2018 SUMMER NEWS

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## Preparing for digital VAT

Tax is going digital, just as sure as Brexit is happening. The first business transactions to be affected by this Making Tax Digital (MTD) revolution will be those relating to VAT.

If your business is VAT registered, and your turnover is £85,000 or more per year, you will be required to submit your VAT returns using MTD-compliant software for quarters that start on and after 1 April 2019. You will also be required to keep the records from which the VAT return is derived in a digital form. This means recording digitally the date, the VAT rate, the VAT paid, and the value of each transaction. It won't be necessary to keep a digital copy of each sale or purchase invoice.

MTD-compliant software must be capable of transferring data to and from HMRC via an application program interface (API). A spreadsheet on its own can't qualify as MTD-compliant, but if it is used with an API add-on (aka 'bridging software'), it may qualify as MTD-compliant.

Your first step in preparing for digital VAT should be to contact your accounting software provider and ask when they will issue an upgrade which is MTD-compliant. HMRC won't provide free software for businesses to comply with the MTD regime.

If you currently keep all your VAT records on spreadsheets and/or paper, we need to talk about how you can digitise your recording systems over the next nine months. We can continue to submit your VAT return on your behalf, but we will need to receive the VAT information from you in a digital fashion, such as transferred on a memory stick, or downloaded from a cloud-based accounting package.

If you are VAT registered but your turnover is below £85,000, you will be able to carry on submitting VAT returns as you do now, either using your accounting software or by typing the sales and purchase figures into the online VAT return form.

It will be possible to claim an exemption from the new digital rules for VAT based on the business owner's disability, the business having no access to the internet, or on certain religious grounds. ●

## VAT on hot food

The general rule is that food for human or animal consumption is subject to zero rate VAT. However, where food is supplied as part of a catering contract, standard rate VAT (20%) must be applied to the cost of all the food whether it is served hot or cold. This covers restaurant meals, and any prepared food to be eaten on the premises.

Where the takeaway food is intended to be eaten hot, like fish and chips, VAT should be applied at 20%. Where the food is to be eaten cold (or at least 'not hot'), such as sandwiches, zero rate VAT should be applied.

Difficulties arise when a café or takeaway outlet cooks the food item and allows it to cool before selling it. This issue was the basis of the infamous 'pasty tax' in 2012, but food sellers are still getting the rules wrong and ending up with huge VAT bills.

In a recent case, a market stall selling Caribbean curries prepared each curry in the morning and kept it warm in a bain marie until it was served to customers at lunch time or later. As the food was served above the ambient room temperature, HMRC regarded the food as 'hot', hence 20% VAT should have been added to the price.

The VAT rules for food and drink can be very tricky to apply correctly, but we can help check whether your business is getting it right. ●

## Who is entitled to SMP?

To receive Statutory Maternity Pay (SMP) the pregnant employee must have been continuously employed by the same employer for at least 26 weeks up to and including at least one day in the 15th week (aka 'qualifying week'), before the week in which the baby is due.

The woman needs to be employed during those 26 weeks, but there is no rule to say she must be paid at a minimum rate for the entire period, or that she has to have an employment contract.

To qualify for any SMP at all the woman must be paid at least £116 per week on the Saturday at the end of the qualifying week. So it is quite possible for an employee who starts on very low or nil pay to qualify for SMP, if their pay is increased later in their employment period.

The amount of SMP payable for the first six weeks is 90% of the woman's average weekly earnings, paid in the eight-week period up to the qualifying week. The SMP for the remaining 33 weeks of the SMP period is the lower of £145.18 (for 2018/19) and the weekly SMP paid for the first six weeks. An employer may pay more than the SMP amounts if they wish.

Another pre-condition of SMP is that the woman must give her employer notice of her pregnancy. This is normally done on form MAT B1; but the notice may also be given to the employer verbally.

There are slightly different qualifying conditions for maternity leave, which lasts 52 weeks. A woman may qualify for maternity leave but not for SMP. We can help you work out what you need to do when your employee reveals she is pregnant. ●

# VAT on exported goods

When you export goods to a customer in a country outside the EU, the sale is zero-rated for VAT if, and only if, seven different points of supporting evidence can show what went from A to B, what it was worth, how it moved, and who received it.

The seven categories of evidence set out in section 6.5 of VAT Notice 703 are:

- the supplier
- the consignor (where different from the supplier)
- the customer
- the goods
- an accurate value
- the export destination
- the mode of transport and route of the export movement

If any of those points are not detailed on documents retained in the UK, HMRC will conclude that the goods were not eligible for zero rating and it will demand 20% of the value of the goods exported.

The goods have to be described in some detail, such as 'make XZ and model number AB17856'. A general description along the lines of 'various electrical goods' will not be acceptable. To prove the goods have been moved out of the country, the original bills of lading, air-waybills, or sea-waybills must be retained. Photocopies won't be acceptable to HMRC unless they have been authenticated by the shipping or airline company.

HMRC also has the power to impose penalties for a careless or deliberate error, of up to 100% of the VAT which should have been paid. ●

## Missing trader fraud

There are so many risks in business nowadays. You need to know your customer to check they aren't trying to launder money through you, but you also need to know your suppliers to protect yourself from VAT fraud.

If your supplier goes missing and deliberately fails to pay its VAT liability for taxable supplies in the UK, you could end up liable for the VAT. This can apply when you knew, or should have known, that a transaction was connected with VAT fraud. HMRC may refuse your claim for the VAT you paid in respect of that purchase.

In determining whether your business should have been aware of the VAT fraud, HMRC will consider whether you took reasonable steps to verify the integrity of your supply chain. Such reasonable steps would include asking these questions:

- What is your supplier's history in the trade?
- Are high value deals offered by a newly established supplier with minimal trading history?
- Do those high value deals have no formal contract?
- Are you asked to make payments to a third party or to an offshore bank account?
- Has the supplier referred you to a customer who is willing to buy the goods?
- Has a prospective buyer contacted you shortly after you made contact with the seller, offering to buy the very same goods?
- Are you offered deals that have a consistent or pre-determined profit, regardless of date, quantities or specifications involved?
- Have you been notified by HMRC that previous deals with the supplier were connected with VAT fraud?

You should always check that the goods exist in the quantity and specification offered and that they are in good condition. Also, beware of large quantities of goods with non-UK specifications offered for supply in the UK, and check what remedies are available if the goods turn out not to be as described. ●

## Last chance to pay Class 2 NIC

As a self-employed individual, you will be required to pay only one class of National Insurance Contributions (NIC) from 6 April 2019. Good news! But there is a catch.

Currently, if your profits are below the small earnings threshold of £6,205 (for 2018/19), you don't have to pay any NIC. But you can voluntarily pay Class 2 NIC of £153.40 (for 2018/19) to ensure the year counts towards your state retirement pension and other state benefits. Class 2 NIC is being abolished from 6 April 2019, however.

Paying NIC voluntarily is a good idea if you don't currently have 35 years of contributions, which are needed to receive the full state pension. You can check how many years you have accumulated by accessing your personal tax account on: www.gov.uk/personal-tax-account.

You can pay Class 3 NIC voluntarily, but that costs £761.80 for the year. So paying Class 2 NIC rather than Class 3 NIC saves you £608.40 for 2018/19.

Similar savings may be made for up to six earlier tax years, where you have gaps in your contribution record but you did make a small amount of self-employed profits in the year. ●

# Trading and property allowances

Since 6 April 2017 you haven't had to report income from trading or rents (property income) if the total amount received in each category is less than £1,000 per tax year, but there are conditions.

The property income allowance can't apply to rent from letting a room in your own home to a lodger. This source of rent falls under a different allowance called rent-a-room relief, which covers up to £7,500 of rent per year. The property income allowance is designed to cover letting of non-residential areas, such as your driveway.

If your property or trading income is more than £1,000 you can elect to be taxed on the excess above £1,000, ignoring any expenses. Alternatively, you may elect for the allowance not to apply and deduct all allowable expenses, so you are taxed on the net profit or loss. This is the better option if you have lots of expenses and have made a loss.

Neither allowance can be set against income from a private company in which you or your close family holds shares, or from a partnership in which you are a partner or are connected with one of the partners. ●

## Repercussions of tax schemes

Convoluted tax avoidance methods are known as 'tax schemes'. Back in 2000, a popular tax scheme was to receive pay from your job as a 'loan', on which there was no tax, and no National Insurance. The individuals who took part in these schemes were told they were 100% legal and the loan would be written-off on their death, so they would never have to pay tax on the loan. In reality, the money provided wasn't a loan if it was never going to be repaid; it was a disguised form of remuneration.

In December 2009 HMRC made it clear that disguised remuneration schemes would not be tolerated. Anyone who took part in such a scheme after that point was taking a huge risk, but the promotors of such schemes often didn't warn their customers.

Now HMRC has got tough and a stiff penalty is due. If you received a disguised remuneration loan at any point in the past, and it is still outstanding on 5 April 2019, it will be deemed to be your taxable earnings received on that date. This special loan charge will apply on top of the tax and NIC actually due on the loan, so in effect a double hit of tax.

There is a partial solution, but only if you act fast. If you engage with HMRC before 30 September 2018 you can avoid the special loan charge in 2019, but you will have to pay tax according to the rates in force when you received the loan. However, we can help you negotiate a repayment schedule so the payment can be spread over time. ●

## Understanding IR35

If you work on projects for larger businesses through your own Personal Service Company (PSC), both you and that larger business can save tax and National Insurance (NI) costs. Your savings arise if you extract funds from your PSC as dividends rather than as salary, and your customer saves employer's NI by not paying you as an employee.

The IR35 tax avoidance rules came into effect in April 2000 to prevent individuals from gaming the system and paying less tax by working through their own PSC, when in reality they should be taxed as employees. You, as the director of the PSC, decide whether IR35 applies to your contracts. If it does, you should pay the net proceeds of the contract out of the company as a salary; if you don't, HMRC will demand the PAYE and NI on an equivalent deemed salary.

To check that IR35 is operated correctly, HMRC has to review the detail of how each contract is performed by a particular PSC, as the law must be applied per contract, not per company. This is very time consuming and expensive, so HMRC want to change the way the IR35 rules are applied.

In the public sector, it is the end customer (the public body) which decides whether IR35 applies to a contract. If it does, the public body instructs the fee-payer in the chain to deduct tax and employee's Class 1 NI from the amount the PSC invoices. The individual contractor doesn't get a say in the matter.

HMRC is consulting on extending these public sector rules for IR35 to the private sector. An alternative option is to ask all businesses to record much more information about each contractor they use.

These changes may take effect from 6 April 2019. If you are negotiating contracts which run over that date, include a break clause to allow you to renegotiate your prices. ●

## Advisory fuel rates

These are mileage rates which employers can use to work out how much to reimburse employees who use company cars for business journeys, but who have paid for the fuel used on those journeys out of their own pocket.

The advisory fuel rates are reviewed by HMRC every quarter, with the new rates taking effect from the first of June, September, December and March. In view of the recent increases in the price of road fuel you would expect all the advisory fuel rates to rise, but they haven't. The pence per mile rates for the current quarter are:

| Engine size | Petrol | LPG |
|---|---|---|
| 1400cc or less | 11p | 7p |
| 1401cc to 2000cc | 14p | 9p |
| Over 2000cc | 22p | 14p |
| **Engine size** | **Diesel** | |
| 1600cc or less | 10p | |
| 1601cc to 2000cc | 11p | |
| Over 2000cc | 13p | |

HMRC can't require you to use these advisory rates. If the fuel costs in your area are much higher than the UK average, or your company vehicles have low fuel efficiency, your business can use its own mileage rates based on the actual fuel costs of your company vehicles.

When an employee uses their own vehicle for a business journey, you can reimburse them tax free using mileage rates of 45p per mile for any size of car for the first 10,000 business miles driven in a year, and 25p per mile for subsequent journeys. These mileage rates for personally owned cars haven't changed since 2011. ●

## VAT on disbursements

There is an important difference between expenses you incur while providing a service to your customer (e.g., travel costs), and costs known as 'disbursements', which you pay on behalf of your customer (e.g., MOT charge).

If your business is VAT registered, you must add VAT to the amount of any expenses recharged to your customer, but you should not add VAT to genuine disbursements, where the customer remains responsible for the fee.

There has been some confusion about whether the cost of online property searches should be treated as disbursements by solicitors and conveyancers. HMRC's position is that if the information obtained in the search is passed on to the customer without comment or further work, the search fee can be treated as a disbursement. However, if the search information is incorporated into a report or used to provide advice, the fee is an expense on which VAT must be charged to the customer.

This distinction could affect all sorts of businesses which undertake online searches on behalf of customers. We can review your systems to check that the correct VAT treatment is being applied to costs you incur. ●

## VAT annual accounting

The VAT annual accounting scheme seems like a good idea, as you don't have to submit quarterly VAT returns. Instead you pay your VAT by monthly or quarterly instalments during the year, and make a final balancing payment with a single VAT return for the whole accounting year.

If you choose to pay monthly instalments, these will be set at 1/10th of your previous year's VAT liability. Nine monthly payments are made (starting in the fourth month of your VAT year), plus a balancing amount for the year paid in the second month of the next year.

However, the discipline of reviewing your accounts every quarter is lost. When you don't have time to monitor your accounts, the final balancing payment may be a lot more than you expect.

When you use the VAT annual accounting scheme, you have two months to submit the annual VAT return after the end of the accounting year. If that return is late, HMRC will send you an estimated VAT bill which may be less than the true liability. If insufficient VAT is paid, penalties will be due.

Annual accounting can suit businesses which have regular predictable income; those with very variable income can end up paying too much or too little VAT. ●

## Don't panic about penalties

If you receive a late filing penalty from HMRC, there is a one in three chance that it is wrong, and you can get it cancelled.

We know that HMRC cancels more than a third of the penalties it issues each year; it says this is because the taxpayer has successfully claimed a reasonable excuse for late filing. However, a high proportion of the late filing penalties are issued incorrectly as the tax return was actually submitted by the set deadline.

We are expecting the HMRC computer to issue a large number of late filing penalties automatically for last year's tax returns, as lots of paper returns were submitted after the paper filing deadline of 31 October 2017. These paper returns were necessary because the electronic route was blocked by HMRC's computer, which couldn't cope with 'unusual' combinations of income and allowances for the 2016/17 tax year.

Taxpayers who were forced to submit 'late' paper returns will have a reasonable excuse, but that has to be claimed, either with the return or by appealing against the automatic penalty.

We can help you submit an appeal against any late filing penalty you receive from HMRC. ●

# Repaying the value of benefits

You may have borrowed assets or money from your company with the intention of repaying or making good the cost to the company in the future. If you make this repayment by 6 July following the end of the tax year in which you received use of the asset or money, no benefit-in-kind tax charge will apply for that tax year.

The taxable benefits which can be effectively cancelled by this repayment mechanism are: non-cash vouchers, cars, vans, fuel for cars or vans, accommodation, credit tokens, and all benefits treated as earnings. It doesn't apply to interest payable on loans.

Where these benefits are 'payrolled' monthly, to avoid a benefit charge, the reimbursement must be made by 5 April, or 1 June in the case of reimbursement for private fuel.

Where a loan is advanced to an employee or director, there is no tax charge for the individual (but there may be for the company) if the amount outstanding at any point in the tax year doesn't exceed £10,000. If a greater amount is borrowed, the tax charge can be avoided if the employee is required to pay interest on the loan at a rate equal to or greater than the official rate (currently 2.5%).

This interest must actually be paid to the company, not just accrued in the accounts. It makes sense to pay any interest due on loans before 6 July 2018, so an accurate form P11D can be completed and submitted by that date. ●

## Clawing back child benefit

If your family receives Child Benefit and you are a high earner (£50,000 or more per year), you need to pay a special tax charge to claw back some or all of the Child Benefit received.

It is your responsibility to tell HMRC that you need to pay the High Income Child Benefit Charge (HICBC), as HMRC's computer systems can't match up claimants for Child Benefit and their high-earning partners or spouses. HMRC did write to a number of taxpayers in 2013 to tell them about the HICBC, but your family's circumstances may have changed since then.

In order to assess how much of the HICBC you need to pay, HMRC will ask you to complete a self-assessment tax return. If you are sent a notice to complete a tax return, don't ignore it as penalties will mount up if the return is not submitted on time. Note: it is your own income, as the higher earner, which is taxed to claw back the Child Benefit, not the income of the person who receives the Child Benefit.

That person can elect to stop receiving Child Benefit by contacting the Child Benefit office by phone or post, or by accessing their personal tax account at www.gov.uk/personal-tax-account. The benefit claim will remain live so the payments can recommence, or be paid for earlier periods if the child still qualifies.

It is important to make a claim for Child Benefit for every child, as it is that claim which triggers the issue of a National Insurance number when the child reaches the age of 15 years and 9 months. The Child Benefit claimant also has their own National Insurance record updated with NI credits for years in which they are not earning and the child is aged under 12. ●

## Paying employees on sleep-in shifts

Certain care workers undertake sleep-in shifts while on duty overnight. Such workers were commonly paid a flat amount for each sleep-in shift, which would be less than the hourly National Minimum Wage (NMW) rate.

An employment tribunal has now ruled such workers must be paid at least the NMW for time spent on sleep-in shifts. HMRC is enforcing that ruling with the penalties applied for periods from 1 November 2017. However, employers may be required to pay arrears of underpaid wages for sleep-in shifts from an earlier date, such as 1 April 2017.

If you are one of those employers, you should register for the government's social care compliance scheme, which will give you further assistance to comply, such as:

- PAYE guidance on NMW arrears
- a template spreadsheet to record the amount of arrears paid
- a template letter to issue to workers when arrears payments need to be made
- guidance on what employee pension contributions are due in respect of arrears of pay

We can help you work out the tax and pension deductions due and submit the necessary updates to HMRC. ●

This newsletter is written for the benefit of our clients. Further advice should be obtained before any action is taken.