TaxTalk

Simplifying the complexities of Tax

May 2023

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TaxTalk: May 2023

PAYE Settlement Agreements (PSAs): why you should have one

So you don't yet have a PSA with HMRC? Find out what they are, what they cover and why they are a good tool for improving your employment tax compliance.

The new tax year means most companies face the usual headache of year end compliance. This includes reporting employee benefits on form P11D and calculating the Class 1A National Insurance liability on form P11D(b).

Running alongside those forms some, but not all, companies must also report to HMRC under a PAYE Settlement Agreement (PSA).

Before we dive into the benefits of PSAs, it's worth first remembering what should be reported on form P11D for your employees. In the absence of payroll reporting of employee benefits, form P11D is used to report **all** benefits and taxable expense payments provided to an employee during the tax year. The point to remember is the "**all** benefits" remit of the P11D.

What counts as a benefit?

Benefits come in many different forms. Easier to identify (and report) are private medical insurance, company car and accommodation. Less obvious, for example, are beneficial loan interest, reimbursement of home broadband costs and non-qualifying relocation expenses.

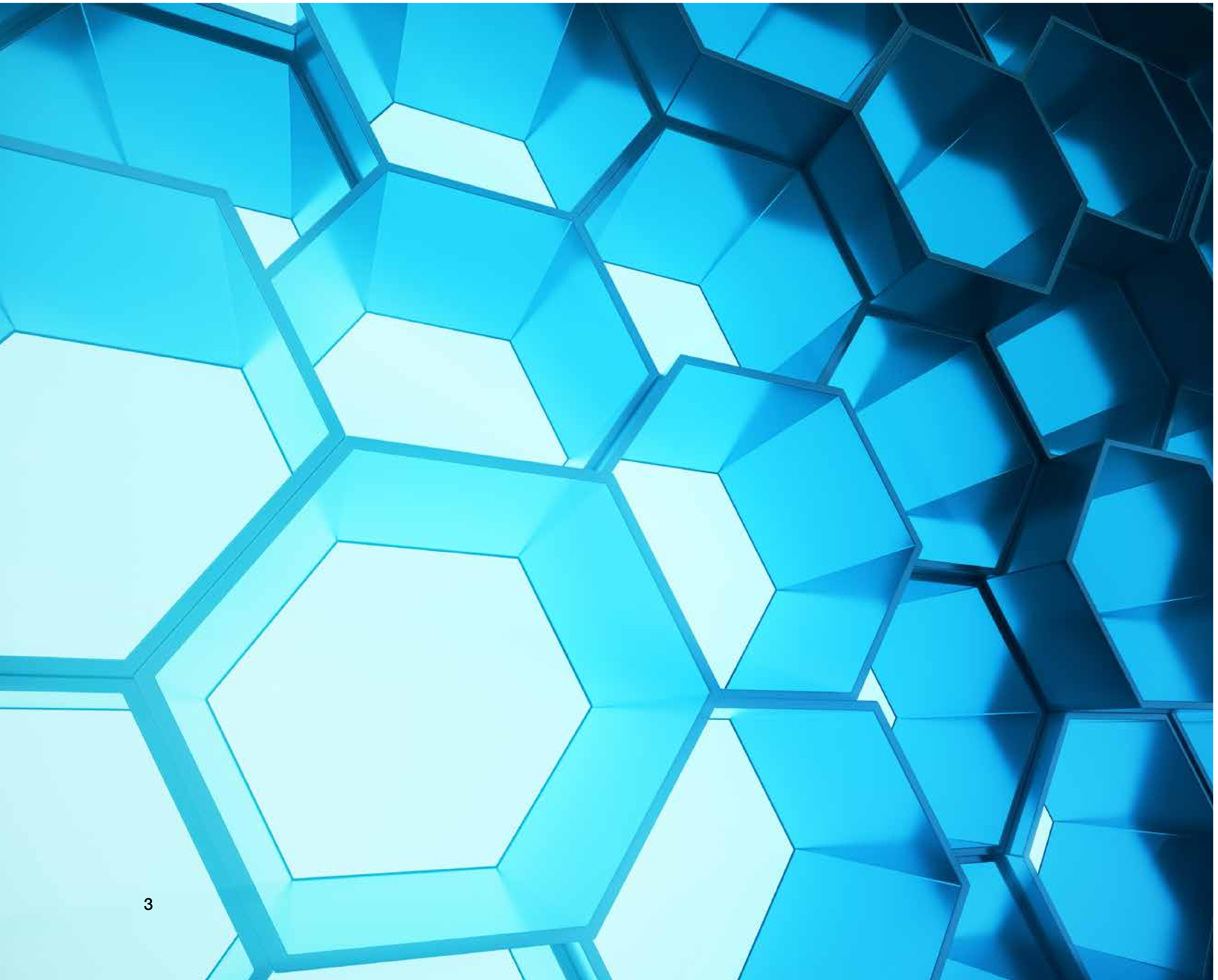
Where provided, they are probably considered part of the employee's total remuneration package, so the reporting requirement is clear and (hopefully) fulfilled each year.

However, there are also likely to be perks you provide to your employees which neither you nor they consider to be an 'employee benefit'. Unfortunately the tax rules do, so they must be reported as benefits to HMRC. Staff entertainment, certain employee gifts, food provided at working lunches, team building activities, and even the subsidy you pay for the weekly 5-a-side pitch are all examples of (potentially) taxable benefits. But few employees consider them as such and certainly don't expect to pay tax. This is where a PSA comes in.

What is a PSA?

A PSA is an agreement between a company and HMRC which enables the company to report certain agreed employee expenses and benefits directly to HMRC via a 'PSA submission' rather than using the employee form P11D. In order to do this, the company agrees to pay the Income Tax and National Insurance contributions on the agreed expenses and benefits on behalf of its employees.

PAYE Settlement Agreements (PSAs): why you should have one



So a PSA allows certain benefits not to be reported via a form P11D, but through a different agreement with HMRC. However, it comes at an additional cost to the company by way of paying the tax due on behalf of the employees (which means the tax charge will be grossed up to allow for the fact that the company paying the tax is a taxable benefit in itself) and a higher NIC cost for the company.

What can be included in a PSA?

Not all expenses and benefits can be reported on a PSA. It is only intended for minor, irregular or impracticable expenses or benefits that are provided to employees.

Examples of minor benefits and expenses include: taxable incentive awards (such as a long-service gift or 'employee of the month' vouchers), telephone bills, small gifts and vouchers not covered by the trivial benefit exemption, or taxable staff entertainment (see below). Irregular expenses and benefits cover things like relocation expenses over £8,000, the expense of a spouse accompanying an employee on an overseas business trip, or the use of a company-owned flat.

The final type of expense or benefit that can be included is one where it's impractical for the employer to determine the cost for a specific employee. This includes taxable staff entertainment (see more below), use of a shared car, or the expense of some in-office beauty treatments (that not all employees use).

This is not an exhaustive list, and you can ask to include anything which qualifies as either a minor, irregular or impractical benefit or expense.

Staff entertainment tax rules

Staff entertainment is one of the main items companies report on a PSA but what should be reported as taxable staff entertainment is often more wide reaching than many realise.

When asked what staff entertainment expenses a company incurs each year, most people immediately identify a big, all-employee event (usually a Christmas or summer party) as the only entertainment they provide for staff. Such parties are of course a form of staff entertainment and only taxable if the annual staff event exemption doesn't apply.

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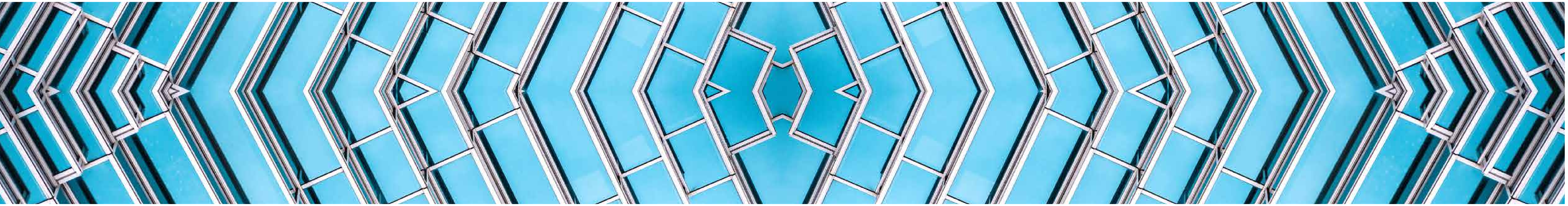

What many overlook is that, throughout the year, there is often a lot more ad hoc staff entertainment provided and paid for via the employee expense system. The cost of team building events, team lunches, coffees when a manager conducts an employee's appraisal off site, a directors' dinner (or even a round of drinks a manager buys for the team in the local pub on a warm Friday in July) are all considered a form of staff entertainment.

Some companies assume that such expenses are an allowable business expense. This might be because the staff were discussing work, or because the cost benefitted the company by the team working together better. Unfortunately, this is an incorrect assumption and there are no exemptions for expenses such as these.

The alternative to a PSA

Without a PSA, the benefit of such ad hoc staff entertainment should be reported on an employee's annual P11D. To do this correctly, a company would need to know exactly what benefit each employee received. The amount of work required to do this even for a company of few employees, is almost unimaginable (so did Neil from finance have two pints and a burger but no chips but Gemma only had a salad with a dessert and a soft drink? – the mind boggles).

Should you consider a PSA?

Companies that do not report benefits such as Neil's two pints and a burger on his P11D are technically not compliant with their employment tax obligations and could face penalties should HMRC investigate and discover this.

With compliance almost impossible and non-compliance a risk for the business, companies may feel stuck between a rock and a hard place. PSAs do offer a means of avoiding this undesirable situation. Reporting those expenses which can be included via a PSA requires much less work and allows the company to fulfil its employment tax obligations. Despite the additional cost, it is likely to be less than the tangible and intangible costs it risks from continuing to do things in a non-compliant way.

So are PSAs worth signing up for if your company does not already have one? In my opinion and experience, absolutely. Yes, signing up for a PSA will mean some extra work and cost but the benefits, specifically the value HMRC places on them, far outweigh that cost.

If you do not currently have a PSA agreed with HMRC, you have until 6 July 2023 to request one. This will apply retrospectively for the 2022/23 tax year.

If you would like to discuss anything about PSAs, new or existing ones, please contact Dan Kelly.

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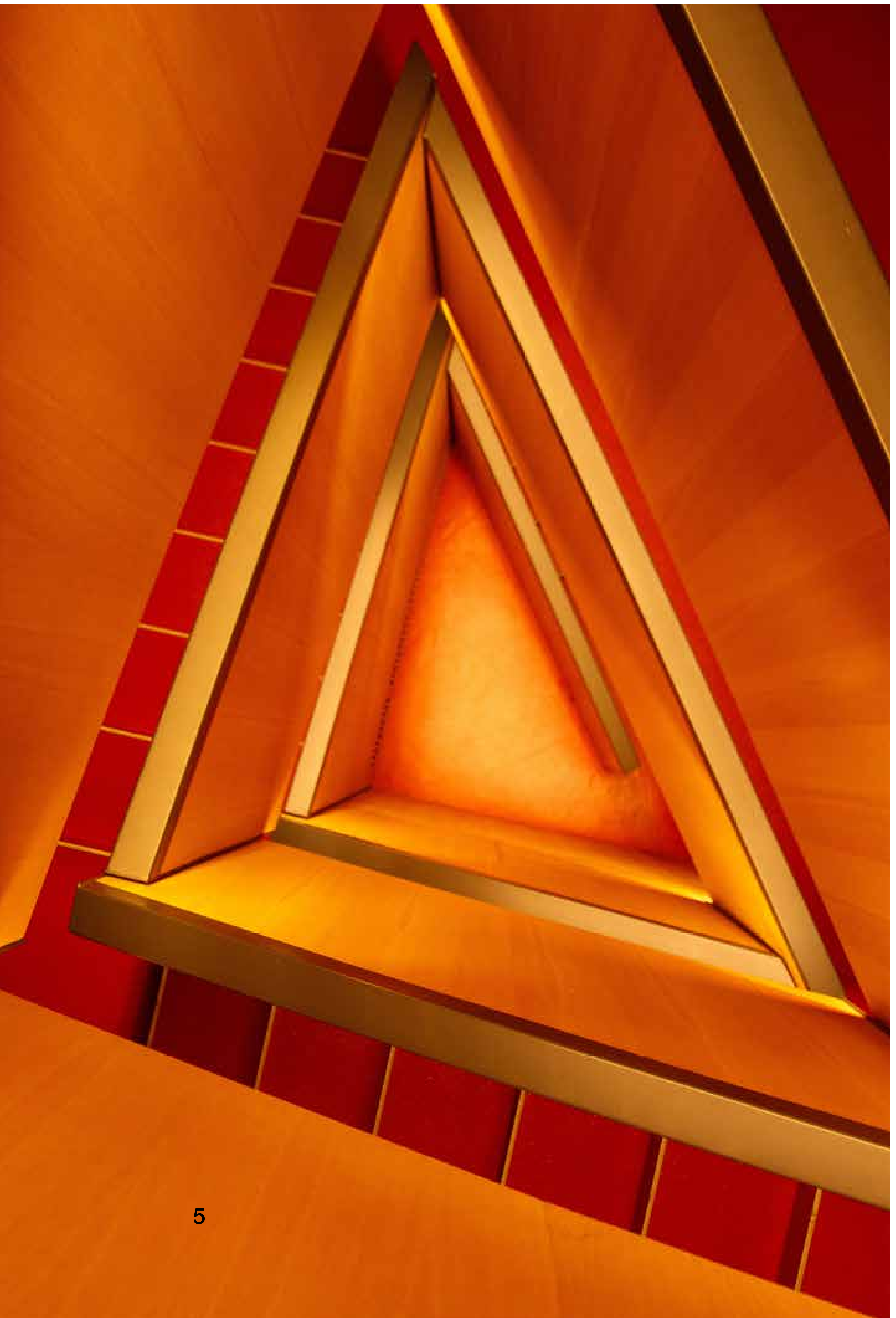
HMRC's VAT decisions: look out for errors

When it comes to HMRC and VAT, it seems there is good reason to be prepared for the worst outcome – and plan accordingly. We look at two court cases that prove the point.



Many businesses make three assumptions:

- All HMRC VAT officers are well-trained and knowledgeable on VAT law, and on HMRC's own VAT guidance
- There are always internal checks to make sure that no wrong decisions are made by HMRC VAT officers
- HMRC does not litigate any VAT cases where HMRC is clearly wrong.

Nevertheless, many VAT advisers who deal daily with HMRC know that none of the above is true. But these advisers find their clients are sceptical when they try to explain that they may receive an erroneous VAT assessment (plus interest and potential penalties) from an HMRC VAT officer. And that the incorrect assessment can only then be overturned through lengthy and costly litigation.

We discuss two cases below which should back up VAT advisers when talking to their clients about the view HMRC may take of their transaction(s) from a VAT perspective. They make uncomfortable reading.

Pavan Trading Limited

Following a VAT inspection on 12 October 2018, HMRC raised a VAT assessment for £70,652 on 14 May 2019 on Pavan Trading Limited ("PTL") for £70,652 ("the assessment"). The assessment was raised on the basis that PTL had failed to provide HMRC with "evidence of export" within three months of PTL supplying goods to US customers and shipping those goods to the US. But this is not what UK VAT law or HMRC's published VAT guidance say that a business needs to do.

PTL asked HMRC for an independent review. HMRC issued a review conclusion letter on 7 August 2019 which upheld the assessment. PTL then submitted an appeal to the First-tier Tribunal on 3 September 2019. The appeal hearing eventually took place over three years later on 13 January 2023.

At the appeal hearing, the tribunal judge pointed out that HMRC's view of the law "is plainly wrong" and went on to say the following:

"So it seems to us the only reason that the appellant has had to bring an appeal was based on an erroneous view of the law set out in HMRC's own Notice 703 (as well as either overlooking or misconstruing the principles in Arkeley).

This error was started by Officer Bains, perpetuated by the nonsense written by the review officer, and then compounded by HMRC's statement of case and skeleton argument.

If there was ever a counsel of perfection for the provision of export documentation, then this appellant has achieved it.

Accordingly, we have absolutely no hesitation in allowing this appeal. To our mind the appellant has more than adequately demonstrated that within the 3 month period set out in paragraph 3.5 of Notice 703, it held all of the evidence of proof of export of the goods, as is required by paragraph 6.5 of Notice 703, in all of the 13 transactions which are the subject of the assessment."

So, PTL finally won on 25 January 2023, five years after the HMRC VAT inspection.

Landlinx Estates Limited

In early 2017, Landlinx Estates Limited ("Landlinx") submitted to HMRC a VAT return for the quarter ending 31 December 2016 in which it claimed a net VAT refund of £23,503, which was higher than usual.

HMRC's VAT decisions: look out for errors

HMRC investigated the return and concluded that Landlinx actually owed HMRC VAT for that quarter. After some correspondence with HMRC, HMRC issued a VAT assessment for £237,500 on 28 June 2017 in respect of the 20% output VAT that it considered Landlinx should have paid on its VAT return for the quarter ending 31 December 2016. This was because Landlinx had received a sum of £1,425,000 in December 2016 from the owner of a piece of land in return for releasing that landowner from its obligations under a 2015 call option allowing Landlinx to purchase the land in question.

So, Landlinx surrendered to the landowner its legal option to purchase the land in question.

VAT law is clear that this type of supply is VAT-exempt (which is how Landlinx had treated it) and HMRC's own guidance said at the time (and still says to this day) the following:

"If you grant someone the right to purchase an interest in your land or building within a specified time you're making a supply of an interest in land. The person acquiring such a right is said to have a 'call option' as they can call on you to sell your interest in the land or building as originally agreed. The liability of your supply will be whatever the liability of the land or building would be if supplied at that time. A grant includes an assignment or surrender"

On 18 July 2017, Landlinx's accountants asked HMRC for an independent review. HMRC issued a review conclusion letter on 20 September 2017 which upheld the assessment. Landlinx then submitted an appeal to the First-tier Tribunal and the appeal hearing eventually took place two years later on 27 August 2019.

At the appeal hearing, the tribunal judge pointed out that HMRC's view of the relevant VAT law was wrong and said the following:

"Landlinx, therefore, had every reason to believe that the grant and surrender of an option to purchase land would be an exempt supply when it entered into the Option Agreement. Indeed, we would have thought that that view would have been regarded as axiomatic for most VAT practitioners. Landlinx, encouraged in that belief by the provisions of UK domestic law and HMRC's published practice, had no reason to require in the contractual documentation that the consideration paid to it should be VAT exclusive.

Had our decision on the main point of this appeal been otherwise, a very real unfairness would have been visited on Landlinx - a matter upon which we would have been unable to adjudicate because we have no judicial review jurisdiction - and one which would have caused us to view this outcome with considerable concern. In the light of our decision, that unfairness does not now arise."

So, Landlinx finally won on 13 May 2020, four years after HMRC VAT inspection.

These two cases do indeed prove that the HMRC makes mistakes, and ones which are onerous and time-consuming to reverse. If you would like to discuss the issues raised in this article, please contact Mark Ellis.

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Rising interest rates: the potential impact on Corporation Tax

The Bank of England (BoE) has been steadily increasing its base interest rate over the last few months. Although the intention was to combat rapidly rising inflation, the increase will also have an impact on the tax liabilities of both individuals and businesses.

From a Corporation Tax (CT) perspective, there are a couple of possible considerations for companies.

1. CT late payment interest

The BoE's decision to increase the base interest rates directly affects HMRC and the interest rates it applies on late payments of tax.

There have been 10 increases in the late payment interest rate since January 2022 (the last change before that was in April 2020). The current late payment interest rate is at 6.75% as of 13 April 2023. This represents a rise of 4% in just over a year.

This can have significant implications for a business in terms of cash flow, when coupled with an increase in the main rate of CT from 19% to 25%. And don't forget changes in legislation to replace the 51% group company test with the 51% associated companies test for quarterly instalment payment (QIPs) purposes from 1 April 2023. More details on the associated company changes and their impact on QIPs can be found in our March 2022 TaxTalk article – New Corporation Tax rules: why QIPs may apply.

When does late payment interest arise?

A company's normal tax payment date is nine months and one day after the company's relevant accounting period.

Where a company has a CT liability for an accounting period, late payment interest will arise for the company in the following scenarios:

- when its' CT liability has been paid late
- where payment towards its CT liability has not reduced the liability down to nil, so that late payment interest arises on the outstanding balance after the company's due date
- where its CT liability increases after the initial return submission (e.g. following an enquiry).

Interest charges arise automatically and are levied by HMRC once the tax return for the relevant accounting period has been submitted.

Where a company is considered 'large' or 'very large', and therefore falls within the QIPs regime, payments not made by the appropriate instalment due dates will incur late payment interest. This will be at the relevant rate applying to outstanding balances throughout the period up to the up to the company's normal due date.

Rising interest rates: the potential impact on Corporation Tax

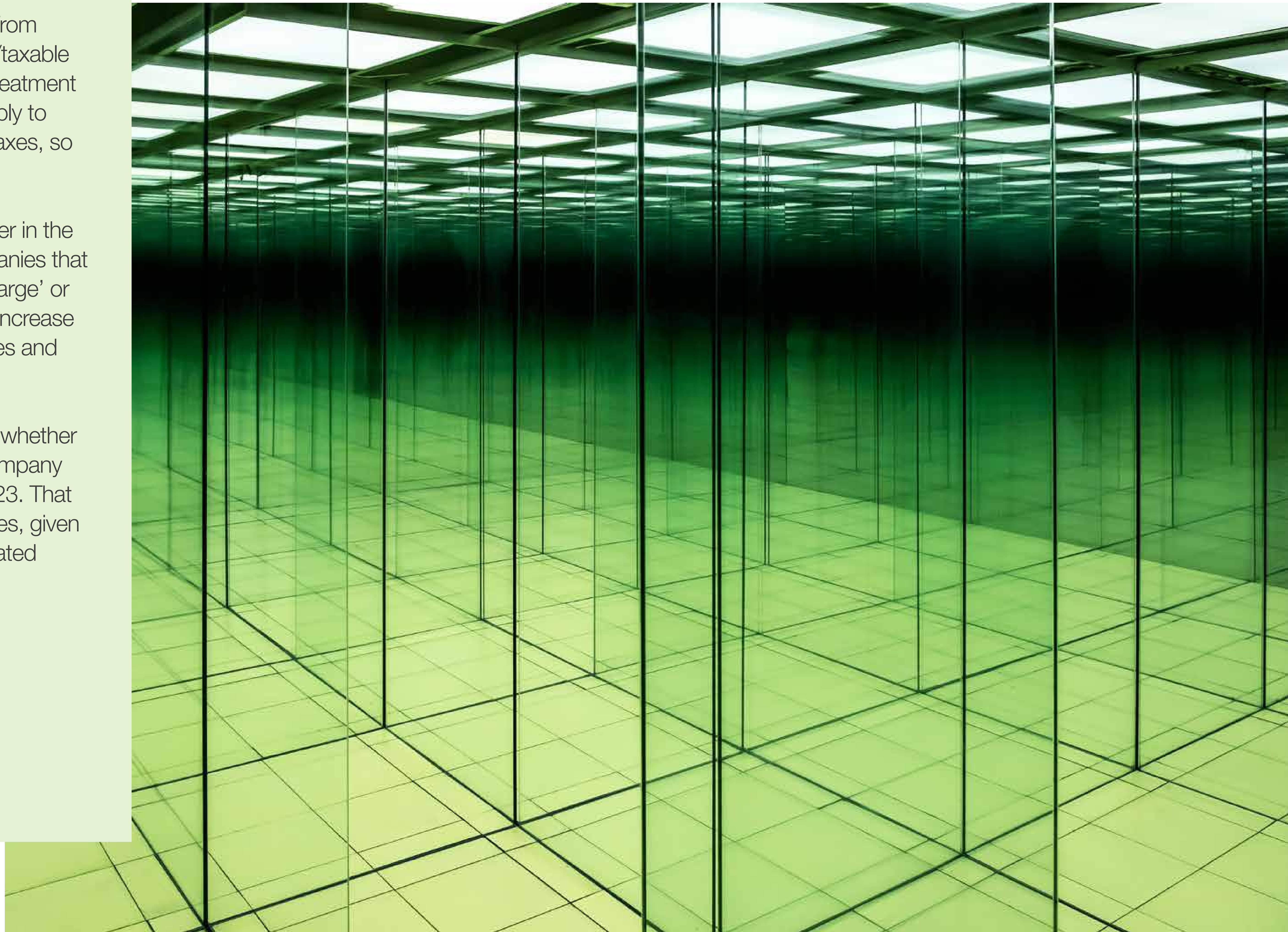
The interest rates that apply are shown in the table below. We also include what the position should be in the event of an overpayment to HMRC:

Scenario	Interest rate levied / received
Outstanding liability after normal tax payment date (nine months and one day after company's relevant accounting period)	Base rate plus 2.5% (currently 6.75%)
Late quarterly instalment payments (up to company's normal tax payment date)	Base rate plus 1% (currently 5.25%)
Early payment of CT 'credit interest' (before normal due date, but from six months and 13 days after company's relevant accounting period)	Base rate less 0.25% (currently 4%)
Overpayment of quarterly instalments 'credit interest' (up to company's normal tax payment date)	Base rate less 0.25% (currently 4%)
Overpayment of CT after normal payment date 'repayment interest'	Base rate less 1% (currently 3.25%)

Please note that interest paid or received from HMRC in respect of CT will be deductible/taxable for CT purposes. But the tax-deductible treatment for CT-related interest does not usually apply to interest paid to HMRC for other types of taxes, so we recommend seeking specific advice.

As interest rates are predicted to rise further in the coming months to control inflation. Companies that are liable to pay their CT via QIPs on the 'large' or 'very large' scheme could see their costs increase significantly if they fail to consider due dates and expected tax liabilities in advance.

So it's worth taking extra care to consider whether they fall within the 'large' or 'very large' company rules for accounting periods from April 2023. That way, they can avoid excess interest charges, given the higher CT rate and changes to associated company rules.



Rising interest rates: the potential impact on Corporation Tax

2. Debt financing and Corporate Interest Restriction (CIR)

A further impact of the BoE's interest rate increases is in relation to a company's debt financing.

Rising interest rates have meant that existing debt held by companies may have become more costly due to likely increased interest payments. What's more, new debt financing has become more expensive making it less appealing than before.

Where companies hold inter-company loans at low interest rates, it's vital to consider transfer pricing, so that the rates applied can be supported as arm's length transactions.

This becomes particularly important for UK companies that are considered 'large' for transfer pricing purposes, and if they receive interest from connected entities.

Where a transaction is deemed not to be arm's length, tax adjustments (increasing taxable profits) may be needed to ensure that the amount of tax payable to HMRC has not been understated.

Interest rate rises may also mean that interest expenses are more likely to be restricted under the CIR rules. A UK group (or company, if there is only one standalone company in the UK) currently has a £2m interest expense de minimis that is treated as an allowable deduction for each accounting period.

If interest expenses exceed this threshold, possibly due to higher interest charges arising from increase interest rates, a CIR analysis should be done to confirm whether a disallowance is likely to be required.

If so, this could affect the assessment of payments due for the year (and the relevant payment regime) as well as the potential CT interest consequences noted above.

If you would like further guidance on any of the issues raised in this article, our Corporation Tax team can provide tailored advice based on your business's specific circumstances. Please contact Ivy Ojediran.

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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

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10th largest Tax practice in the UK

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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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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.

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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.

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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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