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Tax newsletter

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Making Tax Digital (MTD) for VAT

As of 1 April 2019, Making Tax Digital (MTD) became compulsory for most VAT registered businesses with a taxable turnover above the VAT registration threshold.

For a small minority of VAT registered businesses with more complex requirements (including VAT groups and overseas traders), MTD is not compulsory until 1 October 2019.

What changes are in place now?

From the first VAT period commencing on or after 1 April 2019, businesses are required to keep certain records in digital form. Businesses can continue to prepare VAT return calculations in a spreadsheet program, such as Excel, provided software has been obtained which acts as a digital 'bridge' between the spreadsheet and HM Revenue & Custom's (HMRC) Application Programming Interface (API).

The nine boxes of the VAT return must be submitted to HMRC digitally using software compatible with HMRC's API platform. It will no longer be possible to submit VAT returns by entering the details into HMRC's online portal.

What should businesses be doing?

Signing up for MTD

Each business is required to sign up individually to MTD. HMRC will not automatically transfer VAT registered businesses to MTD for VAT. The timing of this step is vital. A business should not sign up to MTD for VAT until it has filed all non-MTD VAT returns.

Authorising MTD software

Before a VAT return can be filed digitally, the software used must be authorised to communicate with HMRC systems. This process is initiated from the software product. The software will require reauthorisation periodically.

Other considerations

Taxpayers who are voluntarily registered for VAT (have a turnover below the registration threshold) will not, at present, have to mandatorily comply with MTD. They should continue to monitor their turnover carefully to establish when they are required to start complying with the MTD requirements. Alternatively, they may choose to opt into MTD now.

Changes in 2020

Businesses must also be aware of the more complex rules coming into force in 2020.

From 1 April 2020 (1 October 2020 if the deferral applies), businesses will also need to comply with the "digital links" requirements. This means that any transfer of data between accounting systems and the software used to prepare the VAT return must be done electronically without manual intervention. Businesses may require changes or upgrades to their accounting software in order to be compliant. Please speak to a member of our team to discuss the detailed requirements here.

Changes to Entrepreneurs' Relief (ER) from April 2019

This valuable relief for individuals disposing of their business interests now has additional conditions attached.

Previously, in order to qualify for Entrepreneurs' Relief (ER), a person making a disposal of shares in a trading company must have met the following conditions for one year prior to the disposal:

- be an officer or employee of the company or group;
- hold ordinary shares allowing them to exercise 5% of shareholder votes; and
- hold ordinary shares representing 5% of the nominal value of ordinary share capital.

What has changed?

Additional tests

Individuals disposing of their shares after 5 April 2019 now must meet the following conditions in addition to those set out above:

- hold ordinary shares entitling them to at least 5% of profits available for distribution to equity holders; and
- hold ordinary shares entitling them to 5% of assets available for distribution to equity holders on a winding up.

OR:

- be beneficially entitled to at least 5% of the sales proceeds available to holders of ordinary share capital.

Two year holding period

The new conditions, together with the original conditions, must have been met for a period of two years prior to the disposal, where the disposal occurs after 5 April 2019 (and where relevant, the business ceased on or after 29 October 2018).

If the business ceased trading before 29 October 2018, the conditions need only have been met for one year prior to cessation, regardless of whether the shares are sold before or after 5 April 2019.

The two year holding period will apply to Enterprise Management Incentive (EMI) shareholders although the 5% tests are not required to be met.

Pre-incorporation period

Previously, where a business had been incorporated, in order to qualify for ER the individual must have held qualifying shares for a period of at least twelve months - regardless of how many years the business had been trading before incorporation.

Following the changes introduced by the Finance Act 2019, the entire period of time spent trading (as a sole trader or partner in a partnership) before incorporation is now also taken into account in considering whether the two year holding period is met.

What do these changes mean in practice?

- pre-sale planning needs to be considered much earlier, company shareholders now need to meet additional conditions for an additional year;
- where more complex share structures exist, eg alphabet shares/preference shares/shares with varied rights, these should be reviewed to ensure all conditions are fulfilled; and
- sole-traders and partnerships can now retain their ER and incorporate their business immediately prior to a sale meaning greater flexibility if needed.

Annual investment allowance (AIA)

Many companies have been fearful of what the post Brexit UK economy will look like and so have been reluctant to invest in capital expenditure. As part of an initiative to encourage capital investment the government have, from 1 January 2019 to 31 December 2020, temporarily increased the AIA limit from £200,000 to £1 million.

AIA is a capital allowance which gives 100% tax relief, up to the AIA limit, for qualifying expenditure. As such this relief reduces the corporation tax liability of the company in the year of expenditure.

The key to maximising utilisation of the temporary extension to the AIA limit is the timing of the expenditure. Due to tricky transitional rules, companies who report outside the calendar year need to be careful of when they incur the expenditure in order to maximise their relief. If such companies wait until 31 December 2020 to invest, relief will be greatly reduced.

In order to obtain the maximum AIA of £1 million expenditure needs to be incurred in a twelve month year end which starts and ends within the temporary extension and not during a year end which straddles the extension.

Companies should determine the ideal time to invest and get their cash flow planning in place now in order to see the benefit to both their business operations and tax liability.

If your company lacks sufficient cash reserves to invest during the temporary extension you may believe this initiative has no relevance, however if your company enters into a hire purchase contract to acquire qualifying assets it will be entitled to claim AIA in the period the contract is entered into. The tax relief available will be based on the future payments to be made under the hire purchase contract.

Changes to tax reliefs for homeowners

For most individuals the disposal of their home is generally free from Capital Gains Tax (CGT) when the conditions for principal private residence relief apply. However, this may no longer be the case following proposals announced to PPR in Budget 2018 due to take effect from 6 April 2020.

Final period exemption
Currently, the last eighteen months of ownership of any dwelling that has been the individual's main residence, is exempt from CGT. For example, if an individual moved out of their main residence to a new home on 1 January 2018, they would have until 30 June 2019 to sell the original home without incurring a CGT liability. From 6 April 2020 the final period exemption will be reduced from eighteen months to nine months. However, special rules apply to those with a disability and those in care where there is an exemption for the gain attributable to the last 36 months of ownership.

Lettings relief
At present lettings relief is available to exempt or reduce the capital gain for a homeowner on the disposal of their home where the owner has let the property as residential accommodation during a period in which the owner is absent. For example, a homeowner may be required to work overseas for a few years and decide to let their home while they are absent. Under current rules the gain on disposal relating to the letting period is reduced by up to £40,000. This ancillary relief often eliminates CGT.

From 6 April 2020 it is proposed lettings relief will only be available where the owner is in shared occupancy with a tenant. This means relief will no longer be available for the periods where the owner has moved out of the property. This could result in an increased tax bill for some on the disposal of their main residence.

Action
In view of the proposed changes taking effect on 6 April 2020, if you are thinking of selling your home in the near future you should review the tax implications to understand how the changes will affect you if you sell before or after 6 April 2020.

Although the government issued a consultation document in April 2019 on the proposed changes highlighted above the purpose was to seek views on implementation and not views on alternative proposals.

Off-payroll working in the private sector

It is imperative that all medium and large businesses now review their engagements with all of their contractors to see if new rules starting in April 2020 apply. These new rules may require payments being made to contractors via a Personal Service Company (PSC) or agency to be processed through the businesses payroll with PAYE and National Insurance Contribution (NIC) accounted for as if the payment was salary to an employee.

In the Autumn Budget 2018 Philip Hammond announced that large and medium sized businesses will now have the responsibility of deciding whether the IR35 rules apply when engaging with contractors, freelancers or consultants through a PSC or agency arrangement. Previously this responsibility lay with the contractor, but as a result of the complex legislation, HMRC's inability to police this and mixed court case outcomes, action has been taken by HMRC to try and remedy the issue by increasing the compliance obligations of employers.

IR35 rules broadly require the PSC to consider whether the contract or engagement would be one of employment but for the existence of the PSC. The rules and HMRC guidance seek to establish whether the PSC is in its own right a real business, subject to real financial risk and with the ability to operate and control its affairs. If this is not the case, and the engagement is more one of employment, then the rules require the PSC to tax any income it receives as if it were salary, with PAYE and NIC charges being processed through the PSC's payroll.

These changes will add another layer of responsibility and paperwork on businesses. It is not enough to review the legal contracts of engagement, the facts of the working arrangements will have to be considered and unfortunately, neither the rules nor the indicators are straightforward.

Getting it right will not always be straightforward. HMRC's check employment status test and traditional self-employment indicators can help (but not always) clarify the status of the worker. Financial risk, control over how and when the work is done and the substitutability of the contractor, are often key drivers and each should be considered in turn with outcomes documented, filed and revisited regularly.

Get it wrong and the PAYE/NIC at stake will be due to be paid by the business rather than the contractor.

Now is the time to identify your off-payroll workers and consider the contractual and factual terms of the engagement.

Reform of tax relief for goodwill

Recent amendments to the corporate intangible fixed assets regime reinstates corporation tax relief for the cost of acquired goodwill in certain circumstances.

The changes aim to improve the attractiveness of the UK to investors and will have effect in relation to acquisitions of goodwill that occur on or after 1 April 2019.

From 2004 to 2015, tax relief was available for acquired goodwill. Corporation tax relief was available for the cost of acquiring such assets as and when the expenditure was written off in the company's accounts ie as the intangible asset was impaired or amortised.

The government felt this tax relief created an artificial incentive to buy assets rather than shares and therefore, for goodwill acquired from 8 July 2015, relief was removed such that amortisation of goodwill is not an allowable expense.

As outlined above, the government made the decision to reintroduce relief for acquired goodwill from 1 April 2019 where a company also acquires qualifying Intellectual Property (IP).

The categories of qualifying IP assets will include: patents, registered designs, copyright and design rights and plant breeders' rights.

Companies that acquire goodwill will receive relief for goodwill up to six times the value of any qualifying IP assets in the business being acquired.

Relief will be given at an annual fixed rate of 6.5% of the qualifying cost of the acquired goodwill. Therefore there will be a tax deduction in the corporation tax computation of 6.5% of the cost per annum.

The new relief does not extend to internally-generated goodwill in a related party incorporation.

Goodwill acquired prior to 1 April 2019 will continue to be subject to the tax treatment prevailing at the time it was acquired. Hence, there is no relief where the goodwill was effectively acquired after 8 July 2015 and before 1 April 2019. However, where relief is denied for amortisation on goodwill acquired during these dates, any loss arising on realisation of the goodwill will be allowed as a non-trading debit.

Robotic Process Automation (RPA)

Constant advances in technology can be disruptive to business models; we have seen this in the uncertainty created by HMRC's roll out of Making Tax Digital (MTD). However, companies should examine how they can embrace these technological developments in their business by using Robotic Process Automation (RPA), especially in their accounting and tax functions.

RPA is software that can be used to automate procedures and operations in the workplace. It captures the procedures implemented by existing IT systems and can interpret and manipulate the data. RPA is most adaptable for repetitive, manual processes that typically take up a significant amount of time.

RPA could be beneficial to accounting and tax functions as it can mimic the interactions of users while enabling the automation of manual processes. This can be applied to invoice processing, report generation, bank reconciliations, credit control, tax returns and submissions and many other tasks.

Any size of business in any sector can benefit from the efficiencies that RPA brings. While the benefits will be on a more significant scale for large corporates, clients who currently have a finance team made up of a few staff members can also gain efficiencies. It is worth noting that many of the manual tasks that could utilise RPA can be prone to error. RPA removes the human error element of data processing and this can cut down on management time spent on quality control rather than adding value. RPA can be invaluable in supplementing existing resources in support functions by standardising tasks, boosting efficiency and cutting costs.

While automation can be seen by some as a negative thing in that it replaces jobs, the focus for businesses going forward should be that using RPA can increase efficiencies and thereby profit. Instead of replacing jobs, it could allow the people who are currently burdened with time consuming and manual tasks to use their time for decision making, thinking and creativity to drive the business forward.

There is no doubt that technology will play a greater role in finance and tax functions going forward. While tax law changes quickly, technology develops at a much faster rate and businesses should strongly consider the opportunities to avail of RPA for staying ahead of their competitors.

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