PKF

Tax Talk

Simplifying the complexities of Tax

September 2022

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Tax Talk: September 2022

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Making Tax Digital for Income Tax

Landlords and self-employed businesses will need to move to quarterly reporting from April 2024

20

Months to go

If you would like to discuss how these requirements may affect you and what you need to do to ensure you are compliant, contact a member of our tax team today.

Why tax matters in divorce

The last thing anyone wants when going through a divorce is unexpected tax liabilities. We focus on some of the key tax issues that arise out of separations, and the pitfalls a spouse should watch out for when splitting assets.

Going through a divorce is usually a stressful, difficult and daunting process. Thinking about each other's tax exposure in trying to reach an amicable agreement is not going to be at the forefront of people's minds. This can be relevant for the division of assets and what to do with the family home. In such difficult circumstances, the last thing a spouse needs is to unknowingly assume new tax obligations as they start a new life.

Where the value of the assets is significant, we recommend you seek professional advice to make sure the division of assets is done in the most tax-efficient way. When preparing for negotiations on how assets should be divided and/or transferred, it's vital to understand the tax exposure.

Capital Gains Tax (CGT): new rules

Currently, transfers of assets between spouses or civil partners don't give rise to a CGT charge. The transfer happens no gain or loss.

But at the moment this rule only applies until the end of the tax year (5 April) after permanent separation. Transfers after the end of the year of separation are deemed to happen at market value and potentially give rise to a CGT liability.

This is a very common situation as it can often take a long time to reach agreement on the division and transfer of assets.

Much depends on when a couple separates in the year. If it's on 1 May, they will have until the following 5 April to transfer assets without triggering a CGT charge.

By contrast, if they go their separate ways in the first quarter of the year, they will have much less time before triggering a liability. For example, a couple separating on 1 March will have just over a month to transfer any assets.

But there is good news. HMRC has recently announced a sensible relaxation to these rules. From April 2023 couples will have up to three tax years to transfer assets between them. This is obviously a very welcome extension and will help ease the strain of divorce by giving more time to reach an agreement.

An important point to note is whilst couples who separate in the year after 6 April 2022 will automatically be within the scope of these rules, those who parted ways before 5 April 2022 must wait until after 6 April 2023 to transfer any assets if they wish to benefit.

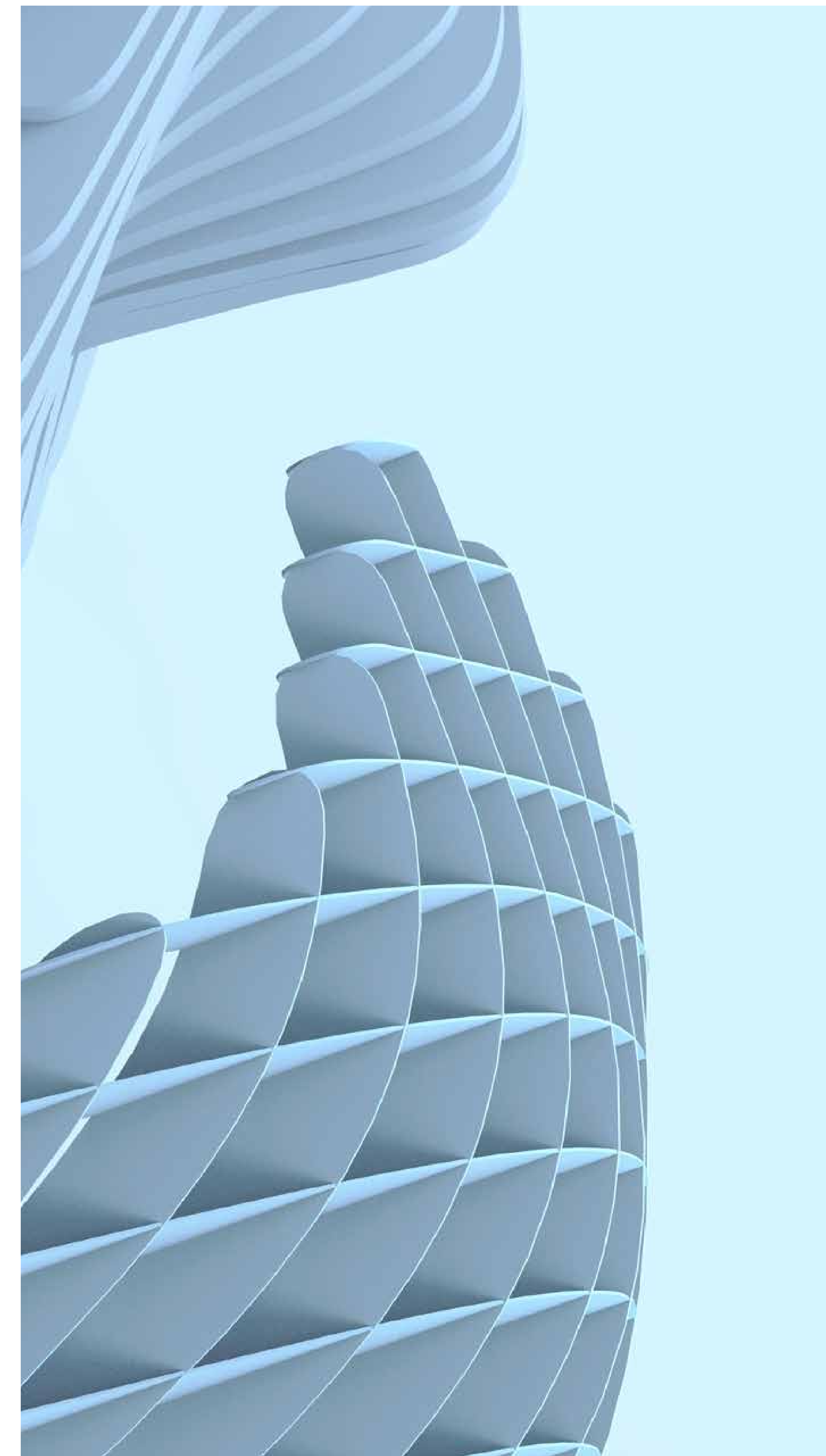
The proposed legislation will also apply the 'no gain or no loss treatment' to assets that are transferred as part of a formal divorce agreement, even after the three year window. Again, this is a welcome relaxation of the current rule for couples with very complex affairs, where it will take a longer time to agree a way forward.

Inheritance Tax (IHT): when exemption applies

Transfers between spouses are exempt from IHT up to the date of the decree absolute (the court order that makes the divorce final). This is restricted to a lifetime limit of £325,000 for transfers made from a UK domiciled spouse to a non-domiciled spouse. But there is no restriction on the transfer from a non-domiciled spouse to a UK domicile.

Transfers of property made after the decree absolute may be exempt, if the transfer was not intended to confer any gratuitous benefit or is being made for the maintenance of the transferor's family.

Any transfers not considered exempt are treated as a potentially exempt transfer (PET). This means when a transfer is made after the decree absolute, and the transferor dies within seven years, IHT may be due at up to 40%.



Why tax matters in divorce

Don't forget the Wills

It's important to note that whilst marriage revokes an existing Will, this is not the case for divorce. The Will remains valid, but the former spouse will no longer be able to act as executor or inherit from the Will. Following a divorce, you should review or revoke any Wills to reflect your intentions.

The family home and CGT

For most couples, the family home is the main asset.

Usually there's no CGT on the family home as it is covered by principle private residence relief (PPR). This exempts the property from CGT for the period they occupy it and for nine months after moving out.

This can create an issue where a spouse or civil partner retains an interest in the family home. The occupying spouse is exempt from CGT on any eventual gain on disposal. But the spouse who has moved out is subject to CGT on the gain they make for their share of the home, for the period they have not lived at the property.

The good news is that from April 2023 HMRC is planning to extend PPR to the spouse or civil partner who retains an interest in the former family home but has moved out.

Individuals who have transferred their interest in the former family house to their ex-spouse or civil partner are entitled to receive a percentage of the proceeds when that home is eventually sold. They can apply the same tax treatment to those proceeds, when they receive them, as applied when they transferred their original interest.

In practice this change should exempt most family home disposal proceeds from CGT, even where there isn't an immediate disposal or retention of an interest.

Non-domicile considerations

For most tax purposes a couple remain connected until the date of the decree absolute. This also applies for Income Tax and non-domiciled remittance basis taxpayers.

This can present a particular risk for taxpayers who have used the remittance basis to keep foreign income and gains outside the UK tax net.

Where they have claimed the remittance basis the funds are only taxed if they are subsequently brought into, or used in, the UK. This could be by the original taxpayer or someone connected to them, including their spouse. So any relevant funds brought into the UK by the spouse, after separation but before the decree absolute, could create a liability for the original taxpayer.

This can be particularly problematic once a couple has separated, as it's much less likely they will keep each other fully informed of their financial arrangements. But it is still possible for an estranged spouse to trigger a tax liability for their partner, possibly without even informing them.

You can manage this risk by agreeing that a transfer to the UK can only to be made after the decree absolute and by having separate provisions for the maintenance of children in the settlement agreement. It's very important for non-domiciled taxpayers to take specialist advice when considering the division of assets on divorce.

Following the decree absolute, the funds can be brought to the UK by the spouse without triggering a tax liability, provided they are not used for the couple's children if they are under 18.

Non-domicile considerations How we can help

Couples going through separation should always give careful consideration to the following:

- what tax liabilities may be relevant or arise, and on what assets
- the timing of any division or disposals
- how the assets are to be transferred.

Tax considerations can be important in prenuptial or postnuptial agreements, divorce and separation, and in financial provision for the parties and their children.

To ensure that any agreement or order on the division of assets is done in the most efficient way, we strongly recommend you take professional advice at the outset. The PKF private client team would be happy to answer any queries or provide advice on these issues. Please contact your usual PKF contact or Stephen Kenny.

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Preparing for an exit: your people

The tax implications for employees can be complex when their company relocates. Here's our guide.

When companies decide to relocate part of the business overseas, it's important to plan for how the move will impact the exiting workforce. Chances are some employees will move abroad with the company. Others may be made redundant.

Relocating employees overseas

You may decide to transfer certain key employees overseas to set up the business and train local staff. If so, you will need to consider immigration regulations, host country employment law, the work and living conditions of the host country and the cost of living.

What are the UK payroll reporting requirements?

UK reporting requirements depend on:

- The employee's UK tax residence status under the Statutory Residence Test
- Whether they will continue to be employed by the UK entity
- Whether they will continue to perform UK duties

If the employee remains a UK tax resident, their employment income will still be subject to UK PAYE.

Relief may be available to avoid double withholding. This applies if the employee is deemed to be treaty non-resident, based on the tax treaty between the UK and the host country, or if there is a tax withholding requirement in the host country.

Where the individual remains employed by the UK entity, any substantive duties they perform in the UK are taxable in the UK. Substantive is any duty that is not merely incidental to their role. An example of non-substantive duty would be to attend a conference. UK National Insurance may still apply if there is a social security agreement between the UK and the host country.

But if the individual ceases their UK employment, there may be tax relief available on their UK substantive duties. This is subject to the employment income section of the tax treaty between the UK and the host country. If the employee is eligible for treaty exemption, the UK entity does not need to report them on the UK payroll, provided there is a short-term business visitor (STBV) agreement with HMRC and details of UK visitors are submitted to HMRC in the annual report.

In cases where the employee receives bonus and equity income, a portion of that income may continue to be taxable in the UK. This applies if they worked in the UK during the bonus performance period or the share vesting period. UK taxable bonus or equity income must be reported on the UK payroll, even if the employee is non-resident and has no UK duties.

How are relocation expenses treated in the UK?

You may decide to provide or reimburse relocation expenses. These might include the transportation of personal belongings, flights and visas for the employee and their family.

If the employee will become a non-UK tax resident when they leave the UK, expenses incurred are not usually reportable in the UK. Instead, the benefits provided may be taxable in the host country.

Where they remain a UK tax resident, the benefits will continue to be taxable in the UK. But there may be tax relief available on certain qualifying relocation expenses up to £8,000.

Preparing for an exit: your people

Letting employees go

For employees leaving the company or being made redundant, from a payroll perspective, you must include the date of leaving on the Full Payment Submission (FPS) when the final payment is made to the employee.

You also need to give the employee a Form P45, which contains details of pay and tax from the start of the tax year to the date the employment terminated. The employee will keep one part (1A) of the form for their records and will give the other parts (2 and 3) to the new employer.

Employees are eligible for statutory redundancy pay if they have been working for you for two years or more. The statutory amount is currently capped at £17,130. But as an employer, you may decide to pay more than that.

The UK tax treatment of termination payments depends on whether they are contractual.

What kinds of income are taxed as normal earnings?

Payments that are reward for services are taxed as normal earnings and are subject to PAYE and Class 1 National Insurance, similar to normal salary.

Examples are:

- contractual termination pay
- non-contractual, but the payment is reasonably expected
- garden leave
- restrictive covenant
- post-employment notice pay

When is income taxed as compensation for loss of office?

Income taxed as compensation for loss of office is also known as an 'ex gratia payment'. Certain payments are fully exempt from tax.

For example:

- Payment made on death/injury/disability of the employee
- Payment made into a registered pension scheme
- Payment relating to outplacement counselling or a retraining course
- Legal fees, provided they are referred to in the settlement agreement and the payment is made directly by the employer to the employee's solicitor

For other ex gratia payments, including statutory redundancy pay, the first £30,000 is exempt from tax and the excess is subject to PAYE and Class 1A employer National Insurance under PAYE.

What kinds of income are taxed as normal earnings?

Termination payments which are taxed as normal earnings from the employment will be deducted for corporation tax purposes by the employer when arriving at taxable profits, in the same way as any other salary payment.

Statutory redundancy pay is specifically allowed as a deduction from trade profits. You will also be allowed a deduction in arriving at taxable profits, in respect of termination payments, which meet the normal test for allowable expenses i.e. wholly and exclusively for the purposes of the trade.

If you are permanently ceasing the trade, the ex-gratia payments are unlikely to meet the wholly and exclusively test. But a deduction limited to three times the amount of statutory redundancy paid to the employee is specifically allowed.

If you would like more guidance on issues raised in this article, please contact your usual PKF contact or Brenda Hu.

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VAT: Exiting the business

Selling up and leaving all your troubles behind for someone else is not always possible. Particularly when it comes to VAT. Here's what to look out for.

Nowadays, many businesses have little (if anything) in writing from HMRC to confirm the VAT treatment of their transactions is correct. This means the tax adviser reviewing the business as part of the transaction's due diligence often identifies potential VAT errors. If these are detected by HMRC, they could lead to a retrospective VAT demand plus interest and/or penalties.

If a potential VAT exposure is identified, it may cause problems (depending on the amount involved) for the seller that may include one or more of the following:

- a reduction in sale proceeds
- tax liability insurance having to be taken out
- monies being held in escrow for a period
- having to obtain written HMRC rulings
- having to correct errors and notify HMRC
- having to correct VAT record-keeping deficiencies, (eg obtaining and retaining evidence that goods sold have been exported outside the UK, obtaining VAT invoices from suppliers).

Sometimes the VAT issue is so significant that the sale of the business is delayed or even stopped altogether. A typical example is a business that is not VAT registered because it considers that it only makes VAT-exempt supplies.

But the due diligence then finds the business should have registered for (and accounted to HMRC for) VAT from a date several years ago for either of the following reasons:

- Purchasing services from non-UK suppliers where those services would have been subject to VAT had they been provided by UK suppliers
- Recharging costs between group companies where HMRC might argue that VAT-able supplies have been made by one group company (eg the holding company) to another (eg the one making VAT-exempt supplies that cannot recover any VAT on its costs under VAT law).

Bearing all this in mind, if you are considering selling up and/or engaging with a new investor or lender in the near future, we recommend you undergo a practice-run VAT due diligence exercise right away. Then, if any VAT issues are identified, you can correct them now before they potentially derail or delay a future sale of, or investment in, your business.

If you would like further advice on VAT in these circumstances, please contact Mark Ellis or your usual PKF contact.

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MTD for ITSA – a look ahead to software

Whether it is API enabled or bridging software for spreadsheets, providers are all jumping on the bandwagon to offer you their wares. But take care to choose what best suits your business.

As a quick recap, from April 2024 MTD for ITSA (Making Tax Digital for Income Tax Self Assessment) will require four quarterly returns, an end of period statement to confirm the business details for the year, and a final declaration akin to a current tax return.

As MTD for ITSA approaches, the recommendation is increasingly clear. Start keeping your records digitally as soon as you can.

But what is not as clear is what kind of software you should be using for the best experience. With so many providers rushing to put out their version, it can be overwhelming to look through the HMRC list of compatible software and choose which is best for your needs.

Note that HMRC does not provide its own software and, unlike with current tax returns, you will not be able to file online using an HMRC portal. To comply with MTD, you'll need to either choose a compatible software, or have an agent do this on your behalf.

Some software options are clearly geared towards certain kinds of businesses. But there are a few underlying types of software, and which is best for you depends on your circumstances.

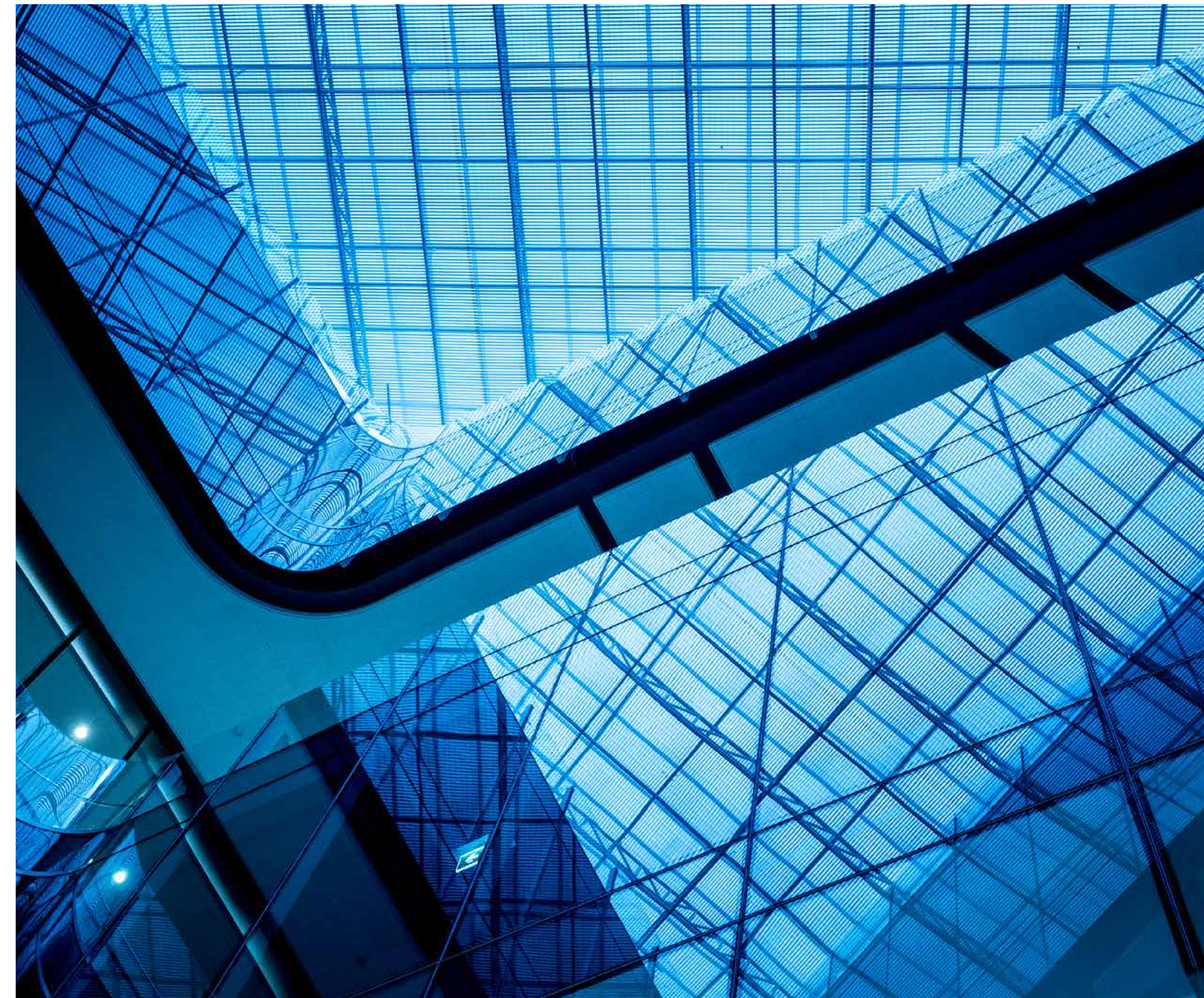
What is API enabled software?

These are software packages that act as a one-stop shop for MTD. They can both hold digital records, and file with HMRC directly using HMRC's API (application programming interface). Many will be geared to a particular type of customer, for example landlords, and will offer additional services by using the data provided.

If you can link your income and expenses to the software, for example by using a compatible business account, this will typically allow you to file direct with HMRC or export your data to send to your accountant and the use of API software is therefore likely to reduce compliance work in the future. If using an API solution it is important to choose the right software for your current business need and future plans for the business.

What is bridging software for spreadsheets?

Some providers are aiming to make software that bridges the gap between existing spreadsheets and HMRC's new API. By doing so, you can continue to use spreadsheets and still be MTD compliant, so long as you follow the correct format, and you or your agent have the necessary bridging software.



MTD for ITSA – a look ahead to software

Contrary to rumours that HMRC might try to phase it out (as they consider it more open to errors), the tax authority has said it will keep the bridging software as a long term solution. This won't offer the bells and whistles of the API enabled software packages, and may be more work in the long run. It will mean people will have the option of continuing to use their tried and trusted spreadsheets.

When consider the options is it important to weigh up the convenience of continuing to use familiar spreadsheets with the short them hassle of changing to API software which will be more efficient in the long terms and help reduce errors.

What else should I consider?

As always, we would recommend you speak to your adviser before making a decision. You need to pick the best software to help you with record keeping, but you also need to examine your compliance needs.

It's important to determine what level of service you will need in the future and choose software accordingly.

For example, not all software will be able to submit a final declaration, but if your accountant can prepare this for you that might not be a concern.

Price could also be a factor. We anticipate there will be some software providers offering the basics for free, so it may be worth asking what your accountant recommends.

As the date for MTD draws nearer, software options will be finalised and clearer. And that should make it easier for you and your accountant to choose the best approach for you in this new system.

If you would like further guidance, please contact Sam Meir or your usual PKF contact.

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Exit: why it pays to be ready

If you are intending to move on from your business, the earlier you start planning the better. You may need to restructure and incentivise key employees. But generally getting all your ducks in a row takes longer than you think.

What is your exit strategy? It's probably something you've thought about, but there are different ways to go about it. A sale to a third party, a management buyout, an IPO or a family succession. Whatever your chosen route it's important that you and your business are exit ready.

What is sale ready due diligence?

It's crucial to start planning this at least two or three years before you exit. The tax position will vary depending on whether you have a share or asset sale. But, most importantly, you want to get as much as possible for your exit. If you have any skeletons in the closet it's best to address them now, so potential buyers have no reason to drive the sale price down.

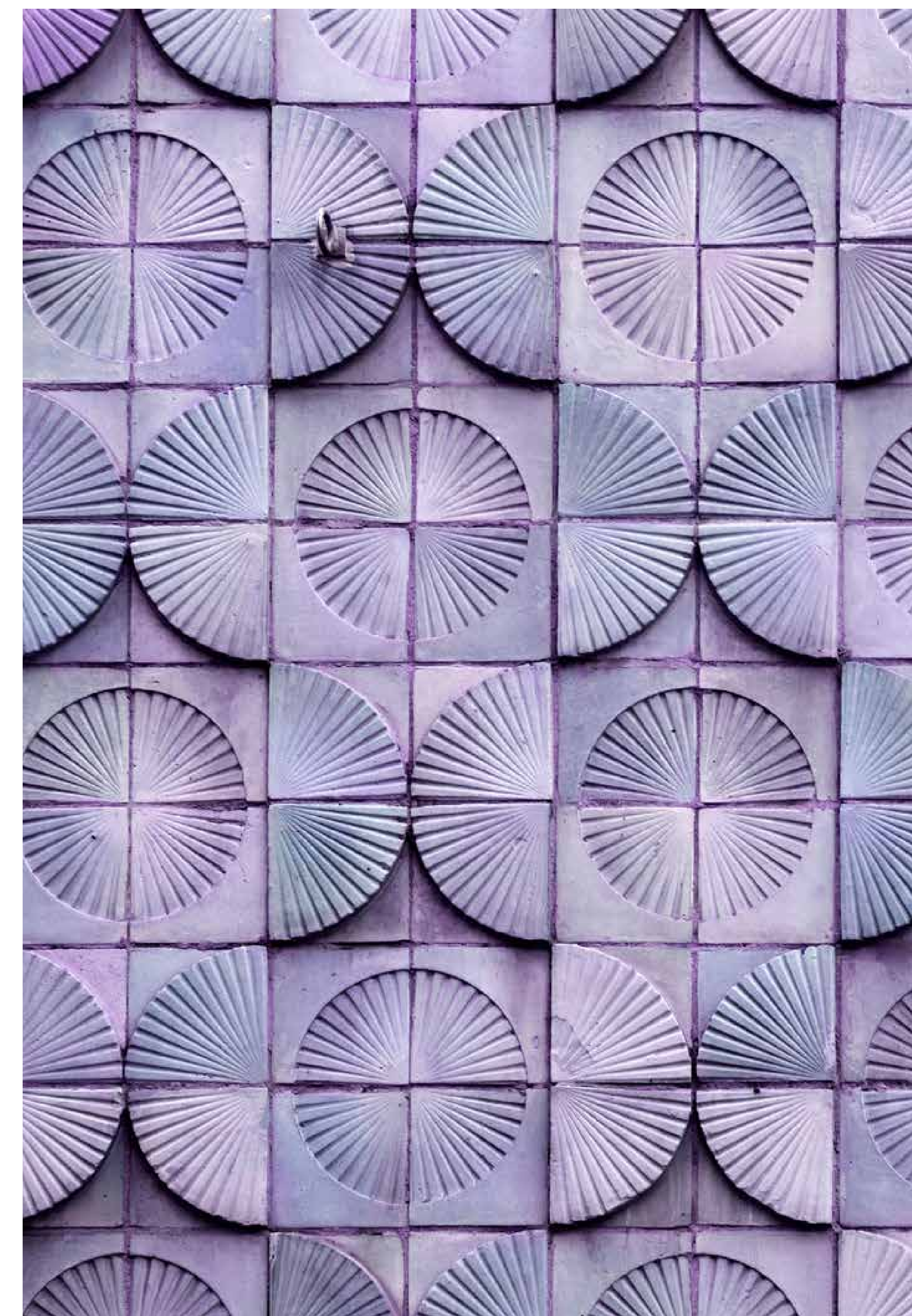
Tax can present nasty surprises. And if there are things you've been putting off, now is the time to act. Sale ready due diligence is an excellent way of identifying any such issues, taking steps to address them and presenting a clean package of tax affairs as part of your buyer's due diligence requirements.

It's often employment and indirect tax issues that can cause the biggest headaches. But Corporation Tax can also present some risk areas. We cover indirect tax issues in our VAT: Exiting the business article in this edition, so this piece will not focus on that.

PKF has helped a number of businesses and their owners through exits. Here are some of the common areas that have caused problems:

- If you are a business that operates internationally with a presence or sales outside your home jurisdiction, it's important to maintain good corporate governance to make sure the corporate residency of your companies is in the jurisdiction that you intended. Activity on the ground in other jurisdictions can trigger local permanent establishments of your business. This may make you non-compliant and produce additional tax burdens that you haven't accounted for.
- If you are making any claims for incentive reliefs, such as research & development claims, take care to provide robust supporting documentation to substantiate any relief you are seeking.
- Participation in any form of aggressive tax scheme will attract a great deal of interrogation and will often lead to retentions from sale proceeds and requirements from the buyer to disclose to HMRC.
- If your business is one that needs to use subcontractors or consultants, lack of compliance with IR35 could cause a transaction to abort should they form a material part of your business. Even if this doesn't apply to you, you must be able to show you have adequate and robust procedures to manage this risk.
- If you are using equity incentivisation plans, you should set these up with appropriate tax advice for both the entity and the employees being incentivised. Not taking sufficient advice, both on set up and during operation of the plan and maintaining adequate documentation could lead to unforeseen liabilities throughout the lifecycle of the plan and on exit.

These examples have all arisen during transactions when we have helped clients, whether as buyers or sellers. A sale can be stressful enough, so a sale ready due diligence can help you identify such risks and resolve any issues in good time.



Exit: why it pays to be ready

Structure of the exit

Have you thought about which parts of the business will be sold? This question may be more difficult to answer if you have multiple streams to your business. Are you selling a business or shares, or will you sell specific assets? The end tax position will vary depending on these factors.

Most business owners hope to qualify for business asset disposal relief (BADR) on the disposal of qualifying shares or business interests. It can attract a favourable rate of 10% Capital Gains Tax, up to a lifetime limit of £1m of gains. BADR now imposes a 24-month ownership condition. To ensure this condition is met, it's best to seek advice at least two years before the exit.

If your business is made up of multiple streams you may need to demerge or hive out part of the business in order to achieve the desired pre-sale structure. Restructuring your business in this way will need detailed tax advice and possible HMRC clearances as a restructure could trigger immediate tax liabilities or others which arise when you exit.

Consideration can take multiple forms, from cash or shares to loan notes. It could be paid upfront or you could structure an earn-out and deferred consideration. The timing and type of consideration will both affect the tax position. A clearance may also be required if it's not obvious that an earn-out will attract payroll taxes rather than capital gains treatment.

How to incentivise employees

If you have not already done so, you may need to incentivise key employees to help you drive the business forward. It's usually more tax efficient to do this when the value of the company is lower so that any tax liabilities that arise are kept to a minimum.

To keep things simple, you may look to provide cash bonuses to staff. But these are inefficient from a tax perspective, attracting both Income Tax and National Insurance. Options schemes such as enterprise management incentives (EMIs) provide a tax efficient mechanism to get equity to key employees. Where the conditions for EMI are not met, alternatives such as growth shares may provide a viable alternative.

Please contact Catherine Heyes, Partner in our Corporate Tax team if you have any queries in relation to this article.

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About PKF
Simplifying complexity for our clients

PKF is one of the UK's largest and most successful accountancy brands.

We provide a full range of audit, accountancy, tax and advisory services, and are experts at simplifying complexity – we're particularly well-known for working with large, high-profile businesses with challenging issues in fast-moving and highly technical areas.

We are also an active member of PKF International, a global network of legally independent accounting firms that gives us an on the ground presence in 150 countries around the world.

PKF in the UK

10th largest Tax practice in the UK

£182.5 million annual fee income

2,035+ UK partners and staff

6th ranked auditor of listed companies in the UK

Our tax services
At a glance

"By bringing together the extensive expertise and experience of our tax specialists we can provide a fully rounded service that offers excellent value for money."

We offer comprehensive tax compliance and advisory services to a range of clients, both in the UK and globally, helping them find their way in the increasingly complex world of tax.

We find practical solutions that we use to our clients' advantage. Our team of experts supports individuals, and businesses ranging from start-ups and SMEs to large international groups, both listed and privately owned.

Where understanding of our clients' sector makes the difference, our experts invest their in-depth industry expertise to provide invaluable support and insights.

We offer the following specialist tax services:

Corporate and business taxes

Our Business Tax team will ensure that you are both tax compliant and efficient.

We provide specialist corporate and business tax advice on both a local and international level, which includes senior accounting officer and large business compliance, transaction services, due diligence, R&D tax relief, employer solutions and global mobility. We also support both the personal and business affairs of partnerships and LLPs.

Read more

Personal tax and wealth management

Our team will guide you through the complex world of taxes, helping you meet all filing requirements and identifying risks and opportunities to help mitigate tax liabilities.

We advise individuals, the self-employed, partners, trustees and executors with their UK and international tax affairs. Our services include all aspects of tax, including Self Assessment, Capital Gains Tax, Inheritance Tax, property (both residential and commercial), trusts, family wealth and estate planning, residence and domicile issues.

Read more

VAT and Indirect taxes

Our indirect tax team will support you in meeting your VAT compliance objectives and advise you on any VAT issues that your business faces.

We can ensure that your VAT risk is assessed and managed, and that your VAT recovery is optimised. We can also provide advice and compliance services on other indirect taxes, such as Insurance Premium Tax, Customs duty, and Air Passenger Duty.

Read more

Tax disputes

HMRC is increasing the number and scope of tax investigations into both individuals and businesses, covering all aspects of potential underpayments of tax, including offshore investments, personal and corporate Self Assessment Tax Returns, PAYE and NIC compliance and VAT.

If an issue arises, our trusted advisors will match the right specialists with your needs to provide you the necessary support – whether for a routine HMRC enquiry or a more complex investigation.

Read more

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