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Digital tax challenges A handbook for the small business advisor

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About Rebecca Benneyworth

Rebecca is a lecturer, writer and consultant on a wide variety of taxes. She lectures extensively to accountants and business people and also to HMRC and the Treasury. Rebecca is well known for her down-to-earth approach to tax and her ability to make the subject matter both clear and interesting, and she was named Best Tax Lecturer at the Taxation awards in 2007.

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1. Finance Acts and other 2017 changes

1.1. Monitoring the use of Employment Allowance

The Red Book states that HMRC believes that some employers are using artificial techniques to benefit from Employment Allowance of £3,000. We are told that use of the allowance will be closely monitored in 2017/18 and action taken where considered necessary.

1.2. Recap: Employment allowance: connected companies

Although Employment Allowance is available at a rate of £3,000 per annum to set against employer NIC's, the allowance must be shared if there are connected companies with separate payroll schemes.

HMRC's guidance issued in 2014 deals with these rules as follows.

"The rules relating to connected companies do not apply to unincorporated businesses or single companies.

This guidance is relevant if a company has control of another company or both companies are under the control of the same person or persons. The 'connected persons' rule for the Employment Allowance is largely based on the connected persons rule used more widely for tax purposes."

The guidance goes on to indicate that if there are connected companies at the beginning of a tax year then the allowance must be operated on a connected companies' basis throughout the year. There is the opportunity, however, to re-allocate available allowance if one of the companies ceases being an employer.

1.2.1. What is the "connected" rule?

"The rules in place for determining if companies are connected are similar to the 'associated companies' rules at sections 25 and 27 to 30 of the Corporation Tax Act 2010. Where 2 companies are only connected with each other through the attribution of rights between certain associated persons (eg relatives), the connected persons rule will only apply if the companies in question are substantially commercially interdependent. For example, when one company gives financial support to another, they have the same economic or commercial objectives and have common management, employees and premises."

1.2.2. LLP's

"This test is modified in the case of a limited liability partnership so that control is where the other company possesses, or is entitled to acquire, rights to a share or more than half the assets or more than half the income of the limited liability partnership."

1.3. EA restriction – director only companies

The July 2015 Budget announced that from 2016 employers who are director only companies will be excluded from Employment allowance. The test is that for a tax year, a company employer has only a single paid employee and that person is a director. If a second employee is taken on at any time in the year, employment allowance will apply, as it will if there are two paid directors.

However, HMRC's guidance indicates that the second employee must be paid sufficient to trigger a secondary liability to bring the employer within the scope of Employment Allowance. Although many commentators disagree with this, it is unlikely that any employers will take a case to Tribunal based on the amount of allowance available. Note that if the "second" employee is a director, they must exceed the relevant secondary threshold on an annual or pro rata (if appointed during the year) basis.

1.4. Simplification – cash accounting threshold

Cash accounting is available to businesses as an option for reporting their trading profits for tax purposes. The turnover limit for cash accounting has been increased to make it available to more businesses as we move into MTD. The new limit (effective 6 April 2017) is £150,000, and once a business is suing cash accounting it can remain on that system until the turnover exceeds £300,000. This is a very significant increase over the previous limits. The new limits will apply to all businesses using cash accounting, including Universal Credit claimants.

1.5. The cash basis - property businesses

In addition, and as promised in the responses to the Making Tax Digital consultations, the second Finance Act of 2017 introduced a cash basis for property businesses from the tax year 2017/18 onwards.

The rules will state that GAAP is to be used if any of the following conditions A to E is met (thus putting the cash basis forward as the default basis for property businesses).

- Condition A – the business is carried on at any time in the year by a limited company, and LLP, the trustees of a trust or a partnership in which not all of the members are individuals.
- Condition B – the cash basis receipts for the year exceed £150,000
- Condition C – the property income accruing to an individual includes a share of a jointly owned property, the profits of which were computed according to GAAP
- Condition D – the business has benefitted from Business Premises Renovation allowance and a balancing adjustment under that legislation arises in the period
- Condition E – the person carrying on the business has made an election to calculate profits according to GAAP.

Generally, the rules follow the same structure as the rules for trading businesses, implemented some years ago. However, there are some additional special provisions.

1.5.1. Deduction for interest

There is separate legislation setting out the deduction available for interest in a property business which is applied **before** the restrictions in s272A (replacing the deduction with basic rate tax relief over the next four years). This is only relevant where the amounts of the loans total more than the market value of the properties. Otherwise a full deduction is available.

Under new s 307 C The interest is an allowable expense if conditions A to C are met:

- Condition A – the profits of the business are calculated on a cash basis for that year
- Condition B – apart from restrictions under s272A, the interest would be an allowable expense of the property business during the year, (the loan is now referred to as a relevant loan) and
- Condition C – the amount of the loan L is more than the total value (V) of the let properties on the last day of the tax year.

New section 307D then restricts the interest treated as allowable by the proportion V/L, that is the amount of interest related to the property value of the loans, rather than the full amount.

1.5.2. Adjustment income

The provisions relating to trading income and the move to or from the cash basis are also imported into the new rules, although note that spreading provisions are only available on leaving the cash basis. It is likely that adjustment income will arise when landlords commence using the cash basis (because of rent paid in advance in the previous period) and thus this will be of limited help.

1.6. Trading and property allowances

The second Finance Act also included the promised exemption for small trading activities and property income.

- That the new legislation will be included at around ss 738A onwards in ITTOIA.
- If the individual's relevant income does not exceed the trading allowance for the year then no tax liability arises on it, unless the individual elects otherwise.
- If the relevant income does exceed the individual's trading allowance for the year then the individual may elect how he is to be taxed on it.
- The trading allowance for 2017/18 is £1,000
- The provisions do not affect income received under rent-a-room arrangements
- Relevant income for a year is the total of the individual's trading and miscellaneous income (that is income that is not taxable under other provisions and therefore falls to be taxed under Chapter 8 of Part 5 of ITTOIA)
- Full relief is available to reduce the profit or loss on a trade to nil, and the income less related expenses to nil. No losses can be generated using this provision.
- Partial relief is available if the relevant income exceeds the threshold. The amount of the threshold is deducted from the income, and a further deduction is available for overlap profits released (where relevant). No deductions are available for the expenses of the trading activity. Where the individual has both trading and miscellaneous income, the allowance may be deducted from either, or split according to the wishes of the taxpayer, but not so that either records a loss.
- No relief is available against income from an employer, a partnership of which the individual is a member or a close company.

A similar structure is followed in respect of property income, but note that rent a room relief is separate to this provision which cannot apply to rent a room income and any individual claiming basic rate relief in respect of interest on a property related loan (the replacement for interest deductions disallowed by s 272A from 2017) is not entitled to a property allowance.

1.7. Corporation Tax: losses carried forwards

The second Finance Act of 2017 enacted the announcements made in the 2016 Budget regarding the carry forward of corporation tax losses.

In essence, the legislation significantly reforms the relief for losses arising under different heads of charge, allowing all losses related to accounting periods starting on or after 1 April 2017 to be relieved by carry forward against any future profits (and not restricted to income of the same type) and also to be eligible for group relief in that carry forward period. However, the new rules also restrict the use of brought forward losses to a maximum of 50% of the subsequent year's profits, after an annual allowance has been made.

1.7.1. Details

The legislation will treat separately any losses arising in periods commencing before 1 April 2017 and those arising after that date. The existing rules about loss offset will apply to prior losses, and also to post 2017 losses which are carried back to earlier periods. The usual rules apply to identify available relief, and some order of set off will be provided.

1.7.2. Restriction on carry forward relief

The restriction will limit the brought forwards losses permitted to be offset against the total chargeable profits for the period to the sum of:

- 50% of the "relevant trading profits" (as defined) for the accounting period, and
- The company's trading profits deduction allowance for an accounting period, which is £5 million per 12 month period.

Thus, provided that losses carried forward do not exceed £5 million, there will be no restriction on set off of carried forward losses. Where the company is a member of a group, the £5 million allowance is shared among group members seeking to set off losses. This works by the group allocating the allowance to companies in the group as desired, thus maximising the effectiveness of the allowance.

For those affected by the change, the definition of relevant profits for this purpose and the calculation is quite challenging. No further consideration is given here, as the actual restriction will not come into play for some months in practice.

1.7.3. Straddling periods

Where a company has an accounting period which straddles 1 April 2017, for the purpose of loss relief the period is to be split into two periods, the new rules applying to the period commencing on or after 1 April 2017.

1.8. Dividend allowance

The dividend allowance remains at £5,000 for 2017/18, but will then reduce to £2,000 from 2018/19. This was intended to balance the effect of the increase in Class 4 NIC so that there is not increased pressure to incorporate to save tax. However, the reducing corporation tax rates make this inevitable, and the reversal of the Class 4 increase amplifies this.

2. Other recent changes

2.1. Property businesses: relief for replacement of domestic items

Section 73 includes a new deduction for property businesses in respect of the replacement of domestic items in a property which is let. Existing legislation precludes the claiming of capital allowances if the item is in a dwelling house which is let, and the first such expenditure will still be denied tax relief under these provisions, but replacement expenditure will incur full tax relief in the year in which it is incurred.

The conditions for relief are:

- A – a person P (or company C) carries on a property business in relation to a dwelling house
- B – P or C incurs expenditure on replacing a domestic item; the new item must be available solely to the lessee, and the old item must n longer be available
- C – The expenditure is not prohibited by the wholly and exclusively rules, but would be prohibited by the capital expenditure rule, and
- D – no capital allowances are available in respect of the expenditure.

There is no deduction for expenditure in relation to furnished holiday lets or where a rent a room relief claim is made. If the new item is "improved" then the deduction is restricted to the "replacement" element. A domestic item means any item for domestic use except fixtures.

The change relates to expenditure incurred on or after 1 April 2016 for companies and 6 April 2016 for those liable to income tax. (Introduces new s 311A into ITTOIA 2005 and new s 250A into CTA 2009).

2.2. Wear and tear allowance for property businesses

This allowance has been abolished. Section 74 makes the relevant change in relation to 2016/17 for income tax and periods of account beginning on or after 1 April 2016 for corporation tax, but where periods spanning 1 April 2016 are split into two periods to exclude the relief on the part post 1 April 2016.

3. 2018 thoughts on incorporation

The dividend changes in 2016 impacted significantly on advice about incorporation. Although the tax increases on the dividends paid do not in most situations take the tax on an incorporated business above the tax burden on the unincorporated business, the tax saving offered by simple incorporation (without involving another party such as the spouse) is certainly lower. Further changes in 2018 – the reduction of the dividend nil rate band impact further, but probably the most important aspect is the successive reductions in corporation tax.

3.1. Dividend tax changes and incorporated status

The following examples consider the position at various levels of profit. In each case, the profits distributed are 100% of the company net profit, so that the comparison of disposable income with the sole trader is similar. It is assumed that the director of the company draws a salary of £8,400 to exclude payment of National Insurance contributions.

	Sole trader 2018/19	Limited company 2018/19
	£	£
Profit	30,000	30,000
Salary		8,400
Personal allowance	(11,850)	
Taxable profit	18,150	21,600
Corporation tax		4,104
Net profit = dividend		17,496
No additional tax on dividend		
Dividend taxation – 7.5% on £12,046		903
Income tax at 20%	3,630	
Class 2 NIC	148	
Class 4 NIC	1,942	
Total tax and NIC	£5,720	£5,007
Saving through incorporation		£713

When the profits rise so that the sole trader is paying higher rate income tax the savings rise, as the corporate structure keeps the taxpayer out of higher rates for longer.

	Sole trader 2018/19	Limited company 2018/19
	£	£
Profit	50,000	50,000
Salary		8,400
Personal allowance	(11,850)	
Taxable profit	38,150	41,600
Corporation tax		7,904
Net profit = dividend		33,696
No additional tax on dividend		
Dividend taxation – 7.5% on £28,246 (33,686+8,400-11,850-2,000)		2,118
Income tax at 20%	6,900	
Income tax at 40%	1,460	
Class 2 NIC	148	
Class 4 NIC at 9%	3,413	
Class 4 NIC at 2%	73	
Total tax and NIC	£11,994	£10,022
Saving through incorporation		£1,972

3.2. Looking at the whole picture

So here are the changes we know about over the next few years, looking only at those that are likely to affect decisions about business structure. This means that I am regarding the tax and NIC thresholds as frozen at 2018/19 amounts, despite the fact that we know they will rise, and in the case of the tax figures, rise fairly substantially.

Each of the sets of figures have been prepared on the following basis:

- For the sole trader, tax and NIC payable have been based on 2018/19 rates and thresholds.

- For the company tax liability, I have assumed that a salary equal to the NIC start point (£8,424 for 2018/19 onwards) is paid, and the balance of post tax profits are distributed by way of dividend. This provides a like for like comparison, as the company profits are then available to spend on living expenses etc.

- There are other factors which will bear on this decision, as indeed there are ways of reducing the tax liability in the company still further by paying interest on a loan to the company from the owner/director, but as not all businesses are in a position to take advantage of this, it has been excluded. The main issue to bear in mind is the additional costs of running the business through the limited company – mainly in administrative costs, but also potentially through issues arising in relation to business motoring.

3.3. Table – comparative tax liabilities– 2018/19 & 2019/20

Profit	Sole trader	Company	Saving
£20,000	£2,820	£2,496	£324
£30,000	£5,720	£5,003	£717
£40,000	£8,620	£7,511	£1,109
£50,000	£11,995	£10,018	£1,976
£75,000	£22,495	£20,287	£2,207
£100,000	£32,995	£31,618	£1,376

At lower levels of profit the tax saving on incorporation is eroded. Note that for this taxpayer, the reduction in dividend allowance has increased his tax liability by 7.5% x £2,000 = £150. In fact 2019/20 will see the abolition of Class 2 NIC, which will save the sole trader £148 per annum, eroding the tax saving on incorporation by this amount.

The marginal rates on profits are as follows: I have calculated these based on the income within the band, rather than taking the dividend allowance into account:

	Self employed	Company
Basic rate	29%	25.07%
Higher rate	42%	45.32%

3.4. Table 4 – 2020/21

In fact, by this point the personal allowance will reach £12,500 and the higher rate threshold £50,000, but as we know nothing about the other variables, I have used the 2018/19 limits. So the change to report is:

- Reduction of 2% in the rate of corporation tax.

Profit	Sole trader	Company	Saving
£20,000	£2,672	£2,282	£390
£30,000	£5,572	£4,604	£968
£40,000	£8,472	£6,927	£1,545
£50,000	£11,864	£9,249	£2,597
£75,000	£22,346	£19,388	£2,958
£100,000	£32,846	£30,382	£2,464

So the final part of the jigsaw is a significant increase in the benefit of trading through a limited company through the two percentage point reduction in corporation tax. This suggests that there may be other action between now and then to reduce the gap which is regarded as "anomalous".

The final marginal rates on profits are:

	Self employed	Company
Basic rate	29%	23.23%
Higher rate	42%	43.98%

3.5. Employ the spouse?

Given the very modest tax savings provided by incorporation for the smaller business, it is worth considering some of the "older" tax planning advice. In all cases it would be necessary to justify the amount paid to the spouse on an arms' length basis. If there is sufficient work in the business to employ the spouse on a salary of, say £8,400, and assuming that the spouse has no other income, a net saving will be available as follows:

Marginal rate 29% (basic rate plus class 4)	£2,436
Marginal rate 42% (higher rate plus class 4)	£3,528

With the availability of Employment allowance, if the spouse has no other income at all, this could be increased still further by paying £11,500. There is a small employee NIC liability, so the net savings are:

Employee NIC on £11,500 = 12% x (£11,500 - £8,164) = £400

Net savings at:

Marginal rate 29% (basic rate plus class 4)	£2,935
Marginal rate 42% (higher rate plus class 4)	£4,430

4. Off-Payroll working in the public sector

The intermediaries' legislation (IR35) requires individuals working through an intermediary (usually a person's own company) to pay broadly the same tax and National Insurance contributions (NICs) as employees, where they would have been an employee if they had provided their services directly.

In the Autumn Statement in November 2016 the Chancellor confirmed that the reforms to off-payroll working in the public sector will be going ahead, and will be implemented from April 2017; the legislation is included in Finance Act 2017 at Section 6 and Schedule 1.

The changes do not introduce a new liability, but are designed to increase compliance with the existing rules. From April 2017 individuals working through their intermediary in the public sector will no longer be responsible for deciding whether the intermediaries' legislation applies and then paying the relevant tax and NICs.

This responsibility will instead move to the public-sector employer, agency, or third party that pays the worker's intermediary. The employer, agency or third party will decide if the rules apply to a contract and if so, make sure the relevant income tax and NICs are deducted and reported through PAYE in real time.

4.1. Overview

When a person working through an intermediary (usually a company, but can also be a partnership) is providing their services to an end user which is a public body, the party paying the contractor company must check whether the IR35 status is in point, and if so, to deduct PAYE and NIC from the invoice amount (net of VAT). This is achieved by putting the worker on the payroll of the paying organisation, using the worker's NI number and details, reporting payments as normal through RTI.

The new rules apply to payments made on or after 6 April 2017, whether the work was carried out before that date or not. There are anti-forestalling rules intended to prevent forward billing and payment.

4.2. Legislation

Schedule 1 of the Finance Act 2017 starts by amending existing legislation which is affected by this new provision. Essentially this excludes contracts affected by the new rules from falling within the existing intermediaries rules (both the original IR35 rules and the managed service company rules, Chapters 8 and 9 of Part 2 of ITEPA 2003).

The new legislation is then introduced as Chapter 10 of Part 2 of ITEPA 2003. Existing provisions affecting agency workers (Chapter 7 of Part 2) and visiting performers (s 966 ITEPA 2003) are excluded from the scope of payments covered by the new rules.

4.2.1. Public authority

A public authority is defined by new s 61L, largely by reference to the Freedom of information Act 2000, and equivalent legislation in Scotland, even where FoA does not apply to every aspect of the organisation's activities.

A primary healthcare provider only comes within this legislation if

- It has a registered patient list for the purposes of relevant medical services regulations, and
- Is within the FoA by reason of providing primary dental services.

4.2.2. Affected contracts

The trigger to the legislation applies to certain engagements, under which:

- An individual (the worker) personally performs or is under an obligation personally to perform services for another person (the client)
- The client is a public authority
- The services are performed not under a contract directly between the client and the worker, but under arrangements involving a third party (the intermediary),and
- The circumstances are such that
    - If the services were performed under a contract made directly between the client and the worker, the worker would be regarded (for tax purposes) as an employee or holder of an office of the client, or
    - The worker is an office holder who holds that office under the client and the services relate to the office.

So the trigger is the same as that for IR35. The third party can be a partnership or unincorporated association of which the worker is a member. The office of statutory auditor is excluded from the office holder definition by s61M(4).

4.2.3. Payments affected

Section 61N sets up the architecture to deal with situations where the intermediary is paid through a chain of different organisations, the highest in the chain being the client and the lowest the intermediary. The person responsible for dealing with the tax and national insurance on an affected payment is the final payer in the chain who makes the payment to the intermediary (normally the worker's company). This payment is known as the "deemed direct payment".

The amount of the payment subject to tax and NIC is arrived at by deducting any VAT on the payment and further deducting any amount of the payment that represents direct costs to the intermediary of materials used or to be used in the performance of the services(note that this is **materials** only). A further deduction is made for expenses which would have been deductible from the earnings of the worker had he been employed directly by the client.

If the worker would not have been taxable on the payment as a payment of earnings in employment by the client, then no tax arises on the deemed direct payment. This is only likely to affect workers who are non resident or non UK domiciled and services performed outside the UK.

4.2.4. Information requirements

Sections 61T to 61V set out information requirements to support the legislation and penalties for failure to provide necessary information, or the provision of fraudulent information. There are obligations on both the client (who determines the status of the worker for these purposes) and the worker to provide certain information.

4.2.5. Prevention of double charge to tax

Section 61W excludes from a charge to tax the payment onwards of remuneration or dividends made out of net deemed direct payments. They may also deduct any payments made in respect of pension contributions to registered schemes and capital allowances that would have been deductible under the employment income provisions. However, such deductions cannot result in a negative amount, so it is likely that for may end workers, the deemed direct payments will be made across as net remuneration intact.

4.3. In practice - the contractor company

There is very little that the contractor company can do to avoid this – some may seek to alter the terms of the contract under which they are engaged, but if the public body has decided that all contractors will be payrolled (as many have) then there is very little the contractor company can do about this. There is a right of appeal, but this is likely to be an expensive and time consuming option.

The company will continue to issue invoices, plus VAT as appropriate, and will be paid the invoiced amount less PAYE and primary NI contributions, plus VAT. VAT will be paid over to HMRC as normal, and HMRC's guidance indicates the following treatment in the accounts of the company:

- The company should declare the net amount received as turnover in the accounts. It is not presently clear whether this complies with company law and accounting standards.
- The company will not be liable to corporation tax on the amounts after deduction. Other income of the company would be liable to tax as normal.
- If payments are made to the director shareholder these can be treated as salary or dividend. In any event, payment of the net amounts to the director/shareholder will not be taxable in the hands of the recipient.
- If payments are treated as pay (employment income) these should be reported through RTI as payments which are free of tax and NIC – note that an FPS should be filed in respect of payments made, even though there is no tax or NIC to account for. There is no secondary liability on the company as this has already been accounted for.
- If the company distributes the whole of the net payments to the director/shareholder, there will be no income to cover administrative costs of the company – even if funds are retained in the company, the expenses will effectively be paid out of "net profits" – there being no tax free income unless the contractor has work outside the public sector.

4.4. In practice - the worker

The director / shareholder who has effectively been taxed to PAYE and NIC is instructed to declare the income on his personal tax return as if it were employment income. He should show the gross pay as the invoiced fees, and the tax deducted – to this end he will be provided with a P60 at the end of the tax year. No payslips are required for individual payments. The paying party (the party making the deductions, which might be an agency) is to be shown as the employer.

As noted above, the individual will not be liable to any further tax or NIC on the amounts paid to him by his company – it is not yet clear whether these must also be declared on the personal tax return.

The director/shareholder will also need to consider the payment of expenses of running the company – whether it be annual accountancy fees or other expenses such as mobile phone etc. These will be met out of taxed income – whether by the company retaining funds or the director lending funds to the company to cover payments. In that case, accounting losses will be declared for as long as the company exists, supported by a director loan account.

4.5. Example

This is extracted from HMRC's guidance for agents which was published in early March.

Assume a worker invoices, through their PSC, an amount of £7200 (including VAT) per month to the end client and the off-payroll measures at Chapter 10 apply. No materials and / or expenses are included.

Invoiced amount	£7,200.00
VAT	(£1,200.00)
Deemed Direct Payment (DDP)	£6,000.00
The fee payer will deduct:	
PAYE	(£1,458.00)
Primary Class 1 NIC	(£413.00)
	£1,871.00
The fee payer will also account for Secondary Class 1 NIC	£645.13
The payment made by the fee payer to the PSC will therefore be:	
DDP	£6,000.00
PAYE	£1,458.00
Primary Class 1 NIC	(£413.00)
	£4,129.00
Plus VAT	£1,200.00
	£5,329.00

The sum deducted from the fee is paid over to HMRC. The fee payer sends the relevant information to HMRC through its PAYE reporting processes.

Invoiced amounts (12 x £6000 - fees)	£72,000
This reflected as	
Less statutory tax & NICs deducted by fee-payer (12 x £1871)	(£22,452)
Turnover	£49,548
(the PSC receives relief against employment income, tax and NICs costs)	£22,452
	£0

The PSC can pay the worker up to £49548 (the DDP, net of tax / NICs) without any further deduction of tax and NICs. The PSC can retain an amount that is not greater than the sum of the net fees less salary / dividend costs without further liability to tax.

Let us suppose the PSC receives some other income, say £20,000 in that same period;

Invoiced amounts (12 x £6000 - fees + £20000)	£92,000
This should be reflected in the company as turnover	£69,548
Less income (12 x £4129 - DDP net of tax/NICS)	(£49,548)
Less tax & NICs deducted by fee-payer (12 x £1871)	
(the PSC receives relief for employment income, tax and NIC costs)	£22,452
	£20,000

If the PSC pays the worker more than £49,548 (the DDP, net of tax / NICs), further tax and NICs will be chargeable. If the PSC retains an amount that is greater than the sum of the net fees less salary costs, it will incur further tax liability.

5. Auto-enrolment – points to watch

5.1. New employers – 1 October 2017

For employers taking on an employee for the first time from 1 October 2017, the obligation to commence auto-enrolment applies immediately. Although there are still some more recent employers with staging dates into 2018, all new employers must make arrangements immediately to comply with the auto-enrolment rules.

5.2. Guidance on missed start dates

The Pension Regulator has put up new guidance for employers who have missed their start date for AE.

1. **Missed duties start date and backdating contributions**
   If your client has missed their duties start date, they still need to work out what their automatic enrolment duties are, if they haven't already done so, and immediately comply with them.

   They may need to backdate contributions for members of staff that need to be put in a workplace pension, to make up for any missed contributions.

   What your client needs to do will depend on how late they are in setting up a pension scheme.

2. **If your client is less than six weeks after their duties start date**
   When your client has chosen their pension provider, they'll need to put their staff member into the pension scheme and start paying into it.

   Your client must backdate their member of staff's scheme membership to the day that they first met the age and earnings criteria to be put into a scheme.

   To do this, they may need to backdate contributions as well.

   Postponement can also be used to delay working out who to put into a scheme, which will mean that your client won't need to backdate contributions. They can postpone assessing their staff for up to three months, which will give them extra time to meet their legal duties if they need to do this.

3. **If your client is more than six weeks after their duties start date**
   If more than six weeks have passed since your client's duties start date before they set up a workplace pension scheme, they will need to take certain steps in line with their automatic enrolment duties.

   Your client will need to pay any contributions that they should have made back to the date their member of staff met the age and earnings criteria to be put into a pension scheme. They will need to work out what these contributions are and backdate them.

   Postponement cannot be used in this case.

4. **How to backdate contributions**
   Your client should take the following steps to backdate any missing contributions:

   5. When your client sets up their pension scheme, they should tell the scheme provider that they need to backdate contributions. Your client may wish to check if their provider can help them calculate the amounts they need to repay, and tell them what they need to do to make these payments.

   6. Your client will need to work out how much they will need to backdate and from when. Payroll software can help them with this if it is already set up for automatic enrolment. If your client is unsure, they should check with their payroll provider.

   7. They should re-run their payroll process for the period back to when their member of staff should have been put into a pension scheme - the day when they first met the criteria for automatic enrolment. This should give your client the contribution amounts that need to be backdated. They can also use our online contributions calculator to help them estimate their costs for each member of staff.

8. Your client will then need to let their pension scheme know these amounts. The scheme provider may let them pay this in instalments, but your client will need to check with their scheme if this is an option.

9. As the employer, your client must pay any unpaid employer contributions and give the option to their staff to pay their own - unless your client decides to pay it for them. Your client should let their staff know what they are doing.

10. Depending on what your client has agreed with their pension provider, they will need to start making contributions.

11. Your client needs to pay the employer and staff contributions into their chosen scheme on an ongoing basis, each time they run their payroll.

5.3. Minimum contribution rates

The amount your client and their staff pay into their pension scheme may vary depending on which scheme provider they choose and what they agree with the provider. However, by law, your client and their staff have to make minimum contributions into the scheme. These minimum contribution rates increase on 6 April 2018 (the new rates can be applied from 1 April if an employer does not wish to time apportion the pay).

For example, the total minimum contribution until April 2018 is equivalent to 2% of a member of staff's gross earnings. The employer must pay at least 1% of this, but can choose to pay the full amount. If the employer decides to do this, the member of staff doesn't have to pay anything.

Date effective	Employer minimum contribution	Staff contribution	Total minimum contribution
Currently until 5 April 2018	1%	1%	2%
6 April 2018 to 5 April 2019	2%	3%	5%
6 April 2019 onwards	3%	5%	8%

6. Making Tax Digital – The current position

6.1. July 2017 announcement

Following the general election there has been a change in emphasis relating to the MTD project.

- MTD will now commence for VAT with mandation of VAT reporting for those businesses over the VAT threshold required to submit their returns through MTD software for the first VAT period starting on or after 1 April 2019.
- Businesses which are subject to mandation will also be required to keep digital records of their transactions.
- The VAT submission must be made by an end-to-end digital process. It is not permitted to print out from one software package and re-key the data into another package.
- The main challenge will be in moving software providers forward technically so that there is a good range of software which can cope with various VAT schemes and requirements.

6.2. Income tax implementation

The undertaking given is that income tax will not be mandated into MTD until April 2020 at the earliest. Meanwhile, HMRC continues to develop and test the process, and will be encouraging income tax businesses and landlords to join the pilot early to help with testing. It is hoped that around 10% of the target population will enter the pilot before mandation to allow for adequate stress testing.

6.3. Legislation

The enabling primary legislation is included in the Second Finance Act of 2017. This covers the income tax requirements and the VAT requirements. Secondary legislation has been consulted on and will be finalised during the early part of 2018.

6.4. VAT implementation

It is important to note that clients who previously were not within scope of the implementation now may be required to file under MTD from April 2019. The key types of client previously excluded are:

- Companies, which were perhaps not expecting to come into MTD until 2020. In fact they would always have been mandated into VAT from April 2019, but were mainly unaware of that fact.
- Charities, which may have been lulled into a false sense of security by the exemption from MTD for income tax awarded to them. Where a charity is VAT registered and above the VAT threshold they will have to comply from April 2019.

So any client which is VAT registered and has taxable supplies in excess of the VAT threshold on 1 April 2019 will be required to file their VAT returns through MTD for the first VAT period starting on or after that date.

6.5. What does MTD for VAT involve?

The requirements are not, on the face of it, very different from the existing requirements. But looking in more detail we find that:

- Affected businesses will be required to keep digital records of their accounting transactions
- The period for which they file VAT returns will not be altered
- The mandatory data filed is limited to the existing 9 boxes on the VAT return
- There will be an option for businesses to file additional data which will demonstrate compliance; this might be the breakdown of supplies between the various rates of VAT. If businesses choose not to provide this voluntary information they may receive more compliance attention. It is not clear as yet how long that might last – whether it would be every return period or not.
- HMRC's current web-based VAT100 will be withdrawn
- Returns must be filed from within the software in an "end to end digital process".

It is the last of these requirements which poses the greatest challenge. Almost 90% of VAT returns are currently filed through the online VAT 100, by entering the figures produced by various calculations. It is likely that almost no software in existence can currently meet these requirements, and it is known that many very large VAT groups have complex spreadsheets which together produce the VAT data. Often the raw data from the accounting system is manually input into these spreadsheet tools, and the result is then manually transcribed into HMRC's web-based return.

So the challenge here is really a technical one for software providers, in relation to smaller businesses, and internal programmers for those businesses large enough to use bespoke software.

6.6. What should we do?

- Identify affected clients and those which are likely to exceed the VAT threshold through growth. It helps that the threshold has been frozen through until 2020 at £85,000.

- Focus initially on affected businesses which do not have a digital record keeping system. They will need digital records to get things rolling. This is the most urgent task to get under way so that clients have adequate time to change their processes before mandation.

- Concentrate first on businesses with "simple" VAT affairs. Where there is a single VAT rate applying to supplies, and input tax is fully recoverable, it is reasonable to assume that well known branded software will be capable of filing returns by 2019.

- Where clients have special VAT schemes such as the second hand margin scheme (for cars, and antiques), or are partially exempt, or in the case of charities also have non business activities, it is by no means certain that common software packages will suffice. It is probably wise to await further developments for those clients. HMRC's announcement that the use of spreadsheets will be permitted provided that data transfer is automated and not re-keyed.

- Most accounting packages are likely to be able to cope with the flat rate scheme. The current proposal is that purchases will not need to be recorded in detail by users of a flat rate scheme, but as those records **will** be needed for income or corporation tax, it is unlikely that the benefit will be real.

- Very large clients and VAT groups with bespoke VAT systems will need reassurance and may wish to start thinking about the end to end digital solution. Passing data between software applications electronically will be acceptable, so it may be possible to "bolt together" an end to end digital solution during the next 18 months. HMRC has confirmed that using spreadsheets to keep records and perform VAT calculations such as partial exemption and capital goods scheme adjustments is acceptable. The use of "bridging" software will enable the returns to be filed from within the spreadsheet. There is already one product available and more are expected as time progresses.

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