Tax Talk

Simplifying the complexities of Tax

November 2022

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Tax Talk: November 2022

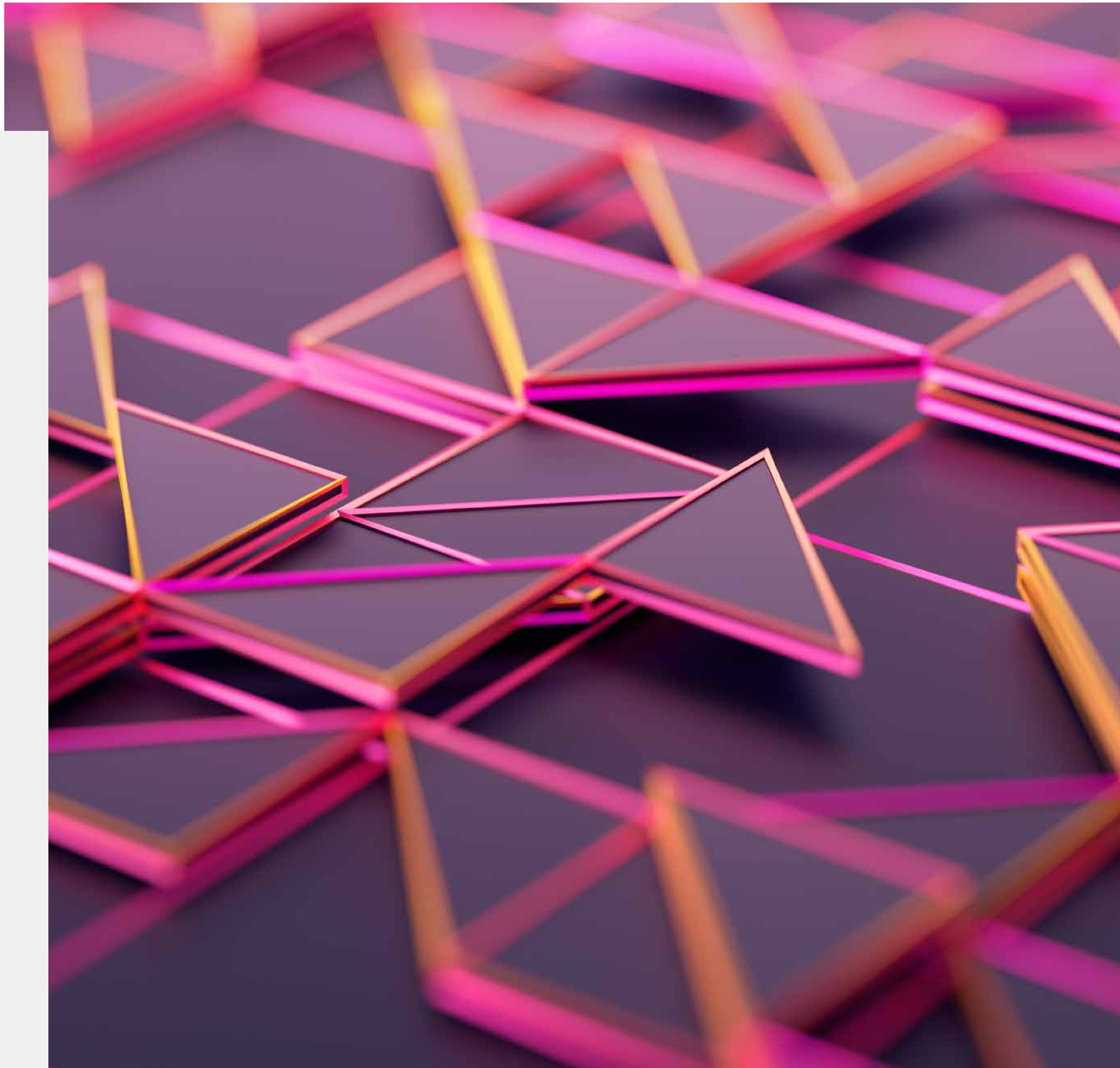
Personal Tax
MTD ITSA: what to do now to prepare 2

Corporate Tax
Cryptoassets mean cryptic tax liabilities 5

Corporate Tax
Salaried Member rules: what they mean for you 7

Personal Tax
Offshore funds rules: don't get caught out 9

About PKF 12



Making Tax Digital for Income Tax

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

17

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.

Making Tax Digital (MTD) insights

We're helping businesses of all sizes at every stage of readiness to comply with, and prepare for MTD.

For more information on how MTD might affect you and your business, please read our insights.

MTD ITSA: Who falls within the scope?
September 2022

Beneficiaries of certain trusts or partners in a partnership who may have not previously thought about the impact of MTD might now be affected, and need to consider whether they should sign up.

Read our article to find out more

MTD ITSA: a look ahead to software
August 2022

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.

Read our article to find out more

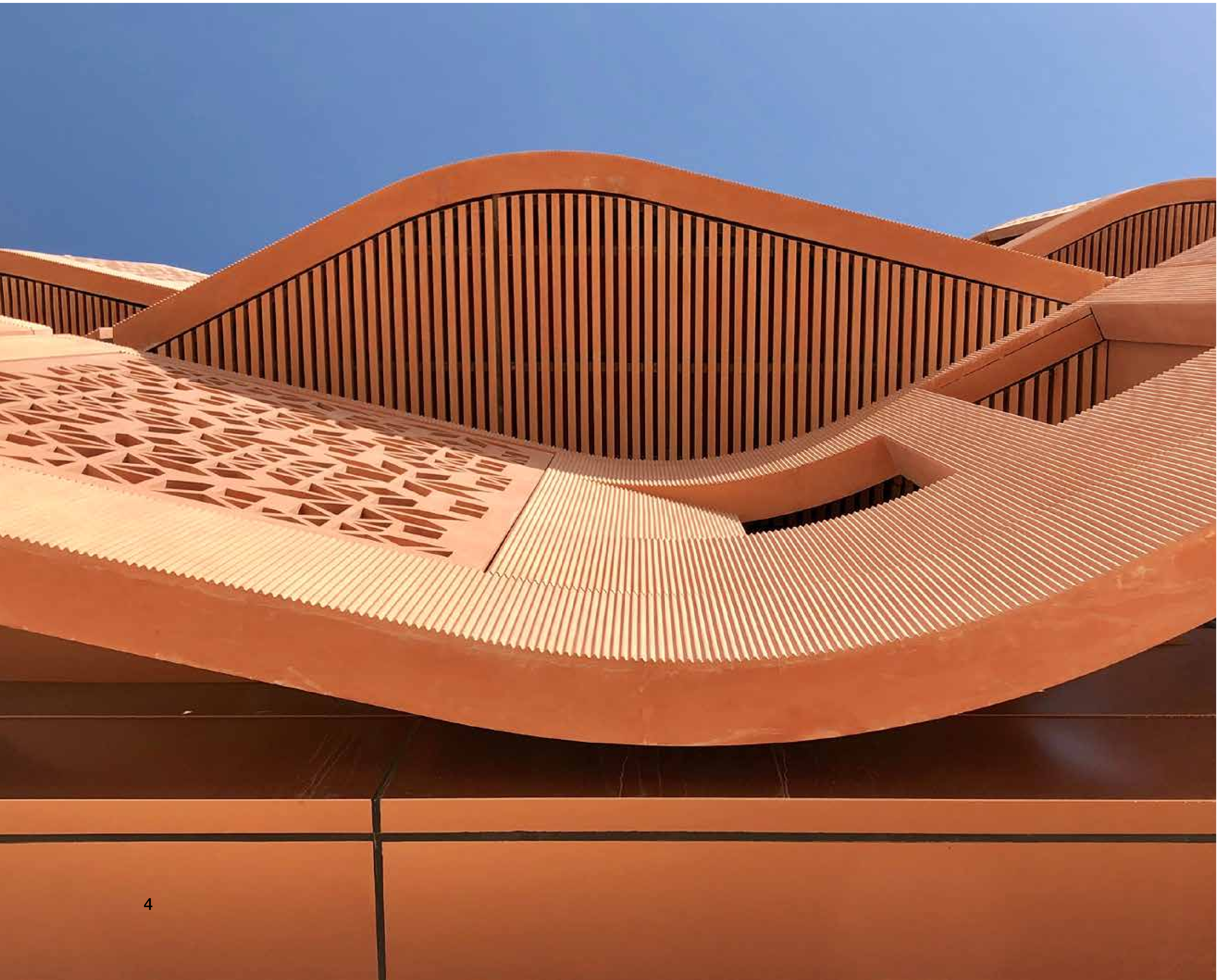
MTD ITSA
July 2022

MTD for ITSA is coming into play from April 2024. If you are a landlord or sole trader who is going to be affected, here are a few tips to preparing for when MTD ITSA goes live in April 2024.

Read our article to find out more

MTD ITSA: what to do now to prepare

If you think you may be affected by MTD for your tax return, find out about the process for registering and the deadlines. Plus complete our survey at the end of the article to help us provide the best service.



We are gradually discovering more details of the new MTD regime for Income Tax Self Assessment, due to come into force in April 2024. So it's important to know if you will be affected, and what you can do now to prepare.

Who is affected?

If you've been following our recent articles, you should already have an idea as to whether the new regime applies to you. If you've missed any of these, you can catch up on the page above. If you are a landlord or a self-employed sole trader, then it's worth a few minutes to get up to speed.

What can I do now?

HMRC has indicated that as a taxpayer registering for MTD you will need a Government Gateway account and must be registered for Self Assessment. If you don't have a Government Gateway account, such as a personal tax account, you should consider setting this up now. Make sure, too, that you are registered for Self Assessment.

Creating a Government Gateway account

The setting up process asks you to provide an email address and create a password.

You will also need to prove your identity. This is done digitally by providing your National Insurance number and two of the following:

- A valid UK passport
- A UK driving licence issued by the DVLA (or DVA in Northern Ireland)
- A payslip from the last three months or a P60 from your employer for the last tax year
- Details of a tax credit claim, if you made one
- Details from a Self Assessment tax return, if you made one
- information held on your credit records, if applicable (such as loans, credit cards or mortgages)

MTD ITSA: what to do now to prepare

Registering for Self Assessment

If you are self-employed and earned more than £1,000 (before subtracting anything on which you can claim tax relief), or received more than £2,500 in a tax year from renting out property, you need to complete a Self Assessment tax return.

If your income from any untaxed sources, such as property rental, is between £1,000 and £2,500 you may not need to do a tax return and instead can notify HMRC through your personal tax account or call HMRC.

If you haven't submitted a Self Assessment tax return before, you have until 5 October after the end of the tax year to notify HMRC that you have an obligation to file one for that tax year. HMRC has an online service to check if this applies to you.

What happens next?

You must submit your Self Assessment tax return for 2022/23 by 31 January 2024. HMRC will review it and check if your qualifying income is more than £10,000.

If it is, HMRC will write to you and confirm that you must meet the Making Tax Digital for Income Tax (MTD for ITSA) requirements by 6 April 2024. If you have an agent, they can meet the requirements on your behalf.

You or your agent must find software that is compatible with, and must then register for, MTD for ITSA.

If you become self-employed or a landlord after 6 April 2023 you do not meet the MTD for ITSA requirements until you've submitted your first tax return reporting such income. HMRC will notify you once your qualifying income is more than £10,000 and tell you when you must start meeting the requirements.

You'll have the option to voluntarily sign up for the system at an earlier date. HMRC is also running pilots of the scheme before its formal start date of April 2024. We will be providing details in a later article on how you can join the pilot, if you are interested.

What are your thoughts?

Our MTD for ITSA team is launching a survey to understand the level of awareness among taxpayers, and the extent to which they will look to agents for help and support. We would appreciate your taking a couple of minutes to respond, so we can tailor our service to meet your needs. If you would prefer to speak to one of the team, please complete your details and we will call you.

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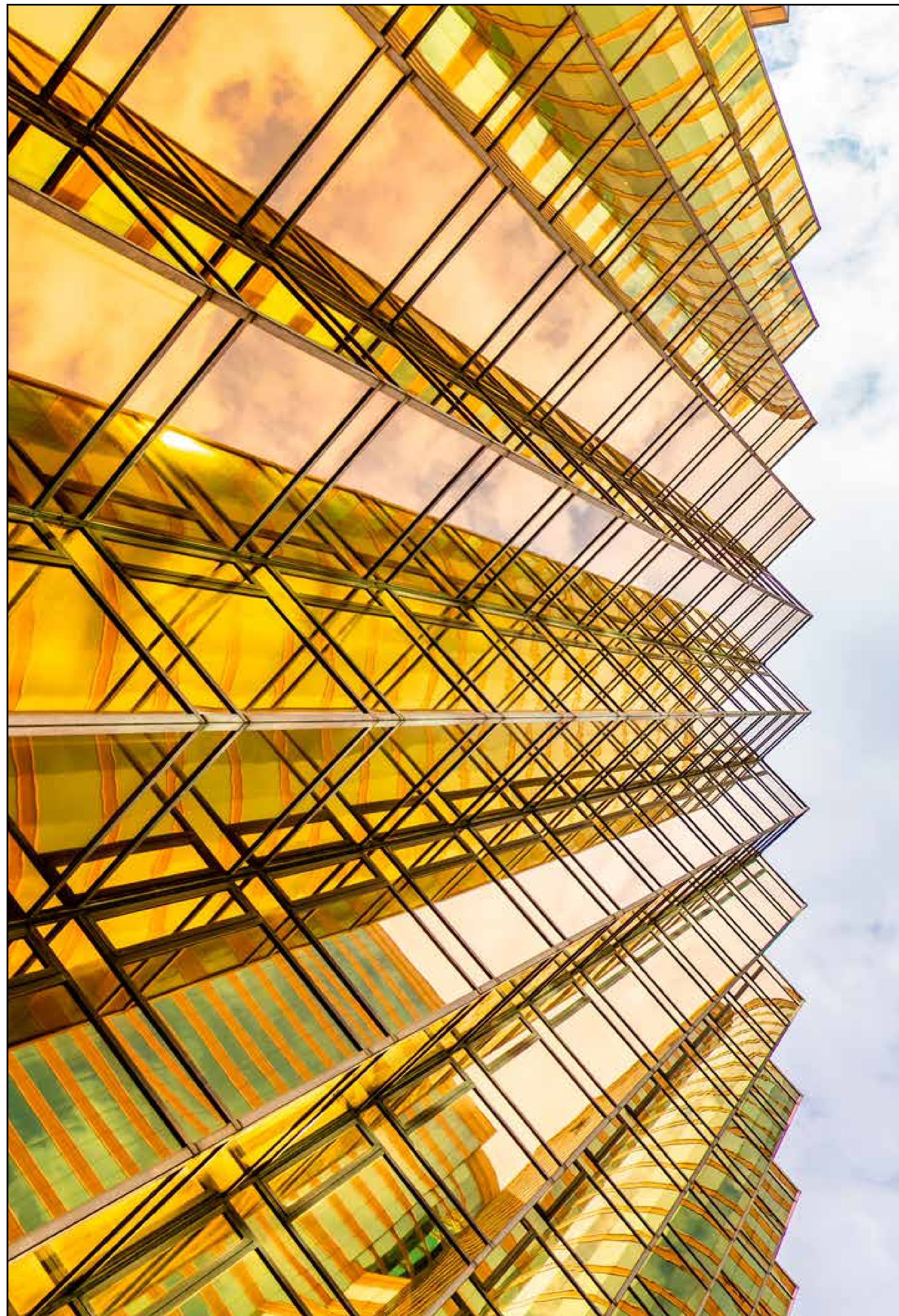

Cryptoassets mean cryptic tax liabilities

What counts as a taxable event for cryptoassets? Will HMRC consider you a trader or an investor? We help you to prepare for being crypto accountable.

The growth of cryptoassets has brought many into direct contact with the UK tax regime for the first time. Most people, employed on payroll with investments limited to ISAs and pensions, will not need to consider a tax return in their lives. But those who hold cryptoassets will almost certainly need to file tax returns, as any taxation event cannot be dealt with at source.

In the early days of crypto, this position was misunderstood and HMRC didn't help. Its very limited initial guidance in 2014 could have been interpreted as saying there were no tax risks. More recently, particularly in 2021, HMRC has been far clearer in its guidance and expectations of tax events. Specifically, HMRC has requested information from exchanges to target individuals who it believes have not reported their crypto activities in a 'nudge campaign'.

Although crypto is still very new in terms of investment and trading activities, tax legislation is definitely not. Crypto activities and events are therefore matched against pre-existing tax treatments to determine tax outcomes. There is very little new legislation in this field. But the language of crypto changes and develops very quickly, so care will always be needed.

When does a taxable event arise?

The key triggers that give rise to a taxable event are when someone disposes of a cryptoasset in exchange for something else. These are the main examples:

- Sale of crypto for fiat currency, e.g. GBP or USD. The disposal value is the value of the currency received.
- Exchange of crypto for a different crypto type, e.g. converting Bitcoin to Ethereum, or using Ethereum to buy a non-fungible token (NFT). The disposal value is the GBP equivalent of the crypto disposed.
- Using crypto as a means of payment, e.g. using £5,000 worth of Bitcoin to place a deposit on a Tesla. The disposal value is £5,000.

The mere acquisition of a cryptoasset in exchange for cash isn't a taxable event. It will, though, give rise to an acquisition cost for computing any profits on a later disposal. Equally, an airdrop of new coins would not usually give rise to taxable income. But if you receive cryptoassets in exchange for services provided (or if some or all of your salary is paid in crypto), those services are taxed in the normal way.

The fact that crypto, rather than cash, is the payment mechanism does not change that underlying presumption. What's more, if you're receiving crypto in return for services, you'll also need to consider VAT.

It's important to note that, to be taxable, cryptoassets need to be exchanged for something else. If, for example, you move Ethereum between wallets or exchanges (you start and end with the same number and value of ETH), there is no disposal to consider. But you should still keep records of these transactions so that you can prove to HMRC, if challenged, that this is what you did.

Income or capital?

Many people investing in crypto will describe themselves as traders. If this is correctly established for tax purposes, it means they are subject to Income Tax in respect of their profits. But to be truly considered a trade, there must be serious organisation and time commitment to the activity, which can often be difficult to demonstrate. The reality for many is that, however they describe their activities to friends, they will be considered investors and subject to the Capital Gains Tax (CGT) regime.

In good times, being in the CGT regime is no bad thing. The rate of CGT for UK individuals is 20%, with an (often unused) exemption for the first £12,300 of gains in the current tax year. For small investors, this may mean no, or low, tax liabilities. But if they are treated as trading, the rate of Income Tax is as high as 45%.

Trading (and therefore Income Tax) status may be beneficial where losses arise, as there is scope to use those losses against income (such as salary) at the higher income tax rates. On the other hand, capital losses can only be used against current year or future capital gains. But beware. Given the number of first time crypto speculators who have been badly burnt this year, HMRC is likely to strongly challenge any individuals who claim a trading status and an Income Tax loss offset in their first tax return.

Why is fungibility relevant for tax?

It was amusing for me as a tax advisor to see the word 'fungible' appear in daily use when NFTs became mainstream. I'd only heard it years ago when studying for my tax exams. Broadly, something fungible is something where all items of that class are identifiable.

Cryptoassets mean cryptic tax liabilities

For example,

- if you buy a Red Ape NFT and a Blue Ape NFT, and then sell the Blue Ape, you can clearly track the Blue Ape purchase and sale, and know you are left holding a Red Ape.
- But if you buy 2 Bitcoin, and then sell 1 Bitcoin, you neither know (nor mind) which Bitcoin you have remaining.

Why this matters from a tax perspective is in determining how you calculate your profit on disposal. With the NFT example, your gain arises solely from the Blue Ape transactions. In the Bitcoin scenario, your Bitcoins form a pool. When you make your 50% disposal, the cost of disposal is 50% of the acquisition costs of your total Bitcoin holding. Again, you'll need detailed records to track these accurately and support your calculations.

As an aside, and regardless of whether an asset is fungible or not, where you incur gas fees to buy or sell crypto these will be considered either costs of acquisition or disposal, and will allow you to reduce your taxable gains.

HODL and losses

As we've said, there's nothing new or unique about the taxation of crypto. It just involves the application of pre-existing tax concepts to new language. This is also the case where assets become of negligible value. Because of extreme price changes in the market, crypto investors often Hold On For Dear Life ("HODL") to their cryptoassets.

Where an asset (normally shares) falls in value so dramatically with no prospect of recovery, it's often possible to agree with HMRC that it's of negligible value. This means it can be written off to give rise to a capital loss.

On a basic level, this could be appropriate for coins that have crashed in value recently, such as Luna. But even if all indicators lead the investor to conclude that the investment is a write off, the asset can still be traded. So, arguably, the prospect of recovery is greater than nil (even if only fractionally so). In such cases, if the availability of a capital loss to shelter current period gains is fundamental then, having considered the remaining investment potential, it may be best to dispose of the asset to crystallise an actual loss, rather than relying on negligible value claims.

If the loss derives not from a collapse in value, but from a theft or fraud, Andrew McCready has considered this in more detail here.

Be ready for HMRC

Although crypto is still a novel means of investing, the tax consequences are well established. HMRC is aware of significant non-compliance in the past. That's why it's actively pursuing taxpayers who it believes have not reported some (potentially sizeable) investment gains in recent years.

Even if you believe you have reported correctly, you cannot rule out HMRC raising questions regarding your crypto dealings. Having detailed evidence to support your transactions and tax treatments will be fundamental for resolving such enquiries quickly.

For further advice on any of the issues raised in this article, please contact Chris Riley.

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Salaried Member rules: what they mean for you

A recent court case has thrown new light on the grey areas of the rules for LLPs. We guide you through the conditions and the jargon.

A recent court case has thrown new light on the grey areas of the rules for LLPs. We guide you through the conditions and the jargon.

Historically all members of a limited liability partnership (LLP) were treated as self-employed for tax purposes.

Each member of the LLP would be subject to Income Tax and Class 4 NIC on their profit share from the LLP. The tax treatment of the partners is beneficial as there is no PAYE or employer NI. This meant it was tempting for an LLP to make everyone a partner even if, in reality, they were more like an employee.

In the face of this, the Salaried Member rules were introduced in April 2014 to ensure that members of an LLP more akin to employees are treated as employees for tax purposes, taxed under PAYE and subject to employer NI.

The three conditions

The Salaried Member rules ensure that an individual is treated as an employee if three conditions are met. If any of the conditions are not met, the rules do not apply.

The 3 conditions are:
Condition A: Disguised salary
Condition B: No significant influence over the affairs of the LLP
Condition C: No significant investment in the LLP

Condition A: Disguised salary

Condition A is met where it is reasonable to expect that at least 80% of the total amount payable by the LLP for the individual's services as a member of the LLP will be disguised salary.

What is a disguised salary? This can be fixed or variable, but without reference to the overall amount of the profits or losses of the LLP, or not in practice affected by them.

Key points to note

- If the reward to an LLP member is fixed, or varies as a result of personal performance or the profits of a part of a business, then it is disguised salary. But if the reward varies with the overall profits of the firm, then it's not disguised salary. This point was considered in the BlueCrest case discussed later in this article.
- The test is forward looking, based on reasonable expectation for the period the remuneration arises. There should be a re-test when remuneration arrangements change. For most LLPs this will be annual, to coincide with remuneration reviews.
- This test only relates to the amount payable related to the individual's services. If a member is paid by the LLP without performing any work for them (for example if they are on gardening leave) this test will not apply.

Condition B: No significance influence over the affairs of the LLP

Condition B is less mechanical and more difficult to ascertain. It looks at the member's influence over the LLP business as a whole. HMRC guidance says this condition is satisfied if a member has no significant influence over, or has influence over only a part of, the business.

What does 'significant influence' mean?

HMRC says the following decisions might be considered as having significant influence over the LLP business:

- Appointment of new members
- Determining areas of business
- Business acquisitions or disposals
- Content of the firm's business plan

Salaried Member rules: what they mean for you

Key points to note

- This condition is looking at whether people are carrying a business together with a view to profit and whether the partners have a genuine say in the running of that business.
- Condition B is easier to fail in small LLPs. But in large LLPs it is likely that only the members of the leadership team will fail Condition B
- This point was considered in the BlueCrest case below and the judgement gave a wider definition of significant influence than HMRC had initially suggested in their guidance.

Condition C: No significant investment in the LLP

This condition is met if, at the relevant time, the individual member's capital contribution to the LLP is less than 25% of the disguised salary they expect to be paid related to their performance during the relevant tax year.

Key points to note

- An undrawn profit share is not itself a capital contribution. But a member can agree to convert his share of undrawn profit to capital and increase his capital account.
- The rule requires significant investment assessment annually. This means at the beginning of every tax year, or whenever there is a change of circumstances which might affect the condition.
- Where someone is a member of an international group, the capital contribution must be made to the UK LLP not to any other member of the group.

BlueCrest Capital Management (UK) LLP v HMRC

What is the case about and why is it important? Before this July 2022 case, there had been no judicial consideration relating to the Salaried Member rules. So, until now, we have all had to rely on HMRC's guidance. The case provides interesting insight into the application of Condition A and Condition B.

Condition A

A large portion of the members' remuneration was by 'discretionary allocation', very common in the investment management sector. The question was whether these payments were sufficiently linked to the overall results of the LLP, or just based on the individual's personal performance.

The court decided that the payments were more like bonuses paid to employees. And that, when the bonuses were allocated, the LLP did not consider the overall profits of the LLP but allocated them based on personal performance.

Condition B

The finding on significant influence was very interesting and broadened HMRC's previous guidance.

The court found that the investment managers who had significant influence over the financial operation would be considered to have significant influence over the affairs of the LLP.

This shows that to fail Condition B it is enough to have responsibility for managing key investment portfolios. The members do not need to have influence over all aspects of the LLP or over managerial decisions.

This finding will be welcome news for senior investment managers in asset management businesses.

What are the key takeaways?

Following this recent court decision, HMRC has been sending more communications to LLPs regarding their compliance with the Salaried Member rules.

So it's critically important for all UK LLP businesses to have effective polices and procedure for reviewing the rules regularly. All the more so when there is a change in circumstances, such as when a member joins or leaves, or there are changes in the remunerations or capital contributions. It could be very costly for businesses that do not have evidence and documentation to support their position or the variation of remuneration packages.

If you would like advice on any of the above, please contact Stephen Kenny or Tilak Lamsal.

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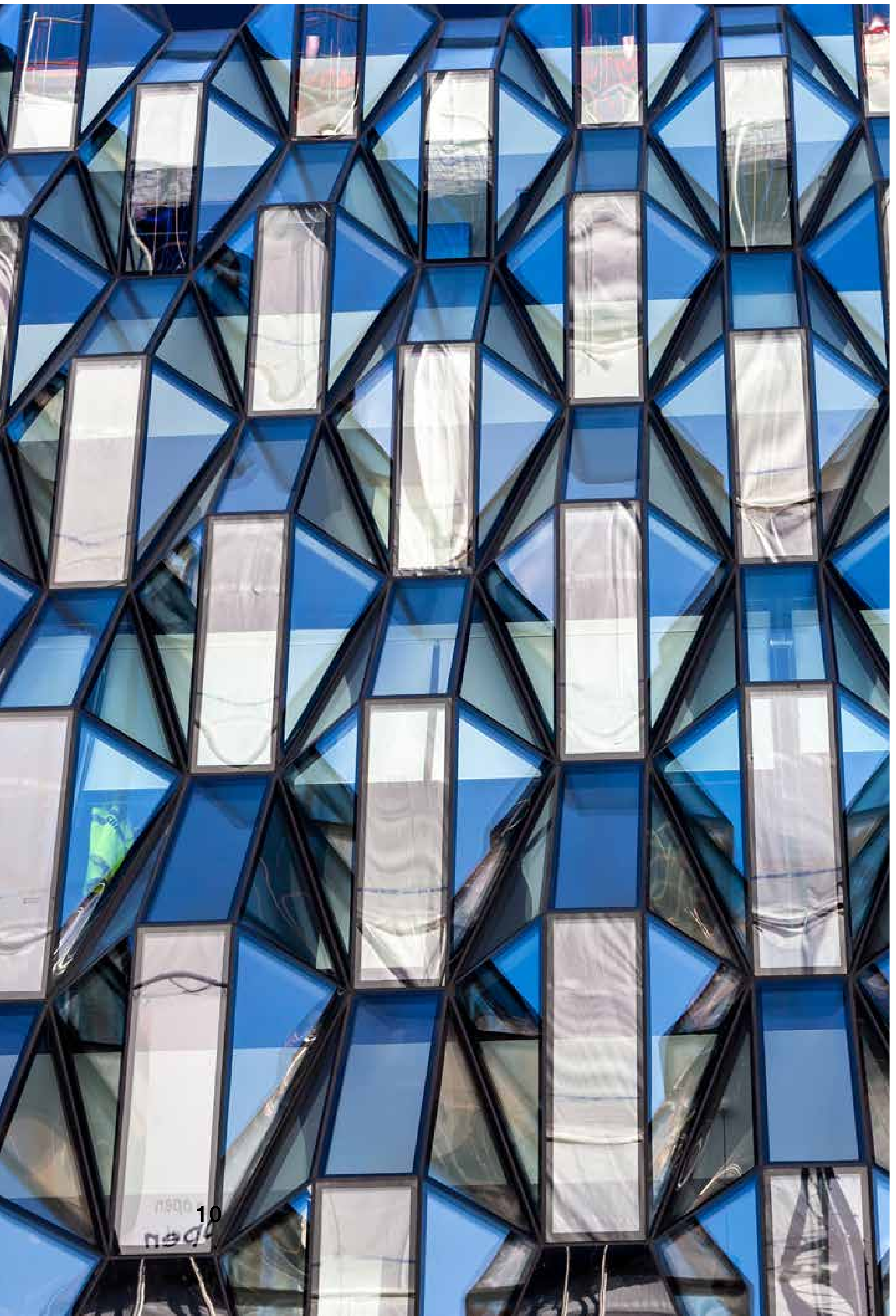
Offshore funds rules: don't get caught out

We explain when the rules apply and look at some of the traps for taxpayers investing in offshore funds.



Offshore investments are a common element of any diversified investment holding. But holdings subject to the Offshore Funds Regime can present particular complications.

The rules for offshore funds are very complex and can interact in unexpected ways with other tax rules. So it pays to be informed and we recommend taking specialist advice.

Separate guidance for non-domiciled taxpayers and offshore investments will feature in next month's Tax Talk.

What do the offshore funds rules do?

The Offshore Funds Regime is a set of anti-avoidance rules designed to prevent taxpayers from using offshore structures to turn income (taxable at up to 45%) into a capital gain (taxable at 20%). This means that without the rules it would be possible to invest in an offshore structure that accumulates the income within the structure (without paying any tax), then dispose of the investment and pay Capital Gains Tax (CGT) on the total. This would defer tax charges and save up to 25%.

The Offshore Funds Regime prevents this by taxing the gains on the disposals of an offshore fund as Income Tax rather than CGT.

So the income accumulated will not be subject to Income Tax. Instead, the gain on disposal is treated as income (and taxed at 45%) rather than as a capital gain (which are taxed at 20%), thus cancelling out the tax saving.

When do the offshore funds rules apply?

At a very high level, these rules apply to corporate mutual funds, where

- the arrangements allow for the management of pooled investments and
- the value of the investor's holding tracks the value of the underlying investments.

It's important to note that whilst these rules don't apply to partnerships, they can catch arrangements that are transparent for Income Tax but opaque for CGT. For example, certain unit trusts or contractual arrangements, such as 'fonds communs de placement' (FCPs), are within the scope of the offshore funds rules.

If a UK investor invests in a structure that is transparent for Income Tax, but within the Offshore Funds Regime, they will be taxable on the income as it arises in the fund (as it is transparent for UK Income Tax).

The ultimate disposal will also be chargeable to Income Tax (as it's within the definition of an offshore fund). This can be a problem: there has been no advantage to the UK taxpayer (no income has been rolled up), but the rules are still turning the disposal and capital growth into income.

Alternatively, if the fund is registered as a reporting fund (see below), the treatment of income is the same but the ultimate disposal is considered a capital gain and taxed at 20%.

When investing in offshore funds, it's vital that UK resident investors study the tax treatment of any overseas investment. We would be able to advise on this.

Offshore funds rules: don't get caught out

The tax charge and double standards

As we've said, when a fund is within the scope of the Offshore Funds Regime, a gain on disposal will be taxable as Income Tax (rather than CGT). But the same treatment does not apply to losses. A loss will remain a capital loss. That means losses arising from non-reporting funds cannot be set against the income gains, even on the same holding.

The mismatch in treatment can produce a higher tax burden. This is particularly problematic when combined with the disposal matching rules. Matching rules are used to determine which purchases and disposals are matched against each other to calculate the gains.

Order for matching rules

Order for matching rules
1. against purchases on the same day as the disposal
2. against purchases in the 30 days after the disposal
3. against all other holdings on an average cost basis

Here is an example of an individual's transactions:

Date	Amount	Purchase	Sale
1 Jan 2022	Purchase 100	50,000	
31 Jan 2022	Sell (100)		150,000
5 Feb 2022	Purchase 100	200,000	
31 Mar 2022	Sell (100)		250,000

In economic terms, the individual has made an overall gain of £150,000.

For tax, the disposal on 31 January is matched against the purchase in February (using rule 2), giving rise to a loss of £50,000. This is a capital loss and cannot be set against income.

The disposal in March is matched against the purchase in January (using rule 3), giving rise to a £200,000 gain that is liable to Income Tax at 45%, with no relief for the earlier capital loss.

The loss can only be set against capital gains (with relief at 20%).

Could reporting funds be the solution?

Under the regime, funds can register with HMRC as a reporting fund.

A reporting fund will report to investors all the income arising throughout the fund's life. This will be taxable regardless of whether it has been distributed or not. Any undistributed income is called excess reportable income and is deemed to arise six months after the fund year-end.

This means that each year the UK investors will report and pay Income Tax on the income arising in the fund.

Whilst the reporting fund status will produce a dry tax charge on the undistributed income, an investor will pay CGT at 20% on a disposal of a reporting fund.

Reporting fund status can also avoid the issue on the mismatch of gains and losses and the treatment of funds which are transparent for Income Tax.

Offshore funds rules: don't get caught out

When a reporting fund gain isn't a capital gain

There are circumstances when an investor in a reporting fund would not benefit from CGT treatment on disposal.

This happens when a fund changes from a non-reporting to a reporting fund after the investor has invested in it. In this situation, the investor does not automatically qualify for capital gains treatment on disposal, and they would have to make an election on the change in status.

The election treats the investor as making a deemed disposal (and deemed acquisition) at the market value of their interest in the fund, at the point when it is converted into a reporting fund. This crystallises any gains from the date of investment to the date of conversion. Any future gains will be treated as capital gains.

The election also gives rise to a dry income tax charge on the deemed disposal. But it allows the investor to claim CGT on future growth. The requirement to make an election is easily overlooked and can be a costly mistake. Often the change in status will be early in the fund's life when gains are minimal. It will usually be better to pay the charge at the time of conversion than pay Income Tax on the ultimate disposal.

If you have any questions about the issues raised in this article, please contact Stephen Kenny or your usual PKF contact, who would be happy to help.

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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.

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PKF in the UK

10th largest Tax practice in the UK

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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:

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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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