significant amendments arising from the FRC's 2017 triennial review are made to the following sections of the SORP:

- Accounting and Reporting by Charities: The Statement of Recommended Practice (SORP) - Scope and Application module. The date from when the amendments in Update Bulletin 2 are effective is inserted.
- Module 10: Balance Sheet. Amendments are made to:
  - Permit charities which rent investment property to another group entity to measure the investment property either at cost (less depreciation and impairment) or at fair value.
  - Remove the undue cost or effort exemption for the investment property component of mixed-use property to require measurement at fair value.
  - Remove the disclosure of stocks recognised as an expense from the notes to the accounts.
- Module 14: Statement of cash flows. Amendments are made requiring charities to prepare a reconciliation of net debt as a note to the statement of cash flows.
- Module 27: Charity mergers. The transfer of activities to a subsidiary undertaking are included as an example of a charity reconstruction that should be accounted for as a merger.
- Appendix 1: Glossary. The definition of the term 'service potential' is included.

There is a further section on more minor amendments arising from the 2017 triennial review.

Charities should consider their own particular circumstances when determining when to adopt the changes contained in Update Bulletin 2:

- Clarifying amendments apply to reporting periods ending on or after 5 October 2018.
- Amendments arising from the 2017 triennial review apply to reporting periods commencing on or after 1 January 2019.
- Charities registered in Scotland with OSCR are not permitted to early adopt the amendments arising from the triennial review, including cross-border charities registered with the Charity Commission for England and Wales.
- The early adoption of amendments arising from the 2017 triennial review is possible for charities registered in other UK jurisdictions, provided all such amendments are adopted.

Please note that the above list of considerations is not necessarily comprehensive. However, all charities preparing 'true and fair' accounts in accordance with the Charities SORP (FRS 102), should adopt Update Bulletin 2 in full for periods commencing on or after 1 January 2019.

The Housing SORP 2018 update

This revised edition reflects the relevant changes to FRS 102 arising from the FRC's 2017 triennial review, as well as clarifying some other areas of the requirements of the Housing SORP 2014.

Significant amendments to the Housing SORP include:

- Clarifying what is included and excluded from operating surplus;
- Removing the undue cost or effort exemption in valuing investment properties;
- Allowing an accounting policy choice to carry property rented to other group entities at either cost or fair value; and
- Drawing attention to the requirement to include a net debt reconciliation as a note to the statement of cash flows.

The Housing Federation has re-published the Housing SORP and branded this as an Update of the 2014 edition. The Housing SORP 2018 Update is available to purchase from the Housing Federation's website at: www.housing.org.uk

The Housing Federation website states that "The updated SORP will be effective for periods beginning on or after 1 January 2019, although early adoption is permitted provided all aspects are adopted." As mentioned previously, early adoption is not available to registered social landlords which are also registered in Scotland with OSCR by SSI 344 of 2018.

The Education SORP 2019

Amendments to the Education SORP 2019 (published in 2018) from the 2015 edition are not expected to result in substantive changes for most further education colleges and universities, although institutions and their accountancy advisers are reminded by Universities UK of the requirement to consult FRS 102 to understand the full accounting requirements.

Education SORP 2019 incorporates previous amendments to the 2015 edition set out in the Further Education Higher Education (FEHE) SORP Guidance Note 2015. In other areas the terminology used in the Education SORP has been more closely aligned with FRS 102.

Universities UK has re-published the Education SORP in full and it is available to download free of charge from its website: www.universitiesuk.ac.uk

Further education colleges and universities must apply the Education SORP 2019 for periods commencing on or after 1 January 2019. However, early adoption is permitted provided all the following conditions are met:

- All of the triennial review 2017 amendments are implemented;
- The amendments to the Education SORP from the 2015 SORP are applied at the same time; and
- The relevant funding body permits early adoption.

Although the Education SORP permits early adoption, colleges and universities registered in Scotland with OSCR are not permitted to early adopt due to SSI 344 of 2018.

ACCOUNTING AND AUDITING QUERIES

FRS105 AND INVESTMENT HOLDING COMPANIES

Query

I am a partner in a small firm of chartered accountants. One of my clients which is a financial services private limited company has asked whether it is entitled to take advantage of the financial reporting provisions that are available to micro-entities. The company's sole trade is to hold a portfolio of investments that are managed by an investment manager. The aim is to make dividends or capital growth on the investments.

The company meets the Companies Act 2006 size thresholds for qualifying as a micro-entity but due to the nature of what it does, is it able to qualify as a micro-entity and hence able to apply Financial Reporting Standard (FRS) 105 'The Financial Reporting Standard Applicable to the Micro-entity Regime'?

Response

Paragraph 384B of the Companies Act 2006 list the entities which, regardless of size are ineligible for the micro-entity regime. These are as follows:

Those entities which are ineligible due to the prohibitions imposed by the small company regime (as per section 384 of the Companies Act 2006) i.e.:

(a) a public company;
(b) a company that:
    (i) is an authorised insurance company, a banking company, an e-money issuer, a MiFID investment firm or a UCITS management company; or
    (ii) carries on insurance market activity; or
(c) a member of an ineligible group. A group is ineligible if any of its members is—
    (i) a traded company;
    (ii) a body corporate (other than a company) whose shares are admitted to trading on a regulated market in an EEA State;
    (iii) a person (other than a small company) who has permission under Part 4 of the Financial Services and Markets Act 2000 (c. 8) to carry on a regulated activity;
    (iv) [F4(ca)an e-money issuer,]
    (v) a small company that is an authorised insurance company;
    (vi) a banking company, MiFID investment firm or a UCITS management company; or
    (vii) a person who carries on insurance market activity.

Additionally, the following types of entity are also prohibited from accessing the micro-entity regime:

(a) an investment undertaking as defined in Article 2(14) of Directive 2013/34/ EU of 26 June 2013 on the annual financial statements etc. of certain types of undertakings;
(b) a financial holding undertaking as defined in Article 2(15) of that Directive;
(c) a credit institution as defined in Article 4 of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, other than one referred to in Article 2 of that Directive;
(d) an insurance undertaking as defined in Article 2(1) of Council Directive 91/674/ EEC of 19 December 1991 on the annual accounts of insurance undertakings;
(e) a charity;
(f) a parent company which prepares group accounts for that year as permitted by section 399(4); and
(g) the company is not a parent company, but its accounts are included in consolidated group accounts for that year.

Under Article 2(14) of Directive 2013/34/ EU of 26 June 2013 an investment undertaking is defined as:

(a) undertakings the sole object of which is to invest their funds in various securities, real property and other assets, with the sole aim of spreading investment risks and giving their shareholders the benefit of the results of the management of their assets; and
(b) undertakings associated with investment undertakings with fixed capital, if the sole object of those associated undertakings is to acquire fully paid shares issued by those investment undertakings without prejudice to point (h) of Article 22(1) of Directive 2012/30/EU.

When reading the Companies Act 2006, it would appear on the face of it that all investment undertakings would be caught by the exclusion from producing micro-entity accounts. For example, a property investment company, or a company holding a share portfolio as its only activity, might appear to fall within the definition of an investment undertaking. However, a company that only holds one, or very few investments may not be 'spreading risk' or giving shareholders 'the benefit of the result of management of the assets.'

Therefore, in practice, it can be argued that the purpose of the definition is intended to catch those investment funds in which there are investors who are not closely involved in the management of the fund. The definition does not, however, state this explicitly. There is merit in this argument as, if there are external investors, they clearly have a right to sufficient information about how their investment is performing, and therefore information in relation to their monies, the company's performance, and accounts that have been prepared in accordance with FRS 105 may not provide enough information in that respect. Whereas, in situations where all the shareholders are also directors, or closely related to them, it would be difficult to imagine anyone objecting to the use of the micro-entity regime.

Ultimately it will be a matter for the directors to apply professional judgement when determining whether they believe application of FRS 105 is appropriate.

ACCOUNTING FOR FARMING PARTNERSHIPS

Query

I am partner in a medium size firm of chartered accountants. I have several clients that are general farming partnerships (not limited liability partnerships) and trusts. I was wondering whether there are specific legal requirements as to what accounting standards, if any, such entities are required to follow?

Response

Section 25 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA) provides that the taxable profits from a trade are to be derived from the accounting profit as determined under UK GAAP. This means that the profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustments required or authorised in calculating profits for income tax purposes.
As per section 997 of the Income Tax Act 2007 'generally accepted accounting practice' means:

- in relation to IAS accounts, the generally accepted accounting practice in relation to IAS accounts; and
- in relation to other accounts, generally accepted accounting practice in relation to accounts of UK companies (other than IAS accounts) that are intended to give a true and fair view.

However, the ITTOIA specifically provides that this does not require a person to comply with the requirements of the Companies Act "except as the basis of computation" or impose any requirements as to audit or disclosure. Thus, the tax legislation does not require the production of true and fair financial statements for partnerships but merely requires the profits to be computed for tax purposes on this basis.

Therefore, it may not be necessary to prepare a full set of Financial Reporting Standard (FRS) 102 accounts complying with all the presentation and disclosure requirements – but the recognition and measurement requirements should be followed in calculating profits for income tax purposes. Additionally, one would need to check to see whether any other documents imposed any specific reporting requirements on such an entity e.g. partnership agreement, trust deed etc.

FRS 102 is available to download from the FRC website: https://www.frc.org.uk/getattachment/69f7d814-c806-4ccc-b451-aba50d6e8de2/FRS-102-FRS-applicable-in-the-UK-and-Republic-of-Ireland-(March-2018).pdf

REGISTERED SOCIETIES

Query

I am a partner is a small firm of chartered accountants. We are considering acting for a new client which is a registered society. It was formerly an industrial and provident society. I was wondering what regulations apply, including whether there is an audit requirement for such entities?

Response

Registered Societies

Before 1 August 2014, all societies registered under the Industrial and Provident Societies Act 1965 (or its predecessors) were legally referred to as 'industrial and provident societies', regardless of what they called themselves. From 1 August 2014 they are now referred to as 'registered societies.

The source of this change was 'The Co-operative and Community Benefit Societies Act 2014 (CCBS Act)' which resulted in the 'industrial and provident society' legal form being replaced with two new legal forms. Therefore, any new societies registered on or after 1 August are referred to as either:

(i) a co-operative society – a business that is run for the benefit of its members, distributing profits between them, or
(ii) a community benefit society – a business that is run for the benefit of the wider community, re-investing profits in the community.

The Financial Conduct Authority (FCA) is the registering authority for 'Registered societies. Industrial and provident societies remain registered but were deemed to be 'pre-commencement societies'. Since 1 August 2014 it has not been possible to register a new 'industrial and provident society'. All societies that were previously registered as 'industrial and provident societies' are also referred to as 'registered societies.

The CCBS Act also consolidated previous industrial and provident society legislation including:

- The Industrial and Provident Societies Act 1965;
- The Friendly and Industrial and Provident Societies Act 1968; and
- The Co-operative and Community Benefit Societies Act 2003.

Friendly Societies

Certain societies registered under the Friendly Societies Act 1974 can convert to become a registered society under the 2014 Act, these are:

- working men's clubs;
- benevolent societies; and
- specially authorised societies.

Section 84A of the Friendly Societies Act 1974 enables these societies to convert to registered societies.

Co-operative society vs Community Benefit Societies

Co-operative societies

These are formed primarily to benefit their own members, who will participate in the primary business of the society.

In order to satisfy the FCA that it will be a bona fide co-operative, a society will normally have to fulfil the following conditions, the first four of which also reflect the International Co-operative Alliance's Statement on the Co-operative Identity:

- Community of interest - There should be a common economic, social or cultural need or interest among all members of the co-operative.

- Conduct of business - The business will be run for the mutual benefit of the members, so that the benefit members obtain will stem principally from their participation in the business. Participation may vary according to the nature of the business and may consist of:

    - buying from or selling to the society;
    - using the services or amenities provided by it; or
    - supplying services to carry out its business.

- Control - Control of the society lies with all members. It is exercised by them equally and should not be based, for example, on the amount of money each member has put into the society. In general, the principle of 'one member, one vote' should apply. Officers of the society should generally be elected by the members who may also vote to remove them from office.

- Interest on share and loan capital - Where part of the business capital is the common property of the co-operative, members should receive only limited compensation (if any) on any share or loan capital which they subscribe. Interest on share and loan capital must not be more than a rate necessary to obtain and retain enough capital to run the business. Section 2(3) of the 2014 Act states that a society may not be a bona fide co-operative if it carries on business with the object of making profits mainly for paying interest, dividends or bonuses on money invested with or lent to it, or to any other person.

- Profits - If the rules of the society allow profits to be distributed, they must be distributed among the members in line with those rules. Each member should receive an amount that reflects the extent to which they have traded with the society or taken part in its business. For example, in a retail trading society or an agricultural marketing society, profits might be distributed among members as a dividend or bonus on purchases from or sales to the society. In other societies (for example, social clubs) profits are not usually distributed among individual members but members benefit through cheaper prices or improvements in the amenities available.

- Restriction on membership - There should normally be open membership. This should not be restricted artificially to increase the value of the rights and interests of current members, but there may be grounds for restricting membership in certain circumstances, which do not offend co-operative principles. For example, the membership of a club might be limited by the size of its premises, or the membership of a self-build housing society by the number of houses that could be built on a particular site.

Community benefit society

The FCA would normally expect a community benefit society to fulfil the following conditions:

- Conduct of business - The business must be run primarily for the benefit of people who are not members of the society and must also be in the interests of the community at large. It will usually be charitable or philanthropic in character.

- Interest on share and loan capital - It is unusual for a community benefit society to issue more than nominal share capital (for example, one £1 share per member). Where it does issue more than nominal share capital or where members make loans to the society, or both, any interest paid must not be more than a reasonable rate necessary to obtain and retain enough capital to run the business.

- Profits and assets - The society's rules must not allow either profits or the society's assets to be distributed to the members. Profits must generally be used to further the objects of the society by being ploughed back into the business. Where profits are used in part for another purpose, that purpose should be similar to the main object of the society, for example for philanthropic or charitable purposes. The rules must specify the beneficiary or beneficiaries, if any. Where the rules of the society allow assets to be sold, the proceeds of the sale should be used to further the society's business activities only.

- Dissolution - The society's rules must not allow its assets to be distributed to its members on dissolution. The rules should state that on dissolution the assets should be transferred, for example, to some other body with similar objects. If no such body exists, the rules should state that the assets must then be used for similar charitable or philanthropic purposes.

Charitable Societies

If a society with a registered address in England and Wales has exclusively charitable purposes for the public benefit it is an 'exempt charity'. This means it cannot be registered with the Charity Commission, but it is still subject to charity law. For details on these points societies are encouraged to contact the Charity Commission.

A society which has its registered office situated in Scotland must register with the Office of the Scottish Charity Regulator (OSCR) in order to be recognised as a charity. For details on these points societies are encouraged to contact OSCR.

Companies

A company registered under the Companies Act 2006 may convert into a registered society. Section 115 of the 2014 Act enables this.

Audit requirements

For each year of account, a registered society must (subject to the exemptions below) appoint a qualified auditor to audit its accounts and balance sheet for that year.

Small Societies Exemption

A "small society" for a year of account is one in which:

(i) the total amount of its receipts and payments in respect of the **preceding** year of account did not exceed £5,000,
(ii) it had no more than 500 members at the end of the previous year, and
(iii) the total value of its assets at the end of the previous year did not exceed £5,000.

Such entities need not appoint a qualified auditor but instead can appoint two or more persons who are not qualified auditors to audit its accounts and balance sheet for that year.

Financial Thresholds Exemption (Not applicable to all Societies)

On 6 April 2018 'The Co-operative and Community Benefit Societies Act 2014 (Amendments to Audit Requirements) Order 2018' came into effect that amended parts of the Co-operative and Community Benefit Societies Act 2014. These revisions in relation to an entity's ability to avail itself of audit exemption are reflected below:
A registered society may, by resolution, disapply the duty to appoint auditors in respect of a year of account if—

(i) the total value of its assets at the end of the preceding year of account did not exceed £5,100,000 (previously £2,800,000) and
(ii) its turnover for that preceding year did not exceed £10,200,000 (previously £5,100,000)

Such a resolution must be passed at a general meeting at which:

(i) less than 20% of the total votes cast are cast against the resolution, and
(ii) less than 10% of the society's members for the time being entitled under its rules to vote cast their votes against the resolution.

However, as previously, the following types of societies are not entitled to avail themselves of this exemption, and therefore must still appoint a qualified auditor to audit their accounts:

- credit unions;
- a Scottish regulated housing association;
- a subsidiary of another society;
- a society with one or more subsidiaries (whether those subsidiaries are companies or societies);
- a society that holds a deposit or has done so at any time since the end of the preceding year of account (unless the deposit was withdrawable share capital)

If a society chooses not to have a full audit from a qualified auditor they must, if their turnover was over £90,000 in the preceding year of account, appoint a qualified auditor to prepare a report on the accounts and balance sheet. Regulated housing associations in England and Wales must appoint a qualified auditor to prepare a report on the account and balance sheet whatever their turnover.

The report on the accounts and balance sheet is less onerous than a full audit. The report must state whether, in the opinion of the qualified auditor making the report:

- the revenue account or accounts, the other accounts (if any) to which the report relates, and the balance sheet are in agreement with the books of account kept by the society
- on the basis of the information contained in the books of account, the statutory account complies with the requirements of the Act, and
- the financial criteria allowing the production of a report instead of a full audit have been met

The qualified auditor preparing the report has the same kinds of powers as an auditor.

These include carrying out any necessary investigation, seeing the society's books and other documents at any time, and being able to demand information and explanations from the society's officers. They are also entitled to attend and speak at society general meetings and get the same communications about the meeting as members. The auditor should sign their report.

Where the relevant conditions are met, and the society produces unaudited accounts, the revenue account and balance sheet must still be signed by the secretary and two committee members of the society acting on behalf of the society's committee.

Societies that are charities

It should also be noted that the full extent of these changes doesn't apply to societies that are charities. For these societies the assets threshold increases to £5.1m; but the turnover threshold stays at £250,000. Charities, of course, also have to apply with the relevant charity specific conditions in the jurisdictions in which they operate.

More information regarding the audit regulatory framework for charities can be found in appendix 2 of the Financial Reporting Council's practice note 11 (Revised)/The audit of charities in the United Kingdom.

Resolution required

The duty to appoint an auditor can only be disapplied if the criteria for exemption are met and a resolution has been passed at an AGM. This must be done on an annual basis.

Rules of the Society

If a society currently requires a professional auditor to audit its accounts and wants to disapply this requirement or use the small society exemption, then a rule change may be needed. For example, a rule that states '…and the audit will be carried out by a registered auditor' ties the society to the appointment of a registered auditor. If the current rules only permit a full professional audit, then a rule amendment must first be passed and registered with the FCA. The small society exemption and disapplication provisions do not override society rules.

ACCOUNTING FOR CRYPTO-CURRENCIES

Accounting for crypto-currencies

Transactions in bitcoin and other crypto-currencies are growing exponentially, and so questions are being raised about how these activities should be treated in the financial statements.

A recent paper prepared for the International Accounting Standards Board (IASB) reviewed the prevalence of crypto-currencies amongst companies reporting under International Financial Reporting Standards (IFRS) in various jurisdictions, and how these transactions have been accounted for. This found some diversity in the accounting treatment selected as follows:

- Holding crypto-currencies – these have variously been accounted for under International Accounting Standard (IAS) 39 'Financial Instruments: Recognition and Measurement' as financial assets at Fair Value Through Profit or Loss, under IAS 38 – 'Intangible assets, or IAS 2 – 'Inventories.
- Initial Coin Offerings (ICOs) – the receipt of funds has been accounted for as deferred income.
- Mining – transaction fees received have been accounted for as revenue.

Holding crypto-currencies

The most common of these activities is the holding of crypto-currencies, and some consensus seems to be emerging. (See Table A).

Initial coin offerings

ICOs are still less commonplace, and the available guidance is less clear on how these should be accounted for. A recent paper prepared for the IFRS Interpretations Committee summarises the options under current IFRSs for accounting for ICOs.

Under an ICO, the entity undertaking this will receive cash or a crypto-currency in return for the issued crypto-asset, creating an asset which is the debit side of the entry. The credit will be dependent on the obligations arising for the entity on the issue of the crypto-assets. The IASB paper considers these potential accounting options. (See Table B).

Table A

Asset category		Explanation
Cash/cash equivalents	✗	Crypto-currencies are not as yet generally considered to be a 'medium of exchange' i.e. they are not recognised as legal tender in most jurisdictions or backed by a central bank.
Non-cash financial assets	✗	Crypto-currencies do not confer a contractual right to receive cash or another financial asset, or to exchange financial assets or liabilities with another entity
Inventories	✓	Entities holding crypto-currencies for sale in the normal course of business may account for these under IAS 2-inventories.
Intangibles	✓	Identifiable non-monetary assets without physical substance, therefore can be accounted for under IAS 38

Table B

Equity	The crypto-assets issued in the ICO may give the holder the right to distributions by the entity, and therefore may be treated by the issuer as equity if it meets all of the conditions set out in IAS 32.
Financial liability	If, for example, the crypto-asset contains an obligation for the issuer to deliver cash to the holder, it may be a financial liability under IAS 32 'Financial Instruments: Presentation'.
Revenue	If the issue of crypto-assets results in the issuer being required to transfer goods or services to the holder, it may be appropriate to account for the proceeds as revenue, if it meets the conditions set out in IFRS 15 'Revenue from contracts with customers'.
Non-financial liability	The IASB gives the example of the issuer having an obligation to construct an exchange through which holders of the crypto-asset can transact with other users of the exchange, which could result in the entity applying IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' to account for this obligation.

Mining of crypto-currencies

None of the available sources of guidance currently address how to account for the mining of crypto-currencies. The IFRS Interpretations Committee has decided not to consider how mining would be treated under current IFRSs due to the infrequency of these activities at the current time. However, it is likely this area will need to be re-visited in the future.

The above analysis is based on IFRS – as yet, there is no guidance on how to accounts for these transactions under UK GAAP. Therefore, for companies reporting under FRS 102, preparers and auditors should exercise professional judgment in determining the applicability of this guidance, as well as taking into account all relevant facts and circumstances of the particular transactions.

Useful resources

For further background and detail, a number of bodies have published papers on the topic, including:

CPA Canada – An introduction to Accounting for Crypto-Currencies

Accounting Standards Board of Japan – Practical Solution on the Accounting for Virtual Currencies under the Payment Services Act (English language information paper)

PWC - Cryptographic assets and related transactions: accounting considerations under IFRS

EY – Applying IFRS: Accounting by holders of crypto-assets

Subscriptions and enquiries

Jeanette Rorison, Practice administrator, ICAS

0131 347 0249

practicesupport@icas.com

ICAS

CA House 21 Haymarket Yards Edinburgh EH12 5BH

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