Veterinary Tax Matters

DRIVING LIFELONG PROSPERITY

Autumn 2022

SPOTLIGHT ON THE TAX POLICIES OF OUR NEW PM

Welcome...

The autumn issue of our Veterinary Tax Matters focuses on the proposed tax policies of our new PM and how they might affect corporation tax, national insurance contributions and the current marriage tax allowance. We also look at the introduction of quarterly reporting through Making Tax Digital (MTD), and how acccommodation benefits can impact on the National Minimum Wage.

Crypto-assets and the tax investigation service are highlighted in our comprehensive tax round up, whilst we shed light on how HMRC are clamping down on irregularities in R&D tax relief claims.

Finally, the VAT impact of the new business test comes under review, along with advice on the trust registration service (TRS), and proposed changes to the tax treatment of transfers of assets on separation.

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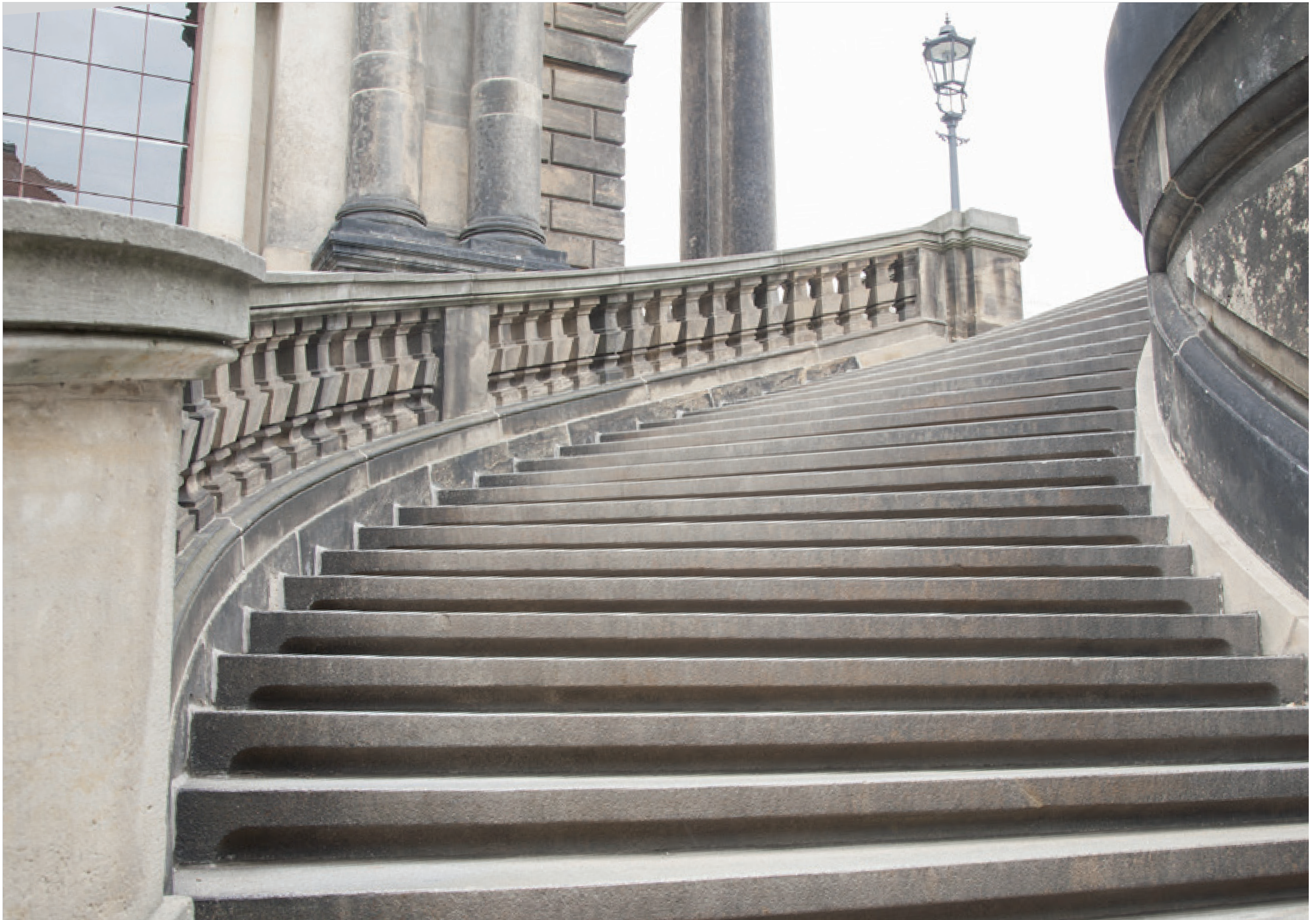


TAX POLICIES OF OUR NEW PM

As Liz Truss settles in at 10 Downing Street, a shake up to the tax regime is almost certainly inevitable. Whether she will call an emergency Budget or perhaps bring forward the Autumn Budget remains to be seen but we do already have an insight into some of the tax changes pledged during her campaign.

Whilst still Chancellor, Rishi Sunak announced that the main rate of corporation tax would increase from 19% to 25% with effect from 1 April 2023. Truss did, however, pledge to cancel this increase if she became the next Prime Minister. The current headlines are all declaring how much this reversal will cost, however, it had also previously been suggested that the tax increase would have actually lost the Treasury more money than it would have raised as larger businesses were looking to invest elsewhere.

Another key pledge whilst running for office was that Truss would scrap the national insurance contribution (NIC) rises. It is hard to see how this will be reversed for the current year, where the NIC rates have already been increased but we do expect that the health and social care levy due to come in from April next year will not go ahead. This levy was due to effectively replace the NIC increases currently in force.

A final tax handout that has been mooted by the new PM relates to the marriage tax allowance. Currently, it is possible to transfer up to 10% of your personal allowance (where unused) to your spouse or civil partner. The receiving spouse/civil partner must be a basic rate taxpayer, resulting in a tax saving of up to £252 of tax in 2022/23 from claiming this relief. It has been suggested that Truss will enhance this relief by allowing for the whole of the personal allowance to be transferred in future tax years. If the rules are changed, a transfer of the full personal allowance (currently £12,570) could equate to a much more sizeable tax saving of up to £2,514 per annum.

The proposed tax cuts are estimated at costing the Treasury in the region of £30 billion a year and, combined with Truss' proposed spending policies upwards of £50 billion a year, the key question that remains now is how she will look to fund these proposals.

MTD FOR INCOME TAX

Making Tax Digital (MTD) for income tax is set to come in from April 2024. Although this still seems like some time away, it is important to understand sooner rather than later whether you may be within the scope of the new rules.

MTD will first apply to sole traders and landlords with total gross property and/or trading income of over £10,000. Income is in aggregate, so if you have £7,000 of rental income and £5,000 of trading income you would still be required to comply.

As part of MTD, you will need to keep digital records and submit quarterly updates to HMRC for each of the following sources of income:

- Self-employment
- UK property
- Overseas property

For each of the above, HMRC has set out sub-categories of the income and expenses that will need to be reported for each of the quarterly updates. These are broadly in line with those that are currently reported on the property and self-employment pages of the tax return.

A welcome announcement, however, is that individuals with income below the VAT threshold (currently £85,000), can choose to just report two figures per quarter, one for total income and the other for total expenses, rather than having to split into sub-categories. This will reduce the administration burden for those with smaller incomes.

Another welcome relaxation for retail businesses is that only a single digital record of the daily gross takings for any retail sales made will be required.

Following the basis period reform, everyone will have the same quarterly reporting deadlines, which will be one month after the end of the tax quarter. For example, the first quarter will run from 6 April – 5 July 2024 with a filing deadline of 5 August 2024. If easier, it will be possible to elect to report on a calendar quarter e.g. 1 April – 30 June 2024, for the first quarterly report. The deadline will also remain the same (e.g. 5 August for the first quarterly update) giving an extra five days to file.

An end of period statement will also need to be filed for each source of income subject to MTD to make any tax adjustments, as well as a final declaration to bring all other income into account (similar to the current tax return).

An individual's gross total income for the 2022/23 tax year will be used to determine whether they will be in the scope of MTD from April 2024. General partnerships will not be subject to MTD until April 2025 and more complex partnerships such as LLPs and mixed/corporate partnerships from April 2026 at the earliest.

If you are likely to be within the rules and do not currently keep digital records, we would recommend that you start to explore the options available to ensure that you can comply with the rules when they take effect.

NATIONAL MINIMUM WAGE AND ACCOMMODATION OFFSET

National minimum wage (NMW) is a statutory employment right that guarantees employees a wage not lower than that set by the Government.

The rates from April 2022 are:

- £9.50 for individuals aged 23+
- £9.18 for individuals aged 21–22
- £6.83 for individuals aged 18–20
- £4.81 for individuals aged 16 –17 (and apprentices under 19)

The onus is on the employer to ensure that NMW requirements are satisfied, and they should be able to evidence this if challenged by HMRC. The following pay elements contribute towards NMW:

1. gross salary
2. bonuses
3. commissions
4. incentive payments
5. piecework payments
6. accommodation offset

The first five above are straightforward and easily identifiable. The accommodation offset, however, is more complicated and is applicable where an employer provides accommodation to an employee.

ACCOMMODATION BENEFITS

An accommodation benefit may arise where an employer provides living accommodation to an employee. This may be provided as part of an employment package or may require the employee to pay a rent. This is the only benefit that can be taken into account when considering NMW.

It is important to note that whilst the accommodation provided to an employee may be an exempt benefit for tax purposes, it will still need to be considered when determining NMW.

As a reminder, Veterinary Nurses only have an exempt benefit when staying in provided accommodation whilst they are on call. Vets can have exempt benefits in kind on accommodation if they are not on call, but only when they meet the 'better performance of duties' criteria.

THE ACCOMMODATION OFFSET

The accommodation offset is a rate set by HMRC that represents the maximum value given towards an accommodation benefit for the purposes of calculating whether NMW has been paid.

The current accommodation offset rates are as follows:

Daily: £8.70 Weekly: £60.90

Any rental contribution made by an employee above the accommodation offset rate is treated as a deduction from wages, reducing the total pay reflected when determining whether the NMW has been met.

For example, Lauren is 22 and is paid £9.30 (more than NMW) an hour for 35 hours per week. Her employer provides her with accommodation for 7 days a week, for which Lucy is charged £10 a day.

£9.30 pay per hour x 35 hours per week = £325.50 weekly pay

£10.00 accommodation charge - £8.70 daily offset rate = £1.30 x 7 days = £9.10 deduction for accommodation

£325.50 weekly pay - £9.10 accommodation deduction = £316.40 adjusted weekly pay

£316.40 ÷ 35 hours = £9.04 adjusted hourly pay

This brings Lauren's pay down to £9.04 per hour which is below minimum wage.

Any contribution up to the amount of the accommodation offset is not considered for these purposes and is not taken into account.

For example, if an employee is paid below NMW and the employer charges them, say, £6 per day for accommodation, no adjustment is made to the employee's deemed pay and so they would be in breach of the regulations.

If, however, accommodation is provided free of charge the employee's pay is deemed to have been increased by the offset rate.

For example, Joseph is 21 and is paid £7.70 (less than NMW) an hour for 35 hours a week. His employer provides free accommodation for seven days a week.

£7.70 pay per hour x 35 hours per week = £269.50 weekly pay

£269.50 weekly pay + £60.90 weekly offset rate = £330.40 weekly pay including offset

£330.40 ÷ 35 hours = £9.44 adjusted hourly pay

This brings Joseph's pay up to £9.44 an hour which is more than minimum wage for a 21 year old.

Any additional expenses an employee is obliged to pay to the employer in respect of the accommodation, such as furniture, rates and utilities, should be considered when calculating the total accommodation charge.

FAILURE TO MEET NMW

Sufficient records must be retained for a minimum of six years from the end of the applicable pay reference period to evidence employees have received the NMW applicable.

If HMRC determine that an employer has not paid NMW, the business may be issued with a notice of underpayment. This will require the employer to settle salary arrears. In addition to this, a hefty penalty of up to 200% of the total underpayment (capped at £20,000 per employee) may be levied against the employer. The employer may also be publicly 'named and shamed' online by HMRC.

TIMING OF TRANSFERS ON SEPARATION

HMRC has released draft legislation proposing changes to the tax treatment of transfers of assets between spouses and civil partners on separation. The proposals include an extension to the time limit that assets can be transferred without a charge to capital gains tax (CGT).

Currently, assets can only be transferred on a 'no gain no loss' basis in the tax year of separation. This means that the receiving spouse or civil partner is treated as acquiring the asset at the original cost of the transferring spouse or civil partner with no CGT charge until they subsequently dispose of it. However, this tax benefit stops after the end of the tax year in which permanent separation occurs.

For example, if a couple decided to permanently separate on 1 March 2022, then they would only have been able to make tax free transfers up until 5 April 2022 (e.g. 36 days). After this time and before the divorce is finalised, transfers of assets are treated as being made at market value and hence could be subject to CGT under the current rules.

The new rules, due to come in from April 2023, propose to extend this time period to allow no gain no loss transfers for up to three years after the year ending in which they separate. Taking the example above, if the same couple could now hold off from making any transfers until the new rules take effect, they could again benefit from the no gain no loss rules between the period of 6 April 2023 and 5 April 2025 (three years after the year of separation). This period is extended to an unlimited time period if the assets are subject to a formal divorce agreement.

This extended period allowing a no gain no loss transfer would end at the point a divorce is finalised, and so could be earlier than the maximum three-year window. After the decree absolute is granted, assets would be treated as being transferred on an arm's length basis, so based on actual proceeds, rather than market value.

The proposals also include provisions to allow for the spouse or civil partner that has moved out of the family home to claim principal private residence relief (PPR) when the house is eventually sold, providing they retain an interest in the former family home. Further, if the individual has transferred their interest in the family home but is entitled to receive a percentage of the proceeds when it is eventually sold, they can apply the same tax treatment to those proceeds when received that applied when they transferred their original interest to their ex-spouse or civil partner. This is in contrast to the current rules where, if the spouse has moved out of the property before it is sold or transferred to the remaining spouse, they could be subject to CGT when it is disposed of if they have not lived there for some time.

The proposed changes are welcome announcements as they will provide couples, often going through a difficult period of separation, more time to reach a settlement and transfer assets without triggering an unexpected tax liability.

TRUST REGISTRATION SERVICE (TRS)

Most UK trusts and some non-UK express trusts in existence should now have been registered under the TRS, unless they fall within a specific exemption.

There was already a requirement to register taxable trusts, however, the regime has since been extended to also include non-taxable trusts. Some exemptions apply for non-taxable trusts, although most are now captured.

The key deadline for registration of non-taxable trusts was 1 September 2022, although HMRC have confirmed that they will take a soft-landing approach to penalties, so there is still time to act if you have not already.

Some common trusts which in most cases will need to be registered include:

- Dormant discretionary trusts - where the assets owned by the trust are not income producing and no capital disposals are made.
- Interest in possession trusts - where income is mandated directly to the beneficiary and there are no capital gains to report.
- Property trusts – jointly held property where the legal owners, trustees and beneficiaries are not the same people. This could include:
  - Property owned solely by one spouse but with a declaration in trust in place to transfer some or all of the beneficial interest to the other spouse;
  - Property legally held by one partner in a partnership but for the benefit of some or all of the other partners (but see below);
  - Property legally owned by four or more people but three or less people are registered at Land Registry;
  - Property left on death with the will stating that the surviving spouse has a life interest in the property but that it will pass to their child on his/her death.

A recent clarification to HMRC's guidance is in respect of property held on behalf of a partnership. Where the property has been purchased using partnership money but held in one of the partner's names, it can be generally assumed that the property belongs to the partnership, without the creation of an express trust and therefore this would not need to be registered.

If, however, there is a written deed or other formal agreement which states that the land is being held on trust for the partnership, this would create an express trust and would need to be registered on the TRS (subject to any other exemptions applying).

Any new trusts created will need to be registered within 90 days and any changes to existing trusts will also need to be updated to HMRC within the same timeframe.

Please get in touch with your usual tax contact if you would like further details on whether a trust may need to be registered or assistance with the registration process.

TAX ROUND UP

BASIS PERIOD REFORM

In conjunction with Making Tax Digital for income tax, the Government is proposing to tax profits arising in line with the tax year, rather than on a current year basis. This change will take effect from April 2024, with a transitional period in the 2023/24 tax year.

The rules will only impact sole traders and partnerships that do not prepare their accounts to 31 March or 5 April and could lead to an acceleration of profits into an earlier tax period. Provisions will apply, however, to allow any transitional profits to be spread over five tax years rather than all up front. We will be writing to all of our affected clients shortly (where we have not already) with further details and explaining the options available to deal with this reform.

LATE PAYMENT INTEREST

With effect from 23 August 2022, HMRC's late payment interest rate has risen to 4.25%. This is the highest that it has been since January 2009 and it is quite possible that we will see further increases in coming months.

Interest accrues for all late payments of tax, including where a time to pay arrangement has been set up with HMRC. Therefore, anyone with such an agreement will unfortunately see their payments increase. To reduce the cost of the debt, you may want to look at accelerating payments if you are in a position to do so and paying any other tax liabilities on time.

ATED – REVALUATION REMINDER

A company which holds UK residential property with a value in excess of £500,000 is subject to the annual tax on enveloped dwellings (ATED) rules. A fixed annual charge applies and was based on the value of the property as of 1 April 2017 for the 2022/23 tax year.

For the 2023/24 tax year it will be necessary to pay the charge based on the valuation of the property as at 1 April 2022. The value must be based on the open-market value of the property and, although a professional valuation is not required, we would recommend that support for the value used is obtained and documented.

This will be particularly important if the property value is close to the entry threshold or towards the top end of a banding in cases where the company is already subject to the ATED charge. If the estimated value is within 10% of an ATED threshold a 'pre-return banding check' can be requested from HMRC.

Not all properties are subject to the charge as certain exemptions and reliefs apply but the company may still be required to file a return to claim the relevant relief, with penalties applying for failure to do so.

CRYPTO-ASSETS

Along with any other asset, crypto-assets are subject to tax on any gains or profits made. Tax liabilities can be triggered when disposing, exchanging or using cryptocurrency to pay for goods/services and in most cases will be subject to capital gains tax.

With the recent crypto market crash, significant taxable gains may not be as prevalent as previous years, however, any capital losses can be crystalised for future offset and any smaller gains may still need to be reported. All individuals have a capital gains annual exemption (currently £12,300) which could be utilised to offset this.

The Government has also opened an enquiry into the role of crypto-assets in the UK. One aspect of this is how the tax system should change should crypto-assets be adopted more widely. We will need to wait and see if there are any changes to the tax regime as a result, but it shows that the government is honing in on the sector.

WORKING FROM HOME – UPDATED GUIDANCE

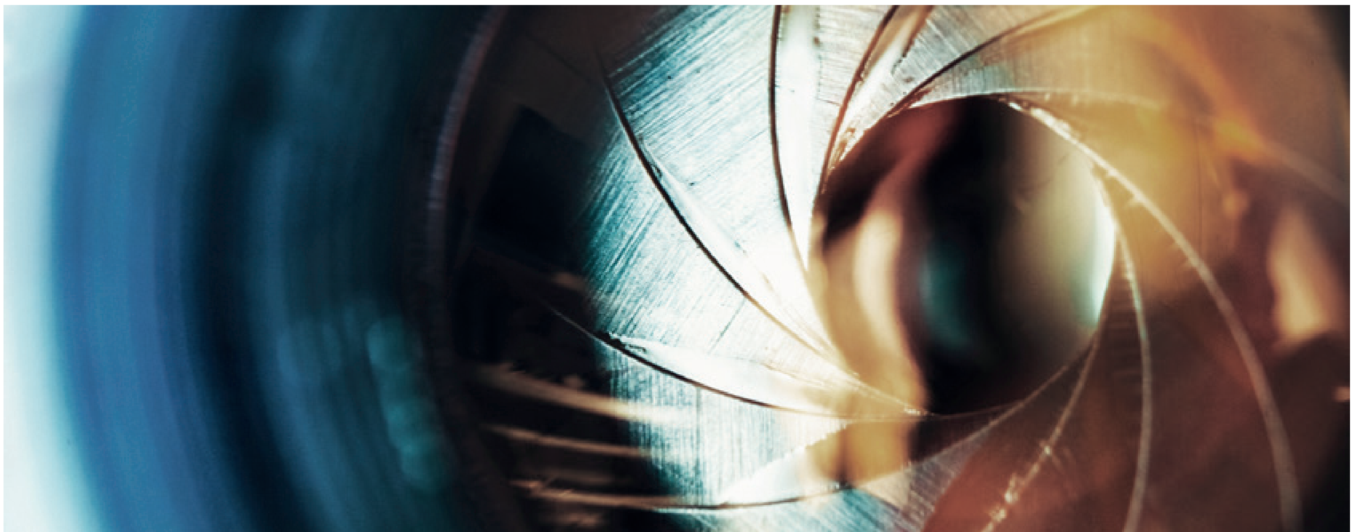
During the COVID-19 pandemic, HMRC relaxed its guidance relating to claiming expenses for employees working from home. For both the 2020/21 and 2021/22 tax years it has been possible for an employee to claim tax relief on the flat rate allowance of £6 per week for the entire year (where the employer has not reimbursed them) even if the employee has only worked from home for one day of each tax year.

From April 2022, however, this has now reverted back to the original guidance and more stringent conditions must be satisfied to be able to claim relief. Employers should still be able to reimburse expenses, tax free, providing there is a formal working arrangement in place, but it will be more difficult for an employee to claim tax relief where not reimbursed. In such cases, the employee will need to demonstrate that they have no choice but to work from home.

TAX INVESTIGATION SERVICE

Following a temporary lull in HMRC enquiries during COVID-19, we have seen the number of enquiries go back towards normal levels as HMRC staff previously redeployed have returned to their 'normal' roles. Our tax investigation service covers our professional fees in assisting you, should you be selected for an enquiry by HMRC.

Please look out for our invitation or renewal letters for subscription to our tax investigation service for 2022/23 in the next few weeks or, if you would like further information, please contact Fiona Isherwood at Fiona.Isherwood@hazlewoods.co.uk or on 01242 680000.



HMRC FOCUS IN ON IRREGULAR R&D TAX RELIEF CLAIMS

R&D tax relief claims have been under increasing scrutiny in recent months as HMRC has looked to clamp down on irregular claims. Just before the summer recess, draft legislation was also published setting out new requirements for businesses claiming under the regime.

HMRC has become increasingly aware of inconsistences between R&D tax claims and have recently recruited 100 new compliance officers to the R&D tax relief team. Further, the draft legislation, which is due to come in with effect from 1 April 2023, is also aimed at tackling abuse and will require companies to:

- make any future claims for R&D reliefs or tax credits digitally;
- include a breakdown of costs for each of the qualifying categories along with a description of the R&D activities;
- inform HMRC of the intention to make a claim within six months of the end of the period to which the claim relates, using a digital service (although this will not be required if the company has made an R&D claim in one of the three preceding periods); and
- claims will need to be endorsed by a named senior officer of the company and will also need to include details of any agent that has advised the company in respect of the claim.

As a firm we have seen a number of questionable claims, with limited information gathering, and often without appropriate support to back the claims made.

As a member of the professional accountancy and taxation bodies, we have responsibilities to adhere to, including the Professional Conduct in Relation to Taxation (PCRT). Professional practices to which PCRT applies are required to satisfy themselves that entries on clients' tax returns are sustainable and are not incorrect or misleading; failure to do so can result in the relevant professional institute taking disciplinary action against the tax adviser concerned. Other advisers may not fall within the ambit of PCRT, although they are supposed to adhere to similar requirements set out by HMRC. By requesting agent details, HMRC should be able to quickly identify any advisers that are consistently making inaccurate claims.

Coupled with the proposed changes to the regime, HMRC are also ramping up their procedures and carrying out more checks at the point the claim is made. For most genuine claims, this may just delay processing slightly, but for others it could lead to enquiries and potentially having to pay some or all of the tax saving back to HMRC.

These additional checks have also worryingly led to HMRC sending out a number of letters to taxpayers stating that "HMRC believe that you may have fraudulently claimed money to which you were not entitled". Although in some cases there may be inaccuracies in claims, the implication of fraud is very strong and it can be quite scary for a company to receive a letter making suggestions of fraud and possible criminal investigations.

If you are considering preparing your own R&D claim or engaging a third party to prepare on behalf of the company, you should carefully consider whether you believe the company has genuinely undertaken projects aimed at achieving an advance in science or technology and whether the quantum of the claim seems too good to be true!

VAT IMPACT – THE NEW BUSINESS TEST

HMRC has issued new guidance revising its interpretation of the law on whether an organisation can be considered to be 'in business' or not for VAT purposes (Business Brief 10/22).

BACKGROUND

The impact of being in business or not can be critical to successfully recovering VAT as input tax or being obliged to register in the first place, as many who have sought to make early claims or stay below the threshold may attest.

This change in direction will be of particular interest to anyone receiving grant income or government subsidies, along with those operating charities or nascent start-ups.

Conversely, some organisations in the low-cost-care and not-for-profit sectors may positively wish to remain outside of the scope of VAT and avoid registration.

THE OLD TEST

Historically, HMRC has applied the 'business test' as delineated by the courts in Lord Fisher [1981] STC 238 and Morrison's Academy Boarding Houses Association [1978] STC 1 as considering whether an activity:

1. is a serious undertaking earnestly pursued;
2. is an occupation or function actively performed with reasonable or recognisable continuity;
3. has a certain measure of substance in terms of periodic supplies or economic output;
4. is conducted in a regular manner and on sound business principles;
5. is predominantly concerned with making taxable supplies for a consideration; and
6. is of a type which are commonly conducted by those seeking to make a profit.

The clear emphasis was on establishing the existence of profit. In both Yarburgh Children's Trust [2002] STC 207 and St Paul's Community Project [2005] STC 95, a nursery failed the test by setting prices at a level intended only to cover costs. Although HMRC has acknowledged that a profit-seeking motive technically need not always exist, this has always been a difficult position to argue.

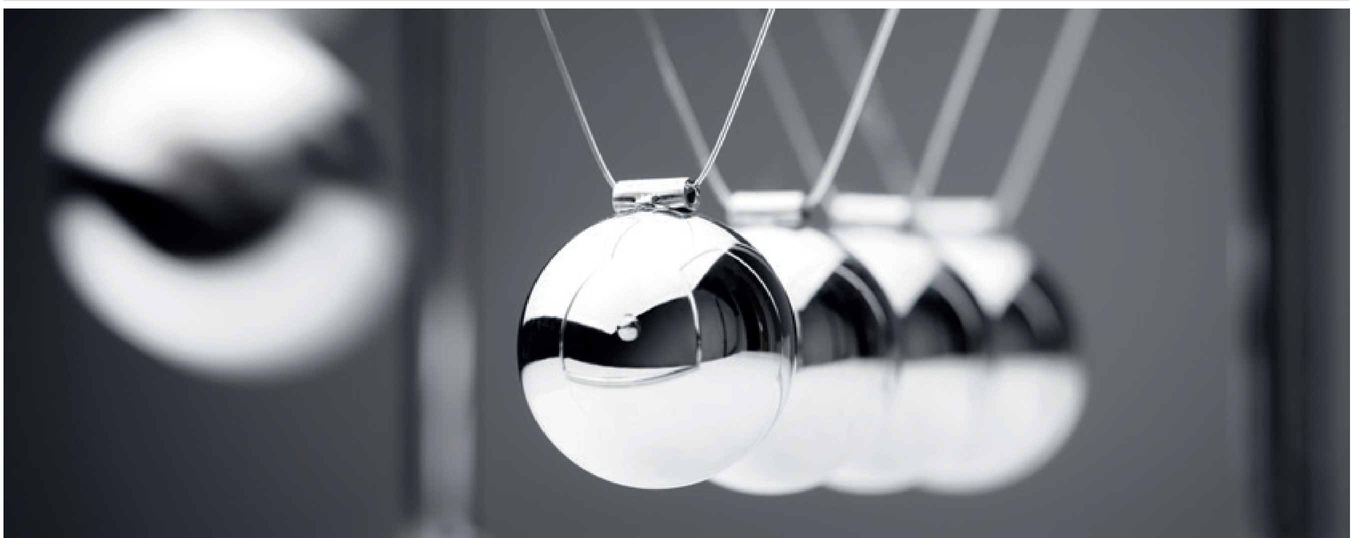
THE NEW TEST

Emerging from the recent Court of Appeal judgments, including Longridge on the Thames [2016] BVC33 and Wakefield College [2018] BVC 22, is now a simplified approach in the form of a two-stage test.

Rather than seeking profit or observing business principles, the focus should now be more on whether there is a direct link between the specific services being provided and the payment made in return.

This new two-stage test in summary is:

1. Does the activity result in a supply of goods or services?
2. Is that supply made for the purpose of obtaining remuneration?



The classic term 'consideration' is deliberately not used here, in seeking to distinguish any form of payment from one which may be specifically set below cost or lack any profit seeking motive at all.

CONCLUSION

This revised approach, focussing more on the direct link rather than hallmarks, is reminiscent of the strategy taken by the ECJ (as it then was) in the early VAT cases of Tolsma (Case C-16/93) and the Apples and Pear Development Council (Case C-102/86).

HMRC now state that the old six business indicators will no longer be applied in their decision making and the new two stage test will now be used to determine whether a taxpayer is 'in business' or not.

QUESTION

The question now is whether these revised criteria will give HMRC greater flexibility to consider whether wider activities should qualify for VAT recovery as a business activity and whether it will be used as both a shield and a sword.

We would hope that any clients who have previously been denied input tax recovery or refused VAT registration on such grounds may be willing to revisit whether the VAT regime is now more accessible to them.

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