

Corporate Quarterly Newsletter

WINTER 2011
EDITION

As Christmas approaches, we deliver to you a hamper filled with a choice selection of updates on current issues affecting entrepreneurs, employers and businesses generally.

At the time of coming to press, the Chancellor's Autumn Statement announcements are just starting to take some real form with further guidance and draft legislation expected on various fronts over the coming weeks. However, we will cover any pertinent changes in more detail once the substance is clear. The government has made a very positive move in attempting to tackle the funding crisis which grips start-ups and smaller businesses by proposing schemes like the Seed Enterprise Investment Scheme as well as widening and speeding up approval of enterprise zones. The expected backtracking on the planned reduction in capital allowances did not come to pass though.

Our focus in this edition, as always, is on current issues which affect owner-managed businesses and corporates more widely. Should any of the issues raised in this edition have particular resonance with you, please contact your usual Rawlinson & Hunter contact to discuss matters further.

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1 Employer compliance issues



Is Santa Claus breaking laws?

The introduction of the Bribery Act 2010 ("the Act") is intended to provide clearer and more effective guidance to commercial organisations and replaces out of date legislation which is now over 100 years old. As Christmas approaches with seemingly endless hospitality opportunities, it becomes even more relevant to consider the Act and how this affects our day to day business relationships.

Without having clear guidance, businesses may have been paranoid to the extent of wondering whether a standard business lunch could be deemed a reportable offence. The Act provides some comfort and specifically states that 'reasonable' business hospitality is acceptable. Unfortunately, as with most legislation, it is open to interpretation and until case law is passed, it makes it difficult to provide specific examples of what constitutes "reasonable".

The Act states it is now a legal offence to give or receive a bribe, to bribe a foreign official or to fail to prevent a bribe being paid. But what is a bribe, who is affected and how can it be prevented?

The dictionary definition indicates that a bribe is "to persuade someone to act in one's favour, by gift or other inducement". The Act indicates that to offer or give a financial or other advantage is an offence where it is intended to bring about or reward the improper performance by another person, or where the acceptance of this offer itself constitutes improper performance. Improper performance is where there is a breach in expectation that a person will act in good faith, impartially or in accordance with a position of trust. There must be intent to bribe for a bribe to have taken place.

The Act is also applicable for UK businesses operating overseas where local customs or practice are disregarded unless such activities are permitted or required with the written law applicable to that country.

The Act alleviates certain fears by confirming the building of professional relationships through hospitality is permitted where reasonable. In a statement issued by Kenneth Clarke, he confirmed "no one is going to try to stop businesses getting to know their clients by taking them to events like Wimbledon, Twickenham or the Grand Prix".

Look at how your business sector operates and whether that gift or event you are organising would be deemed reasonable in this sector. For anything extravagant, you may wish to consider the intent or purpose of the event. The same applies to the receiving or attendance of events offered by your business contacts.

If you have offered or received a bribe, this is a legal offence liable to prosecution through the Courts. A commercial organisation is liable to prosecution if the person committing the offence is associated with that organisation. The associated person can be anyone who performs services for and on behalf of organisations for the benefit of that organisation - so in theory this may include suppliers and contractors. A defence is available to organisations where they can prove adequate procedures were in place to prevent bribery.

The reality is that a bribery offence would need to be severe and it would need to be in the public interest to bring to prosecution. The Bribery Act can therefore be regarded in some way as a safety mechanism for businesses, rather than more onerous legislation for businesses to conform with.

If you haven't already, you should make sure those associated with your organisation are identified and made aware of the Act, the consequences of offence and procedures you have in place to prevent bribes. Look at identifying risk areas specific to your business and seek ways to minimise exposure. The size of your business should be taken into consideration in terms of the level of procedures adopted. For a small company, verbal notification to associates may be sufficient. It may well be necessary to update any business policy documents too.



PAYE pitfalls

HM Revenue & Customs generally try to collect the tax due on benefits provided by employers to their employees through the Pay As You Earn ("PAYE") system. This is generally achieved by deducting the taxable value of the benefit from the employees' allowances so that the tax is effectively collected over the whole of the tax year.

There have been some articles in the Press about various problems that have arisen due to incorrect coding resulting in large underpayments for certain employees at the end of the tax year.

What may not be so apparent is the problem that has arisen as a result of both the restriction of personal allowances for those earning over

£100,000 and the introduction of the 50% tax rate for those with income in excess of £150,000.

One of the overriding principles of the PAYE system is that an employer must not deduct more than 50% of an employee's salary in income tax. If an employee does not have any personal allowances due to the restrictions mentioned above, and they are subject to tax at 50%, then in certain cases it will not be possible to collect tax on their benefits in kind because they are already losing 50% of their income in tax anyway. This situation was not helped in the 2010/11 tax year by HMRC delays in issuing revised coding notices to employers.

This can lead to an unexpected and unwelcome surprise at the year end when the position is reviewed, and in the worst cases can mean a large tax demand. This is perhaps an unforeseen consequence of the higher tax rates currently in force.



National minimum wage increase

From 1 October 2011, the national minimum wage has increased. The current rate depends on the class of worker being employed:

- £6.08 per hour for workers aged 21 and over
- £4.98 per hour for workers aged 18-20
- £3.68 per hour for workers aged below 18 who are no longer of compulsory school age

Apprentices must be paid at least £2.60 per hour for those aged under 19 or are over 19 but are in the first 12 months of their apprenticeship.

As a result of the changes employers should review their pay rates to ensure that they comply with the new national minimum wage requirements.



The waiting game

Since 1 October 2011, employers can no longer enforce employees' retirement at the age of 65. The default retirement age was abolished by the Employment Equality (Age) Regulations which prohibits discrimination in the workplace.

If employers still wish to enforce retirement, they will have to provide justification for this, and they will not be able to enforce retirement on the grounds of age alone.

Employers should therefore review their employment contract, employment handbooks and other reference material to ensure that it complies with the new regulations.

2 Business taxes



Sowing the seeds

The Chancellor announced during his Autumn Statement that a new scheme will be introduced from April 2012 to encourage investment in small and start-up businesses.

The Enterprise Investment Scheme ("EIS") is well established and is a scheme which the government is already busily enhancing the benefits of. However, the administrative and qualification headaches that surround EIS make it often something which is seen as perhaps too difficult to implement for smaller businesses which have limited resources available.

The proposed Seed Enterprise Investment Scheme ("SEIS") is a variant of the original scheme but is expected to be less encumbered by the criteria which cause issues with certainty around qualification for the original EIS. Under SEIS, for the 2012/13 tax year, investors are to be given a 50% income tax rebate (regardless of the rate of tax which they are paying). Further, any capital gains realised during the 2012/13 tax year will also be exempt to the extent that the proceeds are re-invested in SEIS qualifying investments. These benefits are expected to be limited to £100,000 of investment in the SEIS qualifying company.

All told, an investor could effectively receive tax relief worth 78% of the amount reinvested in an SEIS qualifying company. This is further enhanced by the likelihood that the investment would qualify for Business Property Relief for Inheritance Tax purposes.

At this point, the details of the SEIS are still to be made clear. What is apparent is that this move is clearly one in support of the smaller business and will hopefully free up capital for investment in such businesses which find traditional sources of financing, such as bank facilities, difficult to access at the present time.

We will provide you with further updates as and when information becomes available.



Annual Investment Allowance - beware the trap

Businesses may be aware that, following the last Budget, the Annual Investment Allowance ("AIA") available to a business on qualifying expenditure incurred on plant and machinery is being reduced from the current rate of £100,000 to just £25,000 for expenditure incurred on or after 1 April 2012.

What may not be so apparent is the way in which this will affect businesses whose accounting period straddles this date, and in particular the "trap" which can impact on the allowances available for the unwary.

Where a company's accounting period begins before 1 April 2012 and ends on or after that date, the maximum AIA available for that accounting period is the aggregate of the amounts calculated as if the period was split into two parts, one before and one after 1 April 2012. For example:

A Company Ltd had an accounting period ending on 31 October. For the year to 31 October 2012 its maximum AIA entitlement is calculated on the basis of two periods: from 1 November 2011 to 31 March 2012, and from 1 April 2012 to 31 October 2012 ie:

$$152/366 \times £100,000 + 214/366 \times £25,000 = £56,148$$

However, there is a trap for those companies which do not incur any qualifying expenditure in the period to 31 March 2012. If in the above example A Company Ltd had not incurred any qualifying expenditure in the period from 1 November 2011 to 31 March 2012, but instead had bought qualifying plant worth £30,000 in the period from 1 April 2012 to 31 October, the maximum AIA available would be restricted to £14,583 (ie $7/12 \times £25,000$).

Businesses therefore need to consider their capital allowance expenditure carefully in the period up to 31 March 2012. Where possible, companies should ensure that expenditure is incurred in an accounting period prior to one which straddles 31 March 2012, in which case the full £100,000 AIA will still be available. Where this is not possible then they should try to ensure that there is pre 31 March 2012 expenditure sufficient to utilise the maximum available in that period.



Corporation tax and associated issues

Whether or not one company is associated with another for tax purposes can have a significant impact on the amount of corporation tax each pays. In particular, the small companies' rate of corporation tax (currently 20%) only applies to those companies with profits of £300,000 or less.

This limit, however, is shared between all associated companies. Therefore, for example, a company with five associates will only pay the small companies' rate if its profits do not exceed £50,000 ($£300,000 / 6$). Profits above this amount will be subject to the full corporation tax rate (currently 26%) subject to "marginal relief" which is designed to ease the transition between the two rates. It is therefore very important to understand whether particular companies are associated when considering the rate which applies to a particular company's taxable profits.

Generally it is very obvious that two companies are associated with one another. For example where one controls the other, or both are controlled by the same third company or person(s). However, there are circumstances where it is much less obvious that two companies are associated. For example, prior to recent changes, where a husband and wife each controlled their own company, those companies would have been associated even if each company was completely independent of the other.

Recognising that this may lead to an unfair result in certain cases, HMRC published revised legislation on 20 July 2011 which takes effect for accounting periods ending on or after 1 April 2011 (and hence is relevant for accounting periods commencing on or after 2 April 2010). The changes now take account of the wider picture rather than just applying the rules mechanically.

Broadly, the legislation has been amended so that two companies will only be associated for these purposes if there is "substantial commercial interdependence" between them. As a result, in considering whether two companies are associated or "linked" for these purposes, it is necessary to determine the extent to which the companies are:

1. Financially interdependent ie

- one gives financial support to the other (directly or indirectly); or
- each has a financial interest in the affairs of the same business

2. Economically independent ie

- the companies seek to realise the same economic objective;
- the activities of one company benefits the other; or
- the companies have common customers

3. Organisationally interdependent ie the companies have common

- management
- employees
- premises
- equipment

It is likely that most companies will benefit from the change in the rules. However, where a company is likely to be adversely affected, it is possible for it to elect for the new rules to apply only for accounting periods beginning on or after 1 April 2011. This could be the case where, for example, two partners in the same partnership each have their own separate companies outside of the partnership and one makes a substantial loan to the other.

Previously such companies would not have been treated as associated unless there was a tax avoidance motive for the structure. However, the loan would make the two companies "substantially commercially interdependent" and hence could increase the corporation tax liability for each company. Making the election would defer the accounting period from which the new rules apply.

It should also be noted HMRC's view that where one company is caught then both companies are associated. In addition, they consider that "substantial" in this context is 10% (although it is questionable whether a figure this low would be accepted as such by the courts). As a result this could particularly be an issue where one company is much smaller than the other and hence what is "substantial" for one may not be so for the other.

The change from a mechanical test to one which is more flexible may well lead to an increase in compliance costs as it will be necessary to monitor the position in determining whether the small companies rate will be applicable in particular cases.

For those companies which may benefit from the change in the rules it is important to seek advice to ensure that any tax saving is maximised.

3 VAT and indirect tax compliance



Property service charges: To VAT or not to VAT?

When the European Court of Justice ("ECJ") delivered its judgement in *RLRE Tellmer* there was a flurry of activity among professional VAT advisers. The judgement indicated that service charges provided under a property lease were subject to VAT even where the property lease itself was exempt from VAT.

With the uncertainty this judgement created HMRC found it necessary to issue a Business Brief [*Business Brief 67/09*] confirming that if a service charge is incurred as a condition under the lease, and a service is provided by the lessor without the lessee having a choice, then the rent and service charge are treated as a single supply, with the VAT treatment of the service charge following that of the rent. Unlike the tenants in *Tellmer* who did have a choice of provider which seemed to be the determining factor in the ECJ considering that the service charge was subject to VAT.

As HMRC's Business Brief confirmed the status quo there has been a period of certainty. However, there has been a referral to the ECJ questioning whether HMRC's current VAT treatment of service charges is correct.

The question referred to the ECJ concerns a firm of lawyers who occupy tenanted property who are seeking to argue that, by the strict interpretation of *Tellmer*, it is entitled to recover VAT on the service charges supplied as part of the lease, even though the lease is exempt from VAT and neither the landlord, nor the tenant, has accounted for VAT on the supply!

We now enter into another period of uncertainty. Some commentators have suggested that landlords make protective claims (ie claims for the recovery of VAT the landlord has incurred in supplying the services under the service charges). We would suggest that any landlord considering embarking on such an approach should give careful consideration to the issues as such a claim would require a complex analysis of costs which could, in some instances, produce a net payment rather than a repayment.

4 Financial reporting



Year end planning

With the end of December approaching, many companies will be coming up to their financial period end.

Should these companies be planning on awarding staff bonuses or declaring dividends that they want to be reflected in their financial statements for this financial period, they need to ensure that these have been adequately documented before the period end to ensure they satisfy the requirements of FRS 21 "Events after the Balance Sheet Date" and hence can be included in the current year.

Broadly speaking, the approximate quantum and / or method of calculating the bonus or dividend needs to be documented and for bonuses, they need to be communicated to employees such that the employees have a reasonable expectation of receiving the bonuses. In the context of dividends, they need to be approved by the shareholders of the company.



Financial Reporting Standard for Mid-sized Entities ("FRSME")

The FRSME, which is intended to be the complete accounting standard for non-listed entities which do not fall under the UK small companies' regime, continues its development process.

This standard follows similar presentation to IFRS but has greatly reduced disclosure requirements.

The FRSME, which is largely considered a 'finished product' by the Accounting Standards Board ("ASB"), is undergoing fine-tuning, i.e. drafting of implementation and transition documentation and review of a number of inconsistencies with existing available accounting standards in the UK (ie IFRS and UK GAAP), and UK law.

As a result, the current proposed implementation date is for accounting periods ending after 1 January 2014 (i.e. with transition date of 1 January 2013). However, based on past record, this date should be regarded sceptically and implementation is likely to be deferred until a later point.



Deferred tax provisions - update

Following on from our article last year detailing changes to the main rate of corporation tax in the Emergency Budget 2010, the March 2011 Budget actually introduced a reduction in the main rate of corporation tax from 28% to 26% from 1 April 2011, with further annual reductions of 1% to reach 23% on 1 April 2014.

The first 1 per cent reduction from 28% to 27% from 1 April 2011 had already been enacted in the 2010 Finance Act in July 2010. The additional 1% reduction to 26 per cent from 1 April 2011 was passed on 29 March 2011 and is substantively enacted from that date.

The 2011 Finance Bill, which became substantially enacted on 5 July 2011, brought in the decrease in the main rate of corporation tax to 25% from 1 April 2012 but did not include reference to the further phased reductions.

As a result, companies preparing statutory accounts with financial period ends after 5 July 2010 will need to review the tax rates used to calculate deferred tax assets and liabilities as these should be measured at tax rates expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been substantively enacted by the end of the financial period.

By way of example, if a company is drawing up accounts to 31 July 2011, it will need to consider how deferred tax liabilities and assets will be unwinding and whether the new 25% rate should be applied in the calculation of the provisions. As the further changes from 25% down to 23% have not as yet been substantively enacted, the lower rates cannot be used even if the asset/liability unwinds in later years.

However, FRS 21 "Events After the Balance Sheet Date" classifies a change in tax rates as a non-adjusting event and requires disclosure if there is a change in tax rates enacted or announced after the balance sheet date that has a significant effect on current and deferred tax assets and liabilities. As a result, for all statutory accounts still to be issued (whether the financial period end is after 5 July 2011 or not), companies with significant deferred tax assets or liabilities will need to consider whether disclosure of the impact of the announced changes on their deferred tax provisions is required.



Related parties

At the end of last year, new auditing standards, Clarified International Standards on Auditing ("Clarified ISAs") came into force for audits of entities with periods ending after 15 December 2010.

There is one particular area that an entity requiring an audit ("audit entity") will have seen additional information being requested by their auditors, being the identification of related parties.

The Clarified ISAs have introduced an additional requirement for auditors to establish a full list of related parties of an audit entity, even where there have been no actual transactions with that related party during the period under review. The Clarified ISAs consider that this will assist auditors with identifying related party transactions during the course of their audit.

The definition of a related party is provided in FRS 8 "Related Party Disclosures", however, broadly speaking, the information that auditors will require from each beneficial owner, director and key management personnel of an audit entity is listed below. At present, the best approach for obtaining this information is considered to be by circularising the beneficial owners, directors and key management personnel of the audit entity.

Information required:

1. Name of husband/wife or partner;
2. Name of any adult children;
3. Name of any person with whom the beneficial owner / director / key management personnel has a close relationship (as guidance - this would be anyone to whom they would lend money on preferential terms);
4. Any interests in any entities where the beneficial owner / director / key management personnel has significant influence (significant influence is control, joint control, significant voting power or influence – say over 20%); and
5. Any interests in any entities where the persons identified in 1 to 3 above have significant influence.

Financial Controllers and Finance Directors of entities requiring audits should consider preparing this information in advance of their audit process to ensure that this information can be provided to their auditors in a timely manner.

5 Company secretarial issues



XBRL - Companies House deadline delayed

Companies House previously announced the introduction of mandatory electronic accounts filing by March 2013 following the introduction of electronic filing of company accounts by HMRC for accounting periods ending after 31 March 2011 (see the article in our September 2010 newsletter).

However, Companies House has now removed this deadline, with no revised date being given. Companies House has stated that the long-term aim is still to become fully electronic, and that mandating electronic filing of accounts will be reconsidered in 2014 following the end of the moratorium on new legislation for small businesses.



SIC codes update for Companies House returns

Companies should be aware that Annual Returns filed with Companies House after 1 October 2011 must use the 2007 version of the UK SIC codes, which Companies House has now adopted.

There is now a five digit code to classify a company's business activities rather than the previous four digit code. These new codes will also be requested when "WebFiling" returns. The change affects not just the annual return (form AR01), but also forms SE FM01 - SE FM05 and SE TR02 and TR03.

In addition, there are also changes to the shareholder details which must be included on the Annual Return:

- Unlisted companies must now provide a full list of shareholders on the first Annual Return after incorporation and on every third annual return thereafter. Details of share transfers which occur during intervening years should be shown on the relevant year's Annual Return.
- Listed companies will generally be required to provide the names and addresses of those shareholders with 5% or more of the company's share capital (there are exceptions for certain FSA registered companies)

Going forward, companies should ensure that all returns filed with Companies House now include the relevant new SIC codes.

6 Upcoming deadlines

Date	Area	Matter to be addressed
1 January 2012	Corporation Tax	Non-large companies to pay tax for accounting periods ended 31 March 2011
7 January 2012	VAT	November 2011 returns to be filed and electronic payments made
14 January 2012	Corporation Tax	Form CT61 to be submitted and tax paid for the quarter ended 31 December 2011 in respect of any interest payments
14 January 2012	Corporation Tax	Quarterly instalment payments/ final payments due for large companies with December, March, June or September period ends
19 January 2012	PAYE	Payment of PAYE and NIC liabilities for the month to 5 January 2012
31 January 2012	Personal Tax	2010/11 self-assessment tax returns to be filed electronically. Balancing payment for 2010/11 and first payment on account for 2011/12 due
31 January 2012	Financial Statements	Private companies with a April 2011 period end to file accounts
31 January 2012	Financial Statements	Public companies with a July 2011 period end to file accounts
1 February 2012	Corporation Tax	Non-large companies to pay tax for accounting periods ended 30 April 2011
7 February 2012	VAT	December 2011 returns to be filed and electronic payments made
14 February 2012	Corporation Tax	Quarterly instalment payments/ final payments due for large companies with January, April, July or October period ends
19 February 2012	PAYE	Payment of PAYE and NIC liabilities for the month to 5 February 2012
28 February 2012	Financial Statements	Private companies with a May 2011 period end to file accounts
28 February 2012	Financial Statements	Public companies with a August 2011 period end to file accounts
1 March 2012	Corporation Tax	Non-large companies to pay tax for accounting periods ended 31 May 2011
7 March 2012	VAT	January 2012 returns to be filed and electronic payments made
14 March 2012	Corporation Tax	Quarterly instalment payments/ final payments due for large companies with February, May, August or November period ends
19 March 2012	PAYE	Payment of PAYE and NIC liabilities for the month to 5 March 2012
31 March 2012	Financial Statements	Private companies with a June 2011 period end to file accounts
31 March 2012	Financial statements	Public companies with a September 2011 period end to file accounts

What to do next...

If you are interested in any of these issues and wish to discuss them in more detail, please call the Rawlinson & Hunter partner who normally acts for you. If you are not one of our regular clients but would like more information or advice, a full list of partners is provided on this page and any of them will be delighted to help you.

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The information contained in this bulletin does not constitute advice and is intended solely to provide the reader with an outline of the provisions. It is not a substitute for specialist advice in respect of individual situations.

This firm is not authorised under the Financial Services and Markets Act 2000 but we are able in certain circumstances to offer a limited range of investment services to clients because we are members of the Institute of Chartered Accountants in England and Wales. We can provide these investment services if they are an incidental part of the professional services we have been engaged to provide.