Tax Talk

Simplifying the complexities of Tax

April 2023

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Tax Talk: April 2023

R&D tax relief changes: what you need to know

HMRC has long been uneasy about the perceived number of fraudulent R&D tax relief claims. We look at the revisions it has made, and what they mean for your company.

There have been significant changes to the R&D tax relief scheme following the Chancellor's Autumn Statement. How effective they will be remains to be seen. The greatest impact of the new measures is likely to be felt by loss-making SMEs where additional funds from R&D tax credits can prove vital.

Profitable SMEs

Qualifying SME R&D expenditure has been eligible for an uplift of 130% for several years. But that uplift is only now available until 31 March 2023. From 1 April it will be reduced to 86%. If your venture is profitable the net benefit will reduce from 24.7% to 21.5%, with the latter net benefit assuming a Corporation Tax rate of 25%. But with some businesses continuing to pay Corporation Tax at 19% or a marginal rate of 26.5%, the post 1 April net benefit will depend on the specific circumstances.

Loss-making SMEs

SME companies in a loss-making position before 1 April 2023 will have been able to surrender their enhanced R&D expenditure, amounting to 230% of the original expense, for a 14.5% R&D tax credit.

Post 1 April, the enhanced R&D expenditure, being 186% of the original expense, can be surrendered for a 10% R&D tax credit. So, in effect, the Government's subsidy is being reduced from 33.4% to 18.6% from April.

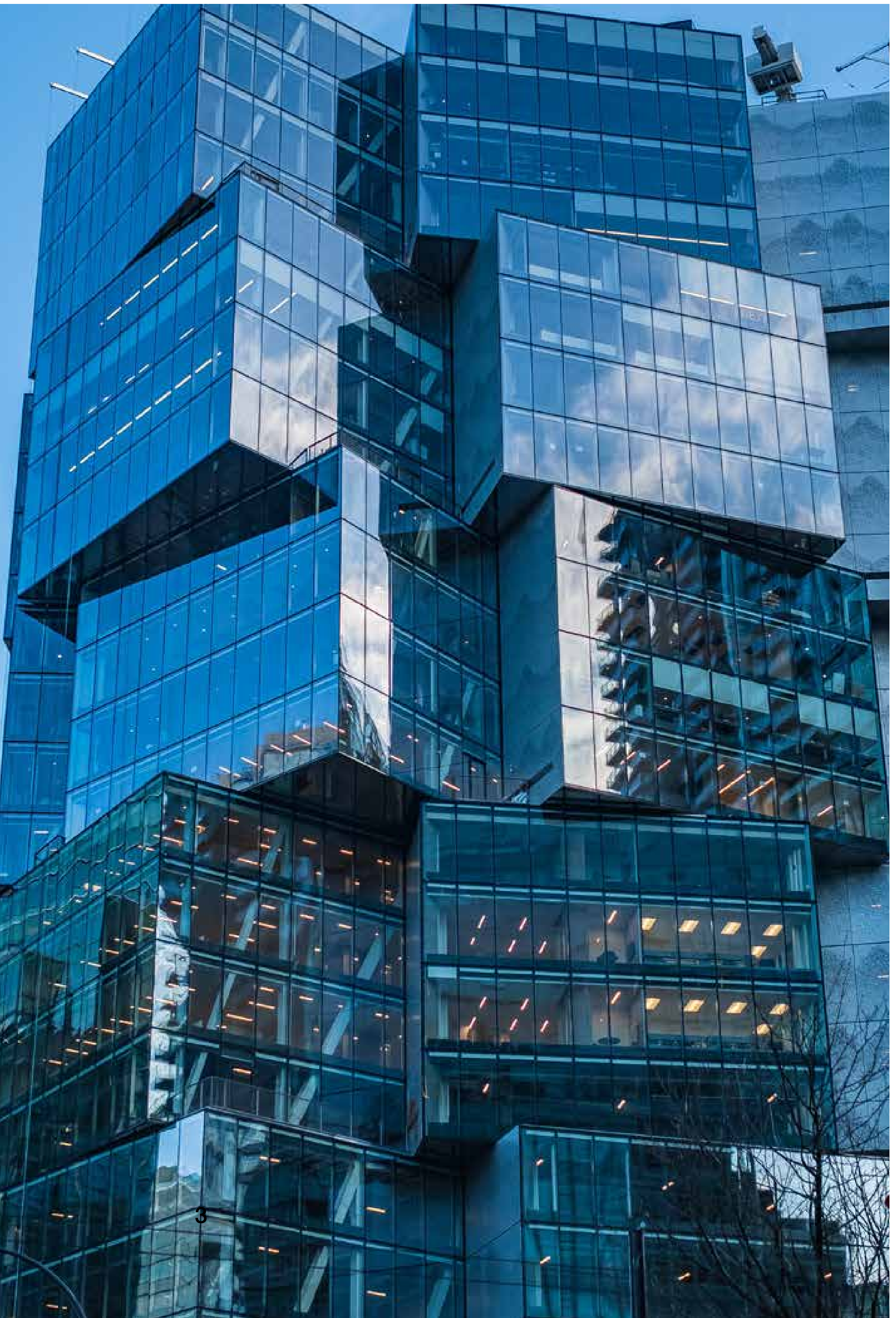
Large company R&D tax relief changes

Large companies claiming R&D tax relief through the RDEC (R&D expenditure credit) scheme will see an increase in their net benefit from 1 April 2023. The RDEC will be increased to 20%, up from 13%. This will result in a net Corporation Tax reduction / subsidy of 15%, up from 10.5%.

Most RDEC claims are made by companies that are large for R&D purposes. But it's worth noting there will also be SME claimants who have been subcontracted R&D work, and others who can only use the RDEC scheme due to certain grant funding that will also benefit from RDEC scheme changes.

HMRC defines a large company as having either more than 500 employees or an annual turnover over €100m and a balance sheet over €86m. The staff, turnover and balance sheets of any connected companies should be included in the total.

R&D tax relief changes: what you need to know



Qualifying R&D expenditure changes

As well as the headline rate relief, there have also been substantial changes to the scope of expenditure that may be included in an R&D tax relief claim, for large companies and SMEs, for accounting periods beginning on or after 1 April 2023. These include:

- Data licences
- Cloud computing
- Pure mathematics.

But sub-contracted work, externally provided worker and (for large companies) contributions to independent R&D, will be limited to focus on UK activity only.

Remember that this new scope of expenditure applies for accounting periods on or after 1 April 2023, so the date from which rules will apply depends on the company's accounting year end. It's worth considering whether it's best to defer costs or to amend the company's accounting period to take advantage of the legislative changes.

Administrative R&D claim changes

Companies whose accounting periods begin on or after 1 April will also have to deal with administrative changes to R&D claims. For example, all R&D claims must be made digitally, and each one must be endorsed by a senior company officer with the details of any agent advising on the claim.

Proposed R&D tax relief changes

It would be reasonable to expect these substantial changes to the R&D tax relief scheme to lead to relative stability in the scheme for some time. But HMRC plans to go one step further. On 13 January it launched a consultation on a potential single R&D scheme for both large companies and SMEs, based on the current RDEC scheme. The single scheme may provide more targeted support for certain industries, such as green technology or life sciences.

If the R&D tax relief schemes are merged, the consultation suggests this could apply to accounting periods starting on or after 1 April 2024. As a result of this review, the originally proposed restriction of qualifying R&D expenditure to UK-Centric activities has been delayed from April 2023 to April 2024.

The consultation closed on 13 March. As ever, PKF will of course keep you updated on the outcome.

Seek good advice

With so much upheaval in the R&D tax relief scheme, and expected additional scrutiny of claims, it's more important than ever to have a diligent, accurate and knowledgeable R&D tax advisor who is familiar with all the recent legislative changes. They will help you navigate the claims process, identify all qualifying expenditure, and make a successful claim. This should provide valuable, additional working capital to help drive your business goals and ambitions even further.

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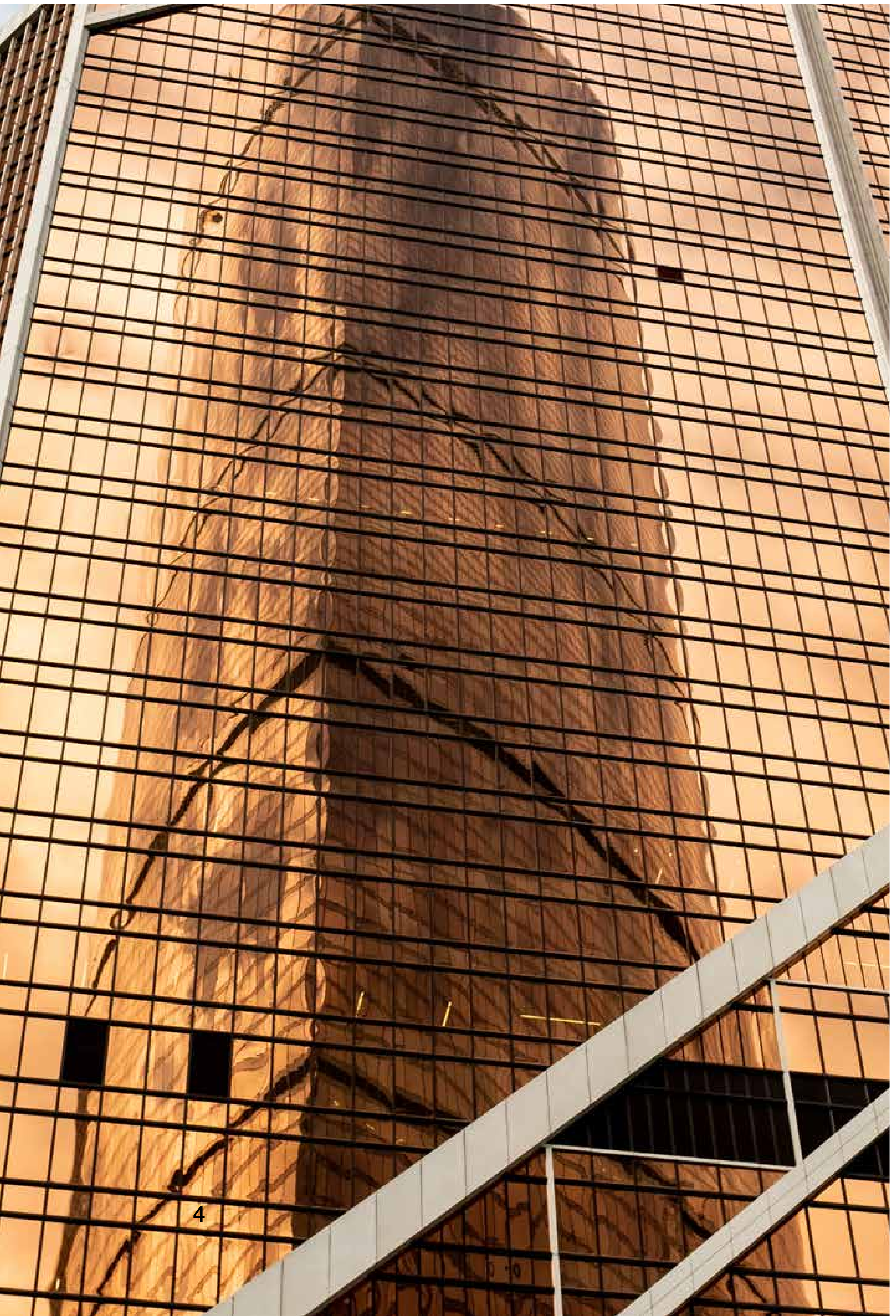
The HICBC: a stealth tax explained

A decade after its introduction, the High Income Child Benefit Charge (HICBC) continues to catch out many taxpayers. Andrew McCready examines the key aspects of this controversial tax charge.



It has been 10 years since George Osborne brought in the HICBC, one of the most idiosyncratic and cumbersome additions to the UK tax system. Created as a cash cow to reduce the budget deficit following the 2008 financial crisis, it was designed to target people on higher incomes who were receiving Child Benefit payments.

The HICBC applies to individuals or their partners who earn more than £50,000. When it was introduced in 2013, the 40% higher tax rate applied to those who earned more than £42,475. Now the 40% rate applies to those earning over £50,270. This means a basic-rate taxpayer may be impacted by the charge.

Even though it has been around for 10 years, the HICBC continues to be misunderstood by some taxpayers. We clarify how it's calculated, who may be liable for it, and how that liability may be minimised.

How is the HICBC calculated?

The HICBC is assessable on the person receiving the Child Benefit or their partner if they earn an adjusted net income of more than £50,000.

It is the partner with the higher income that will suffer the charge.

Adjusted net income for the tax year is calculated based on your total taxable income for that period, less donations made under Gift Aid and qualifying pension contributions, but before deduction of any tax allowances. Don't forget to include in your calculation the taxable value of Benefits-in-Kind, such as private medical insurance or a company car.

The tax charge is calculated based on income at an individual level rather than for the household. This means that a household may have two earners who receive an income of £49,999 each (£99,998 total) and are never liable to the HICBC. But a household with a sole earner receiving at least £50,000 may be liable.

The HICBC effectively withdraws the amount of Child Benefit received at a rate of 1% for every £100 earned by the higher earning partner above £50,000 a year. Therefore, if the individual has adjusted net income over £60,000, they will suffer an HICBC representing 100% of Child Benefit payments received in the tax year.

In some circumstances, the charge can create an effective tax rate of up to 96% on income between £50,000 and £60,000 (source: Inconsistent Incentives: Resolution Foundation, 2022).

The HICBC is worked out as follows:

$$\frac{A - B}{C}\ \%\ \text{x Child Benefit received}$$

Where A is adjusted net income for the tax year, B is £50,000, and C is £100.

The HICBC is assessed through Self Assessment. This means those impacted by the charge must file a tax return to HMRC. If you are liable to the HICBC, and don't usually file a tax return, you should register for Self Assessment by 5 October following the tax year for which you need to pay the charge. For example, if you are liable to the HICBC in the 2022/23 tax year, you must register by 5 October 2023.

Here is an example:

Sarah has two children and received Child Benefit of £1,885.00 for the 2022/23 tax year. Her adjusted net income for the tax year was £55,000, and her partner's was £51,000.

The HICBC: a stealth tax explained

As the higher earning partner, with income of more than £50,000 and in receipt of Child Benefit, Sarah is liable to the HICBC.

The calculation for Sarah is (£55,000 - £50,000) / 100 = 50%; 50% x £1,885.00 = £942.50.

She will need to complete a Self Assessment tax return for 2022/23 and report the Child Benefit payments she received. She must pay the HICBC of £942.50 to HMRC by 31 January following the end of the tax year.

Who is a ‘partner’ for HICBC purposes?

A ‘partner’ is defined as someone who is married to, or in a civil partnership with, the individual receiving the Child Benefit. The couple should not be permanently separated or separated under a court order.

If you are not married or in a civil partnership, you may be considered a partner if you are living with someone as if you were a spouse (or civil partner), and they are in receipt of Child Benefit. There is no legal definition of what constitutes a partner in these circumstances.

But several factors should be considered, including:

- the stability of your relationship
- your financial interdependence
- whether you have children together
- your future intentions as a couple, and
- whether or not your relationship is publicly acknowledged.

To complicate things further, you must assess your liability to the HICBC weekly. That means deciding at what point you began living together as if you were spouses or civil partners.

How can the HICBC be minimised?

If you receive Child Benefit, you may elect to stop the payments. But even without those payments, you can continue to receive the corresponding credits for National Insurance purposes. These in turn go towards your entitlement to the State Pension and other benefits.

If you or your partner are impacted by the HICBC, another option is to ‘shift’ the income of the higher earning partner to the other partner. Shifting income can be achieved through the transfer of assets, for example, by changing the beneficial ownership of a property generating rental income.

This would be advantageous if one partner has income of between £50,000 and £60,000 per year and the other has income below £50,000. The income tax saved by income shifting will vary from person to person.

You should always seek professional advice before transferring assets between partners, as there may be additional tax and anti-avoidance implications to consider.

There are additional measures you may wish to take to reduce your, or your partner’s, liability to the HICBC. Your personal circumstances will determine whether you can benefit from these or not.

HMRC has been increasingly targeting taxpayers who it believes are affected by the HICBC. If you think you or your partner are impacted by the charge, you should review your position as soon as possible.

The information in this article should only be taken as guidance, so you should always ask for professional advice. For more information about the issues raised, please contact Andrew McCready.

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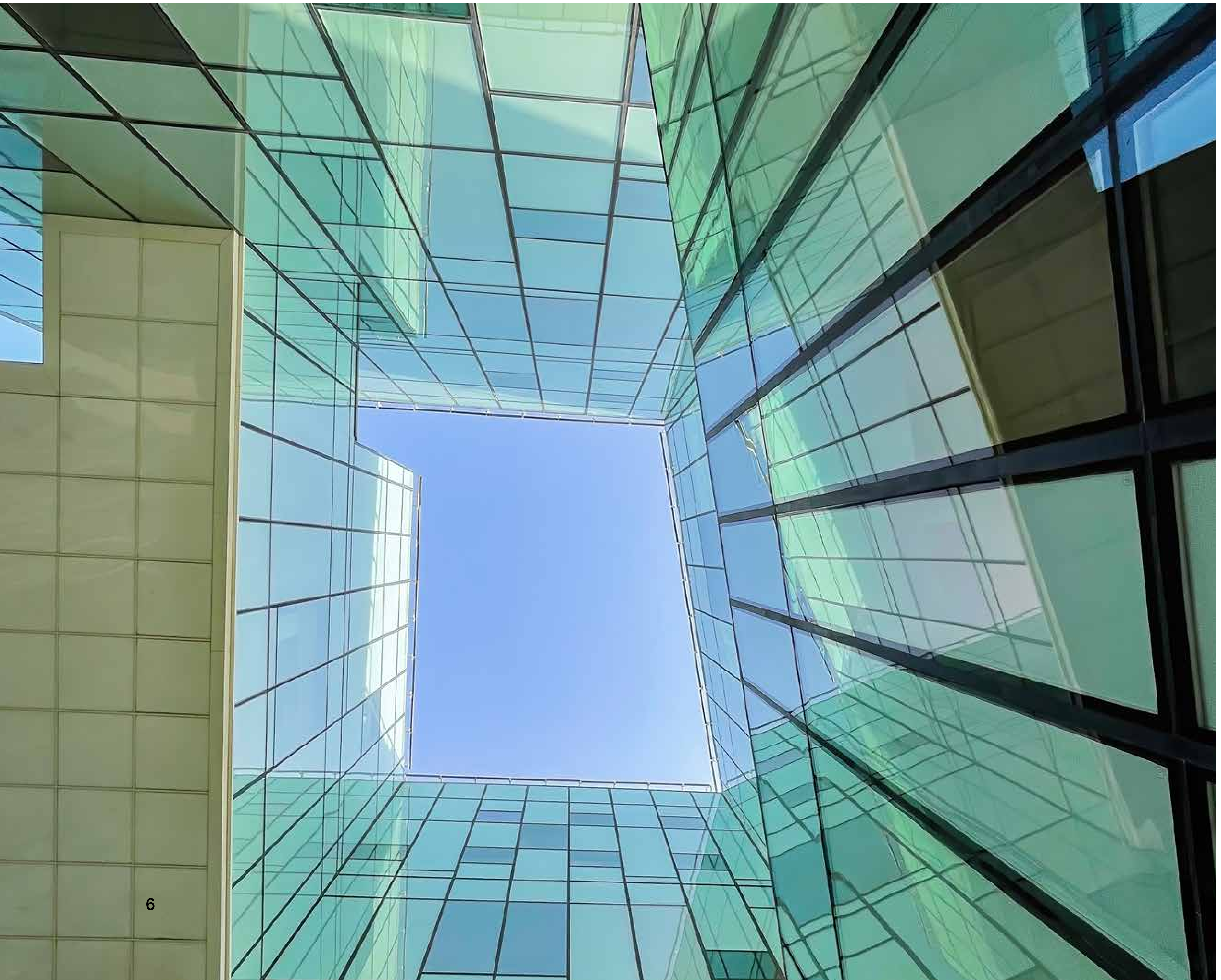
Basis period reforms – are you ready?

We look at the best ways to save tax, particularly in partnerships, summarise the key changes in partnership reporting, and consider the pros and cons of new accounting reference dates.



With taxes there are always winners and losers, especially in this fast-changing taxation world. The higher rate tax band is to be lowered and the new tax year basis of reporting kicks in from April this year. So if you can keep up with it all, you're a winner.

Core reforms

The key reform is to move from the 'current year' basis to a 'tax year' basis. This means business profits will be calculated on a tax year basis rather than using the accounting year. This aligns trading income reporting with investment income reporting.

The move will involve a transitional (catch-up) year for many sole traders and partnerships that do not use 5 April or 31 March as their accounting date. This will advance tax liabilities for many. So it's vital to plan ahead to make the transitional year more tax efficient.

New tax year basis

For practical purposes, the new rules allow the periods to be apportioned by reference to months, if reasonable to do so and should be applied consistently.

Businesses drawing their accounts with a non-tax year end must apportion the profits or losses across the period and adjust their results to the tax year basis.

For any periods with accounts not yet finalised, this apportionment will require estimation, then finalisation and re-submission. For example, a partnership with a December year end does not wish to change its partnership accounting reference date. So, for its partnership return for 2024/25 tax year, it must use the following basis of reporting:

- 9/12 months' profits to the year ended 31 December 2024 and;
- 3/12 months of estimated profits for the year ended 31 December 2025. HMRC allows an estimated profit to be used for the year ended 31 December 2025, assuming the December 2025 figures won't be finalised and are not ready to use for reporting by 31 January 2026. HMRC approves this method, provided the partnership return is amended as soon as the final figures become available.

Basis period reforms – are you ready?

Advantages over current year reporting

From April 2024, it will no longer be necessary for applying the special basis period rules for the year in which a partner joins or leaves a partnership, or where there is a change of accounting date. The current rules which can be very complex to deal with are the opening year, overlap profit calculation and cessation rules. Instead, the relevant reporting period will simply correspond to tax years (ending 31 March, if not 5 April). The 'transitional year 2023/24, utilises all the overlap profit brought forward. This will eliminate 'overlap' profits and the need for their relief in the future years.

Transitional year

The tax year of transition will be 2023/2024, beginning on 6 April. In 2023/24, partnerships with continuing business are taxable on their profits on the current year basis (i.e. for the 12 months to their accounting date ending in 2023/24), plus the period up to the end of the tax year, ending 5 April (or 31 March for simple apportionment).

Depending on the partnership's accounting date, this could bring almost two years' profits into charge in the year.

Businesses with a 30 April year-end are particularly impacted, with almost 23 months of profit taxable in this year. Given this could lead to a much higher tax bill, the transitional rules allow the excess profit to be spread over a period of five tax years to mitigate cashflow impacts. Individuals, however, can elect to be taxed on the transitional increased profit in any way they choose over the five years, including being taxed on the full amount in 2023/24, if desired.

Alternative to transitional year

Partnerships also have the option of changing their accounting year a year earlier to 31 March 2023. This avoids transition rules of reporting and means they can use the full overlap profit brought forward in the current tax year 2022/23.

When a partnership decides to change its accounting date a year earlier to 31 March 2023, it should be treated as a normal change in accounting year. The main benefit is that overlap profit brought forward would get full relief in this year. The Autumn Budget announced a reduction in the higher rate of Income Tax threshold from £150,000 to £125,140 from 2023/24 onwards. This means partners with income over £125,140 could potentially save more than £1,200 in Income Tax just by changing their accounting year, a year earlier, to 31 March 2023.

Basis period reforms – are you ready?

Comparison example: shortening accounting year to 31 March 2023 or 31 March 2024

ABC LLP, a professional services firm with 20 members, draws up its accounts to 30 April. Profit for the year ended 30 April 2022 is £2.4 million, and the partnership results for the next two years are expected to be similar to this year's. Each member has overlap profit brought forward of £80,000.

Year ended 31 March 2024

Under transitional year rules, the 2023/24 net income after tax, per partner

Profit for current year ended 30/04/23 (A)	Profit for the 11 months to 31/03/24 (B)	Overlap profit brought forward (C)	Transitional profit (D)	Transitional profit taxable in 2023/24 (E) (D/5)	Total taxable income in 2023/24 (B + E)	Taxable in the next 4 years (E) x 4	Total IT and NICs for the 2023/24 year + transitional profit taxable in the next 4 years	% of net income out of total income	% of net against total income
£120,000	£110,000	(£80,000)	£30,000	£6,000	£126,000	£24,000	£59,150 (£47,870 + £11,280)	£90,850	61%

Changing accounting date, a year earlier to 31 March 2023

The 2022/23 net income after tax, per partner

Profit for 12 months ended 30/04/22	Profit for 11 months to 31/03/23	Overlap profit brought forward	Profit taxable in 2022/23	Total IT and NICs payable	Net Income after IT and NICs	% of net income out of total taxable income
£120,000	£110,000	(£80,000)	£150,000	£55,907	£94,093	63%

Basis period reforms – are you ready?

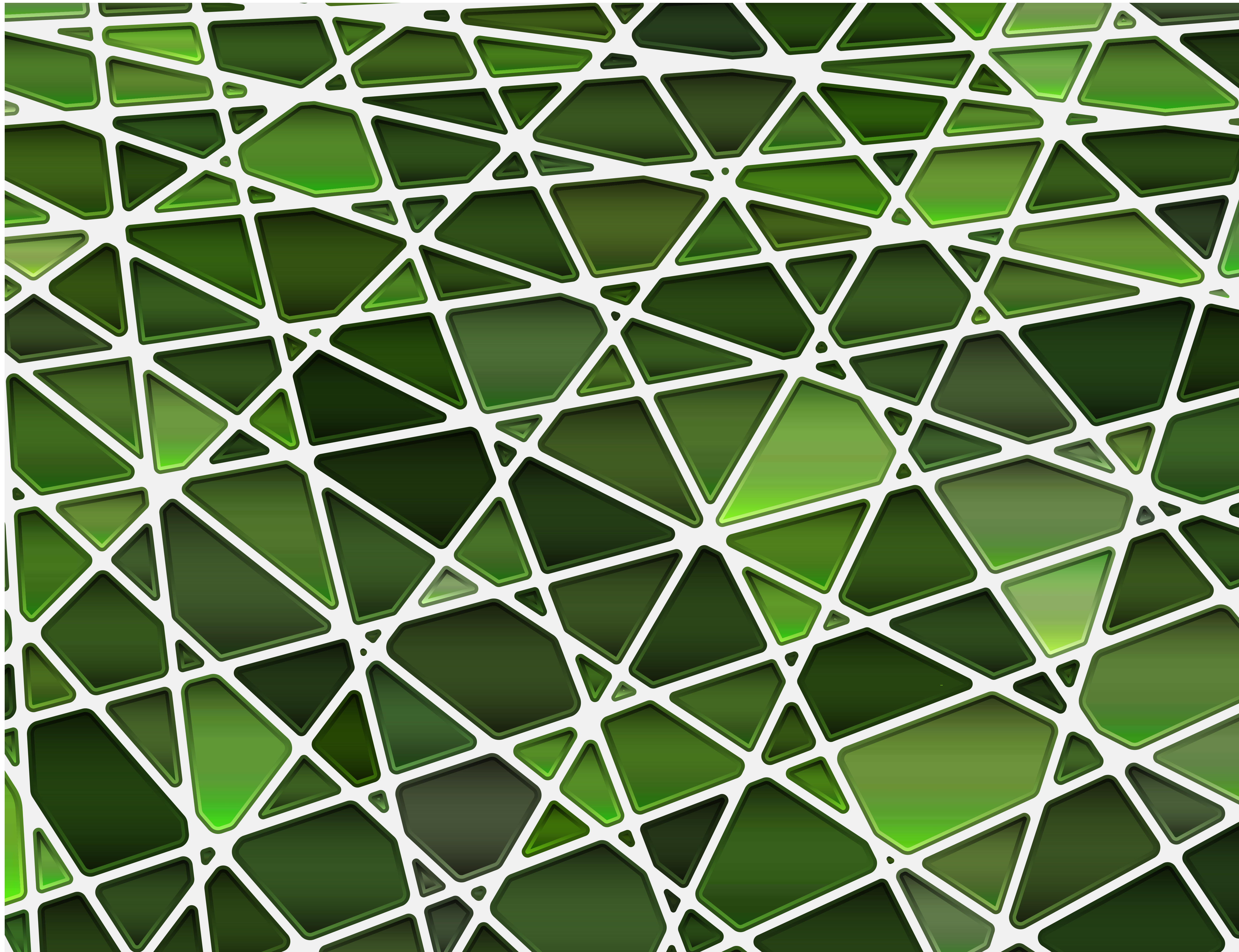
31 March 2023 or 31 March 2024 - who are the winners?

There are various factors to consider before making a decision to change the accounting year end. Looking at the two examples above, there are clearly some tax advantages for choosing March 2023 year end, with over £3,200 tax savings.

This choice looks more favourable, particularly in situations where members' incomes for the current year basis are close to the new higher rate threshold of £125,140 and without taxing all transitional profit (additional months income, less overlap profit available), the current year's higher rate threshold up to £150,000 will be wasted.

But there may be little to gain by choosing March 2023 year end for the members with partnership income over £150,000 in 2022/23 and over £125,140 in 2023/24, as this year's higher rate band will be utilised in full.

Information in this publication is intended for general guidance only, and should not be used in place of professional advice.



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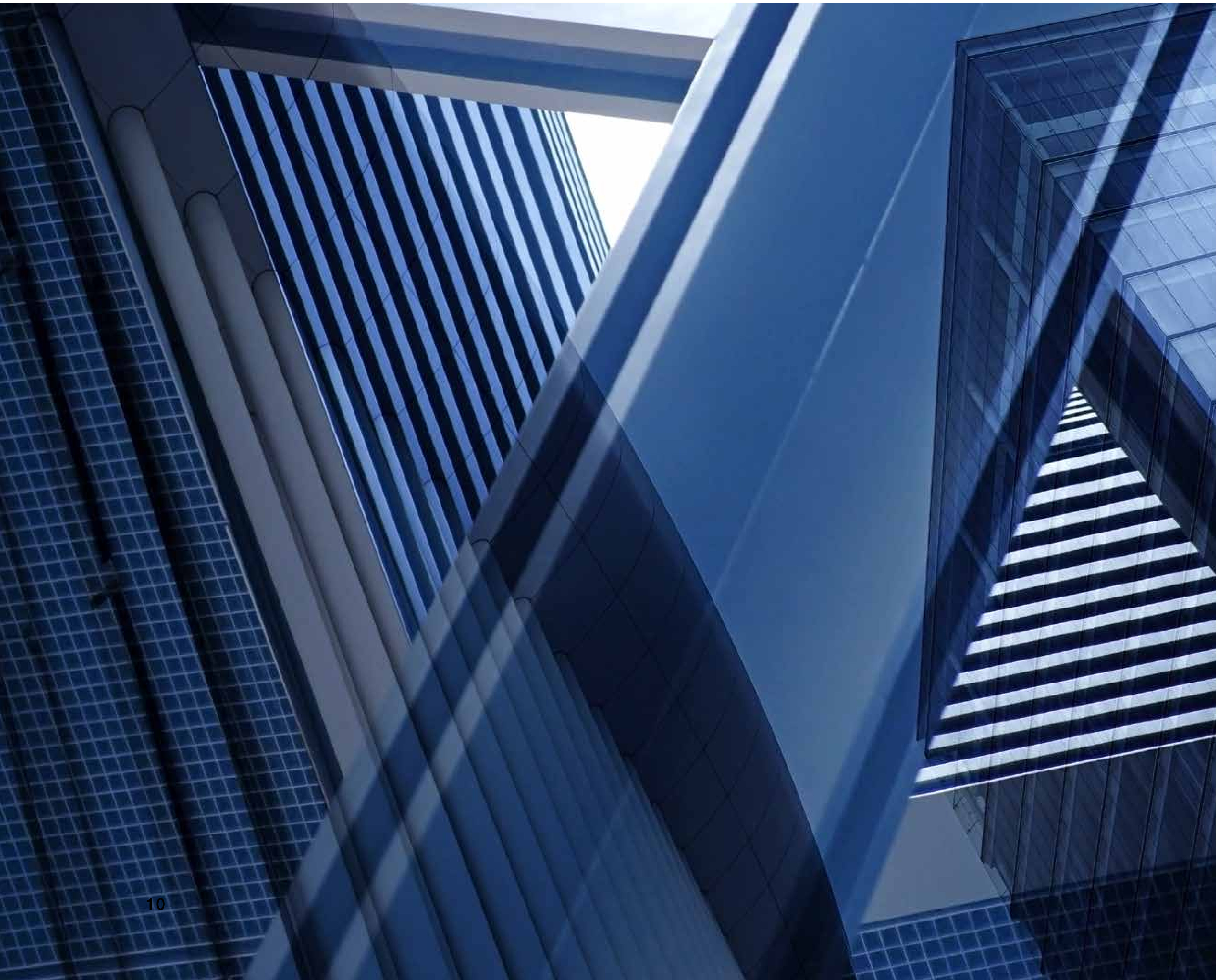
EU Commission VAT in the Digital Age Proposals



In December 2022 the EU Commission proposed wide ranging draft legislation amending VAT Directive 2006/112/EC, Council Implementing Regulation EU 282/2011 and Council Regulation on Administrative Cooperation EU 904/2010 as part of the VAT in the Digital Age package. These far-reaching proposals aim to modernise the EU's VAT system by promoting harmonised e-invoicing and digital reporting requirements, helping to reduce fraud and VAT loss through non-reporting of VAT, as well as reducing compliance costs for businesses currently having to comply with fragmented reporting requirements across the EU.

It is proposed that the legislation will take effect in phases between 2024-2028, and cover three main areas of VAT policy:

1. Digital Reporting Requirements (DRRs), including e-invoicing
2. The VAT Treatment of the Platform Economy; and
3. The Single place of VAT Registration and One Stop Shop regimes.

Digital Reporting Requirements (DRR) and E-invoicing

The DRR will implement real time digital reporting to the local tax authority of standardised information for B2B intra EU transactions. It is intended that this information will feed into the risk analysis systems of EU Member States to help them counter intra community trade VAT fraud, in particular Missing Trader intra community fraud.

Real time transactional reporting under DRR will replace the requirements for suppliers to report intra EU transactions on quarterly or monthly recapitulative statements (commonly known as EC Sales Lists), and for a number of Member States requiring acquisition listings.

Member States will also have the possibility of imposing e-invoicing for domestic transactions. For Member States which introduce e-invoicing and DRR, these national requirements will need to align with the new DRR rules for intra EU transactions.

E-invoicing for intra community supplies

Under the proposals an amended Article 218 of the VAT Directive will create obligatory e-invoicing for all intra community supplies.

EU Commission VAT in the Digital Age Proposals

The proposals will now grant national authorities the right to mandate e-invoicing for domestic transactions without a specific EU derogation.

Given the new mandatory requirement of e-invoicing for intra community transactions, it can be anticipated that different EU jurisdictions will take advantage of this right to introduce requirements for e-invoicing at the domestic level.

In keeping with the aim of real time reporting, the proposals also mandate that e-invoices be issued within two days of the supply occurring where there is an intra community supply subject to the reverse charge by the recipient.

The VAT Treatment of the Platform Economy

Deemed supplier regime

A ‘deemed supplier’ regime will be introduced from 2025 via the addition of a new Article 28a of the VAT Directive for short-term accommodation rental and passenger transport providers within the platform economy.

Under this measure, where the underlying supplier does not charge VAT because they are, for example, under the VAT registration threshold, the platform operator ‘facilitating’ the transaction will be obligated to charge and account for VAT on his deemed supply of accommodation or transport. An amendment to Article 136 of the VAT Directive will mean that the underlying supplier (for example, the accommodation provider) is deemed to be making a (VAT exempt) supply to the platform.

The Single VAT Registration and One Stop Shop

These proposals provide a range of measures intending to ensure harmonised VAT treatment within the EU, reduce opportunities for VAT fraud and mitigate the need for additional VAT registration obligations. It is intended that the proposals will be effective from 2025.

Extension of reverse charge for B2B supplies of goods and services

Currently, a non- established supplier of goods is generally obligated to register for VAT in the territory where a domestic B2B supply of goods takes place (for example, if it procures or stores goods locally for an onwards supply to a business customer).

A change to Article 194 makes the application of the reverse charge mechanism mandatory (it is currently only applied in specific member states) where a business receives a domestic supply of goods or services from a non-established supplier, meaning the supplier of the goods or services will not have to register for VAT in that territory.

Extension of the One Stop Shop (OSS) for margin scheme items

Article 14(4) will be modified to extend the definition of intra community distance sales of goods to cover second-hand goods, works of art, collectors’ items and antiques. This will result in the optional application of the OSS simplification scheme to such sales, potentially removing the need for the supplier to register in additional EU jurisdictions.

In conjunction with this measure, to reduce opportunities for VAT avoidance, Article 39a provides that supplies of works of art and antiques without dispatch or transport (or supplies where the dispatch or transport of the goods begins and ends in the same EU jurisdiction) are taxed at the place where the customer is established.

Extension of the deemed supplier rule to marketplaces selling on behalf of EU established traders

Modifications to Article 14a will extend the application of the deemed supplier rule. Under its expanded scope, this rule will now include all supplies of goods within the EU facilitated by an electronic interface, irrespective of where the underlying supplier is established and the status of the purchaser. This further extends the obligations of platform providers to account for VAT on the underlying sale of goods beyond those introduced on 1 July 2021 for imported goods of under €150, to include intra EU B2C sales made by a non-EU established supplier via a marketplace.

OSS to cover most B2C supplies of services for non-EU suppliers

A modification to Article 359 extends the scope of the non-Union OSS to include supplies of services by non-EU businesses to non-taxable persons which reside in the EU. Certain Member States already extend the ‘use and enjoyment’ provisions beyond those applicable to telecommunications and electronically supplied services, and in such cases non-EU B2C suppliers are obligated to account for local VAT on such sales.

EU Commission VAT in the Digital Age Proposals

However, this currently only applies in a minority of instances.

The changes will mean that non-EU established businesses which supply B2C services not currently covered by OSS (for example, legal or accounting services) will be obligated to register for OSS (or alternatively in each EU Member State where such a supply is made), and pay local VAT. This will clearly represent an additional cost for many non-EU professional services businesses in cases where the amount charged to the customer is adversely affected by the addition of VAT.

Expansion of the Import One Stop Shop (IOSS)

The proposals include the mandatory use of the IOSS for B2C imports made via a ‘facilitating’ platform. Currently, whilst the platform provider is required to account for VAT on B2C imports of goods which the platform facilitates, it can choose to do so via a direct VAT registration in the territory of the customer. It must now declare such sales under the IOSS regime where the consignment value is not greater than €150. The existing €150 value limit for the use of IOSS will remain in place.

Next steps

The draft legislation may be subject to amendments and revisions before being enacted into law. Nevertheless, given the central aims of simplifying VAT compliance, and reducing the VAT Gap and levels of VAT fraud, it can be envisaged that the broad thrust of the legislation will become effective in due course.

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About PKF
Simplifying complexity for our clients

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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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Our tax services
At a glance

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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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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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