Corporate Newsletter

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WINTER 2013 EDITION

Businesses in the UK are still recovering from one of the worst ever financial crises, reeling from austerity cuts by the coalition government and struggling with restricted lending from cautious high street banks. So what better time to hit them with the transition to a major new accounting regime...?

With the effective date of the largest overhaul of UK accounting standards in over 20 years on the horizon, this newsletter provides details of the new regime, as well as explaining the implications for businesses.

We also discuss the advantages and disadvantages of the government's somewhat maligned new "Employee Shareholder" status, the proposed introduction of new tax anti-avoidance legislation relating to close company loans and limited liability partnerships, and some recent VAT developments.

Should any of the articles in this edition raise any particular issues for you, please speak to your usual Rawlinson & Hunter contact to discuss matters further.

Please also see our separate briefing note for details of key developments in the Chancellor's Autumn Statement.

CONTENTS SECTION

RAWLINSON & HUNTER

1 A Winter's Tale

Changes to UK GAAP

Existing United Kingdom Generally Accepted Accounting Practice ("UK GAAP") for medium and large non-listed entities is being replaced by three new UK accounting standards, Financial Reporting Standards ("FRS") 100, 101 and 102.

Small companies will continue to be able to follow the Financial Reporting Standard for Smaller Entities ("FRSSE") (see the article below) and listed companies will continue to follow International Financial Reporting Standards as adopted by the European Union ("IFRS").

FRS 100, 101 and 102 will apply to accounting periods beginning on or after 1 January 2015.

Therefore, the transition date (the first date of the comparative period) of 1 January 2014 is fast approaching and companies need to consider early:

i. which standard they will follow;

ii. the effect on the company's financial reporting, including accounting policies and measurement techniques; and

iii. the data that needs to be gathered.

This article provides a brief overview of each of FRS 100, 101 and 102 and the key matters to be aware of when considering the transition from old to new UK GAAP.

Overview

FRS 100 'Application of financial reporting requirements' provides the conceptual framework for the financial reporting requirements of UK companies from 2015 onwards. It provides guidance on which companies must adopt full IFRS, may adopt the FRSSE or may choose between FRS 101 and FRS 102. FRS 100 also provides details of the transitional arrangements for companies that undergo a change of reporting requirements whether for their 2015 period ends or subsequently.

FRS 101 'Reduced disclosure framework' provides a mechanism for companies to adopt IFRS but with reduced disclosures. This standard will particularly appeal to subsidiary undertakings of listed entities, where the parent company must adopt full IFRS for its consolidated accounts and therefore wants its subsidiaries to follow IFRS but without many of the onerous disclosure requirements.

FRS 102 'The Financial Reporting Standard Applicable in the UK and Republic of Ireland' is the most direct replacement for old UK GAAP and is expected to be the standard adopted by the majority of medium and non-listed large entities. The accounting treatments in FRS 102 do not follow either IFRS or old UK GAAP but instead are a mix of the two with some completely new accounting treatments thrown in for good measure.

Principal differences between FRS 102 and old UK GAAP

As most medium and large non-listed entities are expected to adopt FRS 102, we have provided details of the key differences between FRS 102 and old UK GAAP in a table at the end of this newsletter.

Transition

Transition from old UK GAAP to FRS 102 will generally be applied retrospectively, however there are a number of transitional exemptions, including amongst others:

- tangible fixed assets can have previous revaluations under old UK GAAP or fair value at transition treated as 'deemed cost'. These assets will then apply normal cost accounting going forward.
- the accounting for past business combinations does not need to be revisited.
- companies that were dormant under old UK GAAP, but would not be under FRS 102, can continue to be treated as dormant.

Companies will need to perform a full review of balance sheet items at transition, also considering assets and liabilities that may not be recognised under old UK GAAP, to:

- determine where treatments change from old UK GAAP to FRS 102;

- identify the relevant transitional arrangements; and
- thereby determine FRS 102 valuations for these items.

In practice this is a complex area and many companies will require assistance from their accountants.

Practical and commercial considerations

Due to the differences between old UK GAAP and FRS 102, there are a number of commercial implications which companies will need to consider:

Bank covenants and agreements based on numbers in the accounts

The amounts in the statutory accounts (e.g. profit and net assets) may change significantly due to the different valuation and amortisation requirements under old UK GAAP and FRS 102. As a result, companies will need to review bank covenants and other agreements linked to these amounts, such as performance measures in employee service agreements, to ensure there are no unintended consequences.

Budgeting and group reporting

FRS 102 will not only affect the statutory accounts but also the timings and amounts of items in the company's budgets and cash flow forecasts.

In particular, there will inevitably be tax implications as the taxable profit is generally based on the accounting profit. As a result, there may be the risk of increased or accelerated tax charges. Conversely, there may be the opportunity to reduce or defer tax charges by proper consideration of policies to adopt on transition.

Impact on distributable reserves

Under FRS 102, it is more likely that the profit and loss reserve will not be fully distributable due to unrealised gains on investment properties and the impact of financial instruments being included to the profit and loss account.

Companies will need to maintain an analysis of reserves between distributable and non-distributable elements for the directors to consult when considering dividend declarations.

Systems, data gathering and staff training

Companies will need to review their systems and staff training to ensure they are able to properly collect and analyse the information required by FRS 102. In particular, are processes in place to measure the fair values of financial instruments and will the accounts preparation software be FRS 102 compliant (including iXBRL tagging – see the article below).

Please contact your usual Rawlinson & Hunter contact if you require further information or assistance with planning for the transition to new UK GAAP.

2 Peace on Earth, Good Will to All Men

New FRSSE

FRS 100 introduced a number of changes to the current FRSSE (2008) which are effective for accounting periods beginning on or after 1 January 2015.

The Financial Reporting Council ("FRC") has also now issued an updated FRSSE (2015), incorporating the changes from FRS 100, to give users a single standalone reference point (rather than needing to consult both the FRSSE (2008) and FRS 100). There are no additional changes to the FRSSE (2015).

The principal changes are as follows:

References

The FRSSE has historically taken the approach of referring users to full UK GAAP for guidance in more complex areas not dealt with in detail within the FRSSE.

FRSSE (2015) now refers users to FRS 102 rather than old UK GAAP as was the case for FRSSE (2008).

Goodwill and tangible and intangible assets

Useful economic life ("UEL")

Goodwill and intangible assets, which under the FRSSE (2008) were amortised over a maximum UEL of 20 years, may now be amortised over a longer UEL.

However, where the UEL, which must be finite, cannot be reliably measured, FRSSE (2015) presumes a maximum UEL of 5 years.

Impairment reviews

Furthermore, the FRSSE (2015) has brought in an additional requirement in relation to impairment reviews for goodwill and tangible and intangible assets.

At the end of each accounting period, the company must assess whether there is any indication of impairment of the asset (e.g. damage, worsening of market conditions, declining profitability) and, if there is, the company must estimate the recoverable value of the asset and write it down to that value.

These changes are likely to have a negative impact on profitability though may accelerate tax relief where goodwill/intangible asset amortisation is relievable.

Related party transactions

The definition of a related party has been widened to bring it broadly in line with that of FRS 8 and IAS 24, although disclosure is still only required if material to the reporting company.

Going forward

Further changes to the FRSSE (2015) are expected in the future due to the new EU Accounting Directive adopted in June 2013 which aims to reduce the administrative burden for small companies and changes in relation to micro-entities.

These changes could result in significant changes to the content and format of small company accounts as well as an increase in the number of companies falling below the audit thresholds.

3 Stop the Cavalry

New iXBRL requirements

It is over two years since the introduction in April 2011 of iXBRL tagging of company accounts and tax returns by HMRC.

At that time, HMRC stated they would not make any changes to the tagging requirements and would take a 'soft landing' approach to erroneous tagging for a two year bedding-in period.

Now that the two year period has passed, there are changes on the horizon:

Tagging of Detailed Profit & Loss Account ("DP&L")

For accounting periods beginning on or after 1 April 2014, companies will be required to tag their DP&L in line with a new iXBRL taxonomy developed for this purpose.

HMRC have stated that the DP&L can be tagged in either a company's accounts or tax return or both.

However, the latter option, i.e. tagging in both accounts and tax return, carries added risk of HMRC raising queries as they will be checking for inconsistencies between the two.

Therefore companies should ensure that they only tag the DP&L in either the accounts or the tax return and, since the DP&L should not be filed at Companies House, we suggest that tagging the DP&L in the tax return is the preferable option.

Phasing out of 'soft-landing'

The two year 'soft-landing' period finished in April 2013 and, so far, HMRC does not appear to have toughened its approach to accounts with erroneous iXBRL tags.

However, as mentioned above, HMRC have stated that they will look for inconsistencies where companies have tagged DP&Ls in both their accounts and tax returns, which would appear to suggest that they will also begin to pick up companies for errors in their iXBRL tagging.

FRS 101 and 102

The introduction of FRS 101 and 102 from 2015 will necessitate new iXBRL taxonomies to deal with tagging accounts prepared in accordance with these standards.

These new taxonomies are expected to be available in late 2014 or early 2015.

Companies will need to liaise with their software or service providers to ensure that they will be compliant with the new iXBRL taxonomies for FRS 101 and 102 in a timely manner.

4 He's Checking it Once, He's Checking it Twice

Directors' Report changes

For accounting periods ended 30 September 2013 and subsequently, the requirement for a Business Review in the Directors' Report has been superseded by a new Strategic Report.

The Strategic Report will be a separate report within a company's financial statements and will need to be signed by an officer of the company in the same way as the Directors' Report.

For non-listed companies, the information required to be included in the Strategic Report is the same as that previously included in the Business Review and Principal Risks and Uncertainties sections of the Directors' Report. Consequently these disclosures are no longer required in the Directors' Report.

In addition the following disclosures will no longer be required in the Directors' Report although they should be included in the Strategic Report if relevant to the strategy of the company:

- Principal activities
- Charitable donations
- Policy on payment of creditors
- Acquisition of own shares

The requirement for a strategic report does not apply to small companies.

5 Merry Christmas Everybody?

The new "Employee Shareholder" status

From 1 September 2013 a new type of employee status is available - an "Employee Shareholder". So why has this new status been introduced, how does it differ from a normal employee status and why would a prospective employee want to become an Employee Shareholder?

The Background

The Government announced in October 2012 that it wished to introduce a new status of employee who would own shares in their employing company in return for giving up certain statutory employment rights. This is intended to provide greater flexibility for employers following comments that the UK employment rights are too biased towards the employee.

The Basics

An Employee Shareholder contract requires the issue to the employee of a minimum of £2,000 fully paid up shares in the employer / parent company in return for the employee giving up their rights to:

- unfair dismissal (excluding dismissals which are deemed to be automatically unfair or are in breach of the Equality Act 2010);
- statutory redundancy payment; and
- request flexible working or time off for training.

They will also have stricter maternity and other family rights.

The employer is required to give the Employee Shareholder a written statement of their employment rights and the rights attaching to their shares.

Companies of any size can create Employee Shareholders, although the legislation is clearly aimed at start-up and fast growing small to medium sized companies wishing to create a flexible workforce with fewer constraints compared to standard employees. However it should be noted that, although employers can require new employees to sign Employee Shareholder contracts, existing employees cannot be forced to change their status to being Employee Shareholders.

The individual must receive independent legal advice about the terms of the Employee Shareholder contract, and the employer must meet the "reasonable costs" (not defined) of providing this advice, even if the offer is not subsequently accepted. HMRC have confirmed that this will not be taxed as a benefit on the employee. The individual is also entitled to a seven day "cooling off" period from the day the legal advice is given, even if the contract has already been signed.

The Benefits

- Employee

i. Tax Free Shares up to £2,000

The Employee Shareholder will receive fully paid up shares in their employer company (or parent company) with a minimum market value of £2,000 and a maximum value of £50,000. However, only the first £2,000 can be received free of tax or NIC, as the employee is deemed to give consideration of this amount in exchange for giving up the above employment rights.

The value of any shares received above £2,000 will be subject to income tax and NIC in the normal way. In addition, where an employee holds more than 25% of the shares in the company, the deemed consideration provisions will not apply to the first £2,000 of shares, and hence the whole acquisition of the shares will be subject to tax and NIC if full market value is not paid.

HMRC has announced that a facility will be made available to agree the market value of shares issued to Employee Shareholders along the lines of that provided for shares subject to options under the Enterprise Management Incentive ("EMI") scheme.

ii. CGT Exemption for Gains on Shares with an Initial Value up to £50,000

There is a capital gains tax ("CGT") exemption on disposal of shares with a value of up to £50,000 on acquisition. Any amount acquired above this value will be subject to CGT.

It will not be possible to transfer the CGT exemption to a spouse or civil partner, as the exemption will only apply to the first transfer or disposal of the original shares.

Furthermore, if there is a reorganisation of the share capital of the company (for example as a result of a share for share exchange), any sale of the new shares issued in exchange for the original shares will not qualify for the exemption. However, the disposal of the original shares will qualify.

Changes have been made to the income tax provisions which apply where a company buys back the shares from an Employee Shareholder. Generally the buy back of shares is subject to income tax treatment unless certain requirements are met. However, a new exemption for Employee Shareholders has been introduced so that they will be subject to capital treatment even if the requirements are not met.

- Employer

i. Workforce Flexibility

The employer will be able to require new employees to become Employee Shareholders, and hence will have greater flexibility over working patterns under the legislation. For example the removal of the right to statutory redundancy pay will reduce the costs of laying off staff if there is a downturn in business.

ii. Flexibility over Share Type

Since all types of shares will be eligible, there will be no requirement to issue Employee Shareholders with shares which have voting or dividend rights. Employers will also be able to require employees to forfeit their shares on leaving the company. The value at which this takes place is a matter for negotiation between the employer and employee, but this is likely to be fair market value for a "good leaver".

iii. Corporation Tax Deduction for Share Acquisition in excess of £2,000

The usual provisions relating to corporation tax relief for share acquisitions will apply to the employing company for shares acquired by Employee Shareholders in excess of £2,000.

iv. Simplified Provisions for Company Buy-Back of Shares

Changes have been made to company law to facilitate the buy-back of shares from Employee Shareholders so that shares can now be held as treasury shares rather than having to be cancelled. However, there is no requirement for the company to buy back the shares.

The Bottom Line

Although the new provisions are aimed at small and fast growing companies, there are a number of issues which may make the new Employee Shareholder an unattractive proposition for both employers and employees:

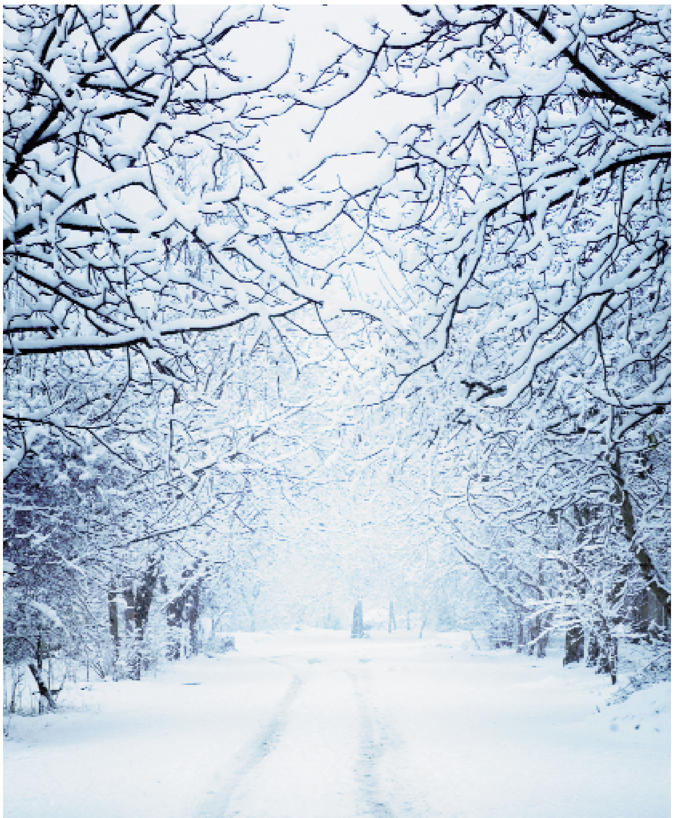
- The requirement to provide a minimum of £2,000 fully paid up shares may be difficult for smaller and start-up companies, as this could represent a very significant proportion of the share capital;
- The award of shares at the beginning of employment may encourage employees to leave following a period of rapid growth in order to realise the gains made to date;

- Gains of up to £10,900 are currently exempt from CGT, and hence, if shares of the minimum of £2,000 are acquired by a Employee Shareholder, those shares would have to increase by more than 545% before CGT would be payable in any event. If the shareholder has a spouse or civil partner, and the shares can be transferred between them, this amount increases to 1,090% before the CGT exemption afforded to Employee Shareholders would give any benefit;
- Since the shares must be issued fully paid up to Employee Shareholders, companies may need to capitalise their reserves in order to be able to do this;
- Employers will incur additional costs associated with agreeing the value of the shares issued to Employee Shareholders. They also need to fund the employees' legal advice. This may reduce the benefit of any savings which would otherwise be made.

As a result of the above, it is possible that Employee Shareholder status will only be offered to senior employees who will be less concerned about the loss of employment rights and who will be incentivised by the CGT exemption available.

Companies considering using the new Employee Shareholder status will need to take appropriate tax advice to ensure that they understand the implications of doing so.

If you would like further advice about this issue, please speak to your usual Rawlinson & Hunter contact.



6 In the Bleak Midwinter

Close company loans

If a close company (broadly one controlled by five or fewer shareholders) makes a loan to a participator (broadly a shareholder) and that loan is not repaid within nine months of the end of the accounting period in which the loan is made, then, unless certain exceptions apply, the company must pay over to HMRC an amount of corporation tax equal to 25% of the outstanding loan. The corporation tax charge arises in addition to any benefit in kind charge which arises on the participator in their capacity as an employee.

This corporation tax cannot be set off against any other liability and is held by HMRC until such time as the loan is either repaid or written off. Repayment is then only made nine months and one day after the end of the accounting period in which the repayment or write-off takes place.

Since this requirement can result in a considerable cash flow disadvantage, companies would historically arrange for the loan to be repaid just prior to 9 months after the end of an accounting period, and then a further loan made a short time later to avoid the 9 month rule (so called "bed and breakfasting" the loan).

HMRC have frequently challenged the validity of this practice and now new anti-avoidance legislation, which applies from Budget Day (20 March 2013), prevents such bed and breakfasting transactions.

The new rules provide HMRC with a statutory basis for denying relief for repayment of loans where, within a 30 day period, amounts of more than £5,000 are repaid to a close company in respect of a loan and are then redrawn as either a loan, advance, or an "extraction of value" (an extension to the current rules intended to cover a transfer of value to a participator which would not have been chargeable to tax or subject to the corporation tax charge rules).

Even where the 30 day rule does not apply, relief will also be denied for a loan repayment if there is at least £15,000 outstanding and, at the time of the repayment, there are arrangements in place, or there is an intention, to redraw the loan through a further loan, advance, or extraction of value.

A further new rule now makes it clear that loans made via a partnership, LLP or trustees of a settlement are also caught by the 25% corporation tax charge.

We *have a great deal of experience in dealing with shareholder loans. If your company has made loans to participators in these circumstances and is seeking ways in which the position can be regularised, please speak to your usual Rawlinson & Hunter contact.*

7 Do they know it's Christmas?

Tax Issues for Partnerships & LLPs

For some time HMRC has been unhappy about two particular aspects of partnership taxation:

- The automatic self-employed status of LLP members; and
- The use of corporate members to defer taxation.

Consultations have therefore been undertaken by HMRC of their proposals for dealing with these two issues.

Automatic Self-Employed Status

The current legislation provides that a member of an LLP is to be treated as self-employed for income tax purposes. There is therefore an "automatic" self-employed status for LLP members, which is difficult for HMRC to dislodge. This contrasts with the position for a partner in a partnership, who must be able to demonstrate that they meet the relevant criteria to be treated as self-employed.

The choice of an LLP as a trading vehicle has a number of benefits, including a potentially significant saving in employers' national insurance resulting from the self-employed status of the members.

Although this is often not the only, or most significant factor for choosing an LLP, nevertheless, HMRC consider that saving NIC is likely to be a significant factor, and is aware that, in certain cases, LLPs have members who they consider should not be treated as self-employed. As a result, HMRC is targeting LLPs and is proposing the creation of a "salaried member" who will no longer be treated as self-employed and will therefore be taxed as an employee. This means that their drawings will be subject to PAYE and NIC in the same way as other employees.

The principal focus for these changes is low paid employees, who are required to become members of the LLP as a prerequisite for accepting the job, and high-salaried employees in legal, financial and other similar sectors.

Based on the draft legislation published on 10 December, a worker would be deemed to be an employee of an LLP if all of the following conditions are met:

- The member receives a fixed remuneration for their services, or it is varied according to some criteria other than the profit or loss of the LLP (termed "disguised salary").
- The member does not have any significant influence over the LLP's affairs.
- The member's capital contribution is less than 25% of his "disguised salary".

In introducing the above tests, there is a concern that HMRC may seek to require the use of their "status" tests (the validity of which has been questioned as being biased in HMRC's favour) rather than applying the principles of self-employment which have arisen as a result of case law.

In addition, the meaning of "significant influence" in this context is likely to prove problematic, and may result in many more workers being classed as salaried members than may perhaps have been anticipated.

The draft legislation also provides that certain expenditure in respect of a salaried members' employment, which would not otherwise be deductible, will be deductible in accordance with general principles.

There will also be an anti-avoidance provision to ensure that the rules cannot be side-stepped by an individual providing their services to the LLP through a non-individual LLP member.

Mixed Member Partnerships

Although there can be good commercial reasons for the inclusion of a corporate member of a partnership or LLP, they have also been used in order to defer taxation of profits and take advantage of the difference between the high personal income tax rates and the much lower corporation tax rates.

This is particularly the case since all profits of a partnership or LLP are taxed on the members, regardless of whether those profits are distributed or are retained for use in the business. The use of a corporate member (such as a service company which employs staff) to reduce the tax on profits required for use within the business is therefore a common tax planning technique.

There have also been more aggressive tax planning schemes involving the allocation of losses against the more highly taxed income of individual members and the sale of partnership interests to members with a beneficial tax position (for example because the member has capital losses to set against the gain).

The proposals seek to counter these forms of tax planning to ensure that profits are taxed when they arise, and that the allocation of profits and losses cannot be manipulated to create tax advantages as follows:

- Individual members of a partnership or LLP will be taxed on the profits of a corporate member where there is an "economic connection" between the individual and the corporate member. This economic connection includes being a shareholder of the corporate member.
- Where there is reallocation of losses, and it is "reasonable to assume" that the main purpose of the profit / loss sharing arrangements in place is to allocate losses to a partner in order to obtain a reduction in their tax liability (income tax or CGT), then those losses will be disallowed rather than being reallocated.
- In cases where an attempt is made to transfer profits to an incoming member who will pay less tax than existing members, and those members are paid for giving up their partnership share, then, if it is reasonable to assume that creating a tax advantage was a main purpose of the arrangements, the payment made to the incoming partner will be taxed as income of the existing partners.

Whilst it is accepted that HMRC are justified in acting against aggressive tax planning arrangements, there are often legitimate business reasons for wishing to retain funds within a business, and in its current form the proposals make no allowance for this. Furthermore, the proposals do not recognise that businesses may use a deferral mechanism as part of a long term incentive award scheme which seeks to replicate a share scheme for senior staff.

The proposals go further than simply attacking aggressive tax planning arrangements, and seem also to target what could be viewed as sound commercial management of the business. However, HMRC's view seems to be that any mismatch between the amount of taxable profits and the amounts received by the partners is simply a consequence of being in partnership.

It is anticipated that the changes will be introduced from 6 April 2014, and without any grandfathering provisions. However, there are still many unresolved issues and, until there is greater clarity about how these proposals will be introduced, it may be too soon to consider restructuring. It will therefore be important to keep up to date with developments and to take appropriate action once the position is clear.

If you consider that your LLP or partnership may be affected by the proposed changes, please speak to your usual Rawlinson & Hunter contact to discuss how your business can prepare itself, and how to mitigate the impact of the changes where possible.

8 I saw Three Ships

VAT exports

UK businesses that are in the business of exporting goods to customers located outside the EU will be pleased to hear that there have been two meaningful developments affecting the treatment of exports that should benefit UK exporters:

- Exports to customers who are established outside the UK but also have a requirement to be VAT registered in the UK may be zero rated.
- A tribunal decision disagrees with HMRC's view on export evidence.

Goods exported to a customer who is also registered for VAT in the UK

EU law does not deny an export being zero rated where the customer is registered for VAT in the same country as the supplier as long as the customer has no establishment in that country. The UK has been forced to amend UK VAT legislation to comply with EU law.

The amendments to the UK VAT law now mean that a UK supplier exporting to any customer established outside the UK will be able to zero rate that export even if that customer is VAT registered in the UK. HMRC have provided four practical examples to demonstrate the revised VAT treatment:

Example 1

UK VAT registered business supplies goods to a customer established in the USA. That customer is also VAT registered in the UK but has no business establishment here. The customer arranges for the goods to be collected from the UK supplier for subsequent export outside the EU. *The supply is eligible for zero rating as an indirect export.*

Example 2

A UK VAT registered business supplies goods to a customer in China. That customer also has a business establishment in the UK and it is VAT registered here. The goods are collected by the customer and exported outside the EU. This is an indirect export involving a supply made to a customer who is established in the UK. *The supply is not eligible for zero rating.*

Example 3

A UK VAT registered business supplies goods to a customer established in South Africa. That customer also has a business establishment in the UK and is VAT registered here. The goods are sent direct to a destination outside the EU by the UK supplier. *This is a direct export and the supply is eligible for zero rating.*

Example 4

A customer (A) who is established in Canada orders goods from the UK VAT registered supplier (B). The Canadian customer is also VAT registered in the UK but has no business establishment here. The UK supplier (B) sources the goods from another UK VAT registered supplier (C). The overseas customer (A) collects the goods from the UK supplier (C) and subsequently exports those goods outside the EU. There are two separate supplies in this scenario – from UK supplier (C) to UK supplier (B) and from UK supplier (B) to Canadian customer (A). *The supply from (C) to (B) is a standard rated supply and UK VAT is due. The final supply in the chain i.e. (B) to (A) is eligible for zero rating.*

Exporter's evidence of export supported by the Tribunal

A company exported goods from the UK, however, HMRC challenged the evidence provided by the exporter to support the company's claim to zero rate the export. Furthermore, HMRC argued that in any case the goods had not physically been exported from the UK.

The Tribunal decided that the fact the goods had not been physically exported was not relevant. The Tribunal decision went on to say it was a matter of whether the exporter had obtained sufficient evidence of export to support zero rating. This is even if the goods had not been exported as long as there was no allegation that the supplier had not acted in good faith, or knew or should have known of fraud connected with the transaction.

This case demonstrates that if an exporter claims to have exported goods and acquires adequate evidence of that export the supply is properly zero rated. If at some point in the future it transpires that the goods were not exported, zero rating will still stand unless the exporter was aware, or should have known, that the goods were not in fact exported. In other words, this decision suggests that what must be asked is whether, in the absence of knowledge of fraud, the evidence of export was, at the time of the claim, adequate to support zero rating.

9 Do you hear what I hear?

VAT update

Various VAT cases brought before the Tribunal have had a significant impact on VAT legislation. A selection of some of the changes in VAT treatment implemented over the last twelve months have been highlighted below.

Storage

Rights over an area of land (for example property rental) have always been exempt from VAT, subject to the supplier's option to tax of that property. Whilst storage services provided by a warehouse where the customer does not have rights over a defined area of land have always been standard rated, self-storage has always been a grey area for VAT purposes with the majority of supplies being treated as VAT exempt.

From 1 October 2012 all self-storage (where storage is not incidental to the supply) is compulsorily standard rated.

Self-storage is defined as the granting of facilities to a person for the storage by them of goods. A facility includes any unit, container of building.

What is important here is what is the intention of the lessee. If a tenant rents a flat but does not occupy the flat themselves and merely uses the space for storage of their belongings, the rent should arguably be subject to VAT. If a lessee rents a warehouse space for storage, but they do not store their own belongings and sublet the space to another who uses the space for their storage - the first transaction between the warehouse owner and the tenant would be exempt from VAT whereas the sublet would be standard rated.

It is important to ascertain whether a supply falls under the self-storage VAT rules. If a business charges VAT on a land and buildings supply believing it to be a self-storage supply in error, HMRC could deem the charging of VAT as having applied the option to tax. Once applied, the option to tax could remain in effect for 20 years making all future supplies from that property as standard rated for VAT purposes which may not be what the owner had anticipated or requires.

Holiday caravans

Holiday caravans which, within a certain size criteria, were capable of being towed have previously been standard rated for VAT purposes. Mobile homes to be occupied as permanent residences were zero rated.

This led to a potential loophole within the legislation with certain caravans meeting the size criteria of a mobile home and being sold zero rated when clearly the intention was for use as a holiday caravan.

From 6 April 2013, HMRC no longer define a holiday caravan versus a mobile home in terms of a size criteria, but on whether the British Standard BS3632, relating to caravans suitable for year round occupation, applies.

Many caravans, which were previously being sold zero rated, now fall into the standard rated criteria and this has caused much controversy amongst caravan suppliers.

Due to industry representations the VAT rate to be applied to holiday caravans has been reduced from standard rated (currently 20%) to reduced rated (5%) to ease the burden on the industry.

Listed buildings

The VAT relief previously available for listed buildings has been reduced to the extent that in future any VAT relief will rarely be available in practice.

Alterations to listed buildings from 1 October 2012 are now standard rated. Generous transitional rules allow for continued zero rating of alterations to listed buildings (where the criteria was met) up to 30 September 2012 where a binding contract was already in place before the 2012 Budget.

The resale of a listed building which has been majorly refurbished rarely qualifies for zero rating. Such sales would now be exempt for VAT purposes resulting in VAT recovery issues for a business under partial exemption rules. Only where the refurbishment is so substantial that only the external walls remain of the original structure could the sale qualify for zero rating.

Pasty tax

There has been much litigation surrounding whether food should have a zero rate or standard rate of VAT applied and you would not have been able to miss the media frenzy surrounding the “pasty tax” as it has become known.

Standard rated VAT has been applied to take away hot food for almost 30 years where the intention of the supplier is to provide the food hot.

From 1 October 2012 revised provisions have been introduced in an attempt to improve clarity in the law and reduce the number of food cases being brought to Tribunal. Food that has been heated above the ambient air temperature and that has either:

- been heated for the purpose of being consumed hot;
- been heated for sale;
- been kept hot after being heated;
- been supplied in heat retentive packaging; or
- is advertised as hot food

will be standard rated for VAT purposes.

Vouchers

Since May 2012, face value vouchers which give the right to receive goods or services up to a predefined value now trigger a different tax point.

On sale of face value vouchers where the voucher can only be redeemed for one type of supply at one VAT liability rate (i.e. standard rated household goods), the payment received is treated as an advance payment against those eventual goods or services that the voucher will be redeemed against.

The tax point is therefore triggered much earlier with VAT being accounted for on sale of the face value voucher, rather than redemption.

The early tax point is also triggered when sold on a wholesale basis rather than being sold to the end customer who will redeem the voucher.

Principal Differences Between FRS 102 and UK GAAP

Area	FRS 102	Old UK GAAP
Financial Instruments	Classifies financial instruments into 'Basic' and 'Other'. Basic financial instruments (such as debtors, creditors and non-complex bank loans) to be measured at amortised cost. Other financial instruments (such as foreign exchange forwards or complex loans) to be measured at fair value with movements taken to the Profit and Loss Account.	No specific distinction. Measured at historic cost. Often not recognised under old UK GAAP with only disclosure required.
Deferred Taxation	Recognised on the basis of timing differences, including revaluations (such as investment properties), and the difference between the fair values and tax values of assets and liabilities acquired on a business combination. No discounting of deferred tax balances permitted.	Recognised on the basis of timing differences, excluding revaluations. Discounting of deferred tax balances permitted.
Investments	Investments in listed shares to be measured at fair value.	Investments in listed shares may be measured at cost or fair value.
Tangible Assets	May be held at depreciated cost or valuation, based on fair value.	May be held at depreciated cost or valuation, based on existing use value.
Goodwill and Intangible Assets	If no reliable estimate of the useful economic life can be made, it should be limited to 5 years.	Rebuttable presumption of a maximum useful economic life of 20 years.
Consolidation, Business Combinations and Group Accounts	Merger accounting only available for group re-organisations. Identifiable intangible assets that can be reliably measured to be recognised.	Merger accounting available if certain criteria met. Intangible assets have to be capable of being disposed of or settled separately and hence are not likely to have been split out from goodwill.
Leases	Lease incentives (e.g. rent free period) to be recognised in the Profit and Loss Account over the initial term of the lease.	Lease incentives to be recognised in the Profit and Loss Account over the period to the first rent review / break clause.
Investment Properties	Requirement to measure at fair value (equivalent to open market value). Revaluations to be taken to the Profit and Loss Account.	Requirement to measure at open market value. Revaluations to be taken to the Statement of Total Recognised Gains and Losses.

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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