TaxTalk

Simplifying the complexities of Tax

December 2023

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Personal Tax

Basis period reform – how to keep it simple 2

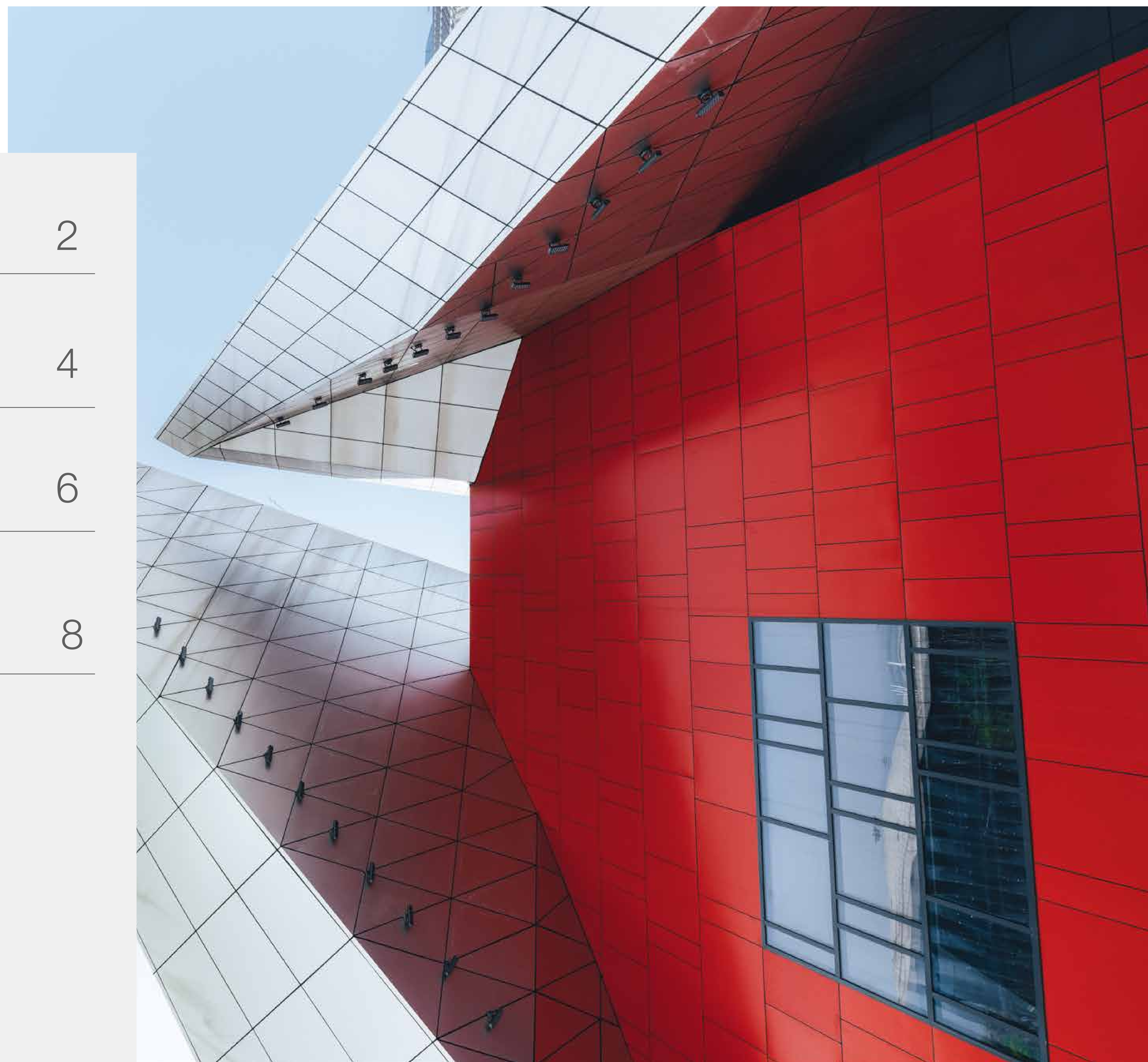
Corporate Tax

More R&D disruption in the UK 4

Transfer Pricing

Transfer pricing in a turbulent economy 6

About PKF 8



Basis period reform – how to keep it simple

We are already in transition towards a fundamental change in the way the self-employed and partnerships calculate their taxable profits. How should you plan, and what should you be doing now?

From 2024/25, all self-employed individuals and members of partnerships will be taxed on the profits generated during the tax year from 6 April to 5 April. This applies regardless of the year-end to which the business prepares its accounts.

Businesses that are unable to change their accounting date to 5 April, for commercial or other reasons, will be left having to apportion profits from two accounting periods to arrive at profits for the tax year. This will likely mean that individual members have to file tax returns on provisional figures and refile the return the following year. It is at least reassuring, though, that a year end of 31 March will be treated as 5 April, with no need to adjust for the 5 days in between.

While the changes may be unwelcome to businesses, the announcement does provide the opportunity to make plans in advance. There are various complexities, but it's still not too late to deal with them, if you haven't already done so.

Partnerships should consider the following areas carefully:

1. Accounting year: to change or not to change?

Those businesses without a 5 April (or 31 March) year end must decide whether to change to 5 April (or 31 March) or keep their existing year end.

For example, in a partnership with a 31 December year end, whether or not it changes to coincide with the tax year, the members will need to file as follows:

- For 2023/24 tax year, the profit share for the 15 months to 5 April 2024 (or 31 March 2024). See details below for transitional year arrangements.
- For 2024/25 tax year, the profit share for the year ended 5 April 2025.
- For 2025/26 tax year, the profit share for the year ended 5 April 2026.

2. Partnerships not wishing to change their accounting year

When a partnership has a different accounting year end to the tax year, it will have to apportion the results for the two accounting periods that fall within the tax year to arrive at the figures that cover the year 6 April to 5 April.

I.e. for the tax year 2024/25, members of a partnership with a December year end must report their financial figures as follows:

- 9/12 of figures reported in the Financial Statements for the year ended 31 December 2024 &
- 3/12 of figures reported in the Financial Statements for the year ended 31 December 2025

The default is that apportionment would generally be made pro rata of the number of days in each relevant period.

Basis period reform – how to keep it simple

3. Apportionment of bonus and performance fee

There may be some cases, especially for hedge fund businesses, where the members' bonuses and performance fees for the year can only be determined at the year end. One solution might be to recognise the performance fee for the three-month period from 1st January to 5 April at the year end, and incorporate this in the next year's partnership return with a disclosure note to explain the basis of the apportionment, and to notify HMRC that it is a more accurate measure of the profit for the period.

4. Plan for the transitional (catch-up) year

The current year, 2023/24, is the transitional year. Members must report their results for the period from the date of the last accounting period to 5 April 2024. So, for a partnership with a 31 December year end, the members should report their profit share for the 15-month period ended 5 April (or 31 March) 2024.

There are rules for the transitional period (1 January to 5 April 2024). A deduction is given for the members' overlap profit brought forward, and the net transitional profit is spread over a period of up to five years.

We advise that partnerships plan for this in advance and ensure that the information is available for reporting well before 31 January 2025. This includes establishing and evidencing the overlap profits for the individual members.

5. Partners tax reserve forecasting

Many partnerships have prepared high-level estimates of their members accelerated tax liabilities. We recommend these calculations are now refined, bearing in mind individual circumstances which could significantly alter their cash flow positions. It's important to take into account increasing or falling future profit shares, and the extent of tax reserves, when deciding whether to leave transitional profits spread over the five years, or to accelerate them.

6. Communication with members

For partnerships where the transitional rule applies, the members' taxable profit in this year is likely to be higher than in previous tax years. This means their tax liabilities will be higher too. Those funding their tax liabilities themselves in this year must understand the impact of accelerated tax payments and make sure they have the funds to pay their tax. Regular communication with members, or a short seminar for those affected, may help to reduce their queries and provide them with more certainty.

Planning and advice

To ease stress and time pressures, set a clear timetable for providing relevant members with profit estimates for the tax years, and estimate a date for the subsequent amendment of the return where apportionment applies, as in point 2 above.

PKF Littlejohn can provide FAQs and organise seminars for members. If you would like to discuss how we can help your business, please contact Stephen Kenny or Tilak Lamsal.

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More R&D disruption in the UK

Enquiries on R&D tax relief claims have increased. But how has the Autumn Statement changed R&D policy? Here's the latest.

Could the turmoil created by HMRC's numerous, and sometimes unjustified, enquiries mean the days of R&D tax relief are numbered? Or will the policy changes outlined in the Autumn Statement simplify the R&D tax landscape? We consider the growing toll on businesses claiming R&D tax relief and the far-reaching consequences this could have on the UK economy.

Administrative red tape

In our April issue, we discussed the significant changes to the absolute tax benefit of the SME and RDEC schemes.

HMRC has subsequently increased the administrative burden of submitting a successful R&D claim. This additional challenge risks businesses being caught unawares and perhaps being denied a legitimate claim.

For accounting periods beginning on or after 1 April 2023, companies must submit a claim notification form to HMRC. This is required before you make the claim if it's your first R&D claim, or if your earlier claim was made more than three years before the end of the claim notification period.

What's more, all claims must be made digitally, and endorsed by a senior company officer together with details of any agent advising on the claim.

From 8 August 2023, your company must also send an additional information form to support the claim before submitting the Corporation Tax return. This should include details of the qualifying expenditure, an in-depth narrative of R&D project(s) carried out and how they meet the qualifying criteria for R&D tax relief. Without this form, HMRC will deny the claim.

Proposed single scheme: the implications

The Chancellor confirmed in the Autumn Statement that the existing Research and Development Expenditure (RDEC) and SME schemes will be merged for accounting periods beginning on or after 1 April 2024. The Government says the merger of the schemes "will be a significant tax simplification".

Currently, under the RDEC scheme, the notional tax rate applied is 25%. But under the single scheme, the notional rate applied to loss-making companies will be lowered from 25% to 19%, enabling loss-making companies to receive more cash benefit upfront. With the single scheme the proposed eligibility of subcontracted expenditure is extended to include work subcontracted to all third parties. But we must still review the detail, and see how this is operated in practice.

Although the headline is that there will be a single merged scheme for accounting periods beginning on or after 1 April 2024, the current SME scheme will continue to operate for so-called 'R&D intensive companies'. The threshold at which a company is considered 'R&D intensive' has reduced from 40% to 30%, for periods beginning on or after 1 April 2024, measured by its qualifying R&D expenditure as a percentage of its total expenditure. This will bring more companies into scope. A grace period has also been introduced so that should a company fall below the 30% threshold for accounting periods beginning on or after 1 April 2024, they will continue to be eligible for the enhanced relief for one year.

More R&D disruption in the UK

From 1 April 2024, R&D claimants will no longer be able to nominate a third-party payee for R&D tax credit payments. This means claimants will have greater oversight of claims and will receive payment more quickly, because the tax relief will be paid directly to the claimant company.

Finally, the Government is now concluding its review of R&D tax reliefs. We note that further action may be needed to reduce the unacceptably high levels of non-compliance. HMRC will be publishing a compliance action plan in due course. It will also continue working with industry to develop better support for R&D intensive SMEs, and consider further simplifications to the scheme.

It seems the plan is still to exclude overseas expenditure from claims in the future. This has been under discussion for some time.

Enquiries: the possible consequences

HMRC has identified high levels of fraud and abuse in the R&D tax credit scheme. For this reason, it increasingly appears to take a 'guilty until proven innocent' line, leading to great uncertainty for claims and considerable frustration in the profession.

There are also suggestions that HMRC is not following enquiry protocol, indicating a lack of experience and R&D training in its team.

There is a risk that this current treatment of R&D enquiries, on top of the already complex claim rules, could push R&D investment outside the UK. In turn, jobs could also exit the UK, resulting in long-term negative impacts on the UK economy.

What should you do now?

The R&D world may be weighed down by HMRC's numerous enquiries, but this should not stop legitimate R&D claimants from seeking relief. More than ever, it's important to have diligent R&D tax advisors guiding you through the process.

For more information, please contact David Emery or Dushiei Manokumar.

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Transfer pricing in a turbulent economy

Even in times of economic stability, making adjustments to transfer pricing is far from straightforward. Here's our guide to year end best practice.

As we approach the end of 2023, UK-based multinational groups have experienced a highly unstable global economy with high inflation and low growth. Resulting erosion of group operating profits is bound to impact the expected returns of individual entities and related party transactions too. This means transfer pricing adjustments, where appropriate, should be made before closing the financial year, both for tax compliance and risk management purposes.

Review of inter-company transactions and pricing

Multinational groups should comply with the transfer pricing rules of the different countries in which they do business. At year end, before approving financial statements and no later than submission of annual tax returns, this compliance requires that groups make an appropriate allocation of income and profits between different tax jurisdictions.

As many UK-based multinational groups approach their year end, they should review what impact the year's economic conditions have had on their transfer pricing arrangements. Inflation might have affected both internal and external pricing arrangements, in the way it has changed interest rates, foreign exchange rates, forecasts for budgeting or valuation purposes, and inter-company agreements. Groups might also have had to reduce their market prices to reflect lower demand for their products or services.

Multinationals should revisit their transfer pricing policies and make adjustments to reflect the changed economic conditions. These adjustments are corrections to the prices of transactions between related entities made, ideally, on a real-time basis or at the year end where appropriate. They are made to ensure that these prices (known as transfer prices) are in line with what would have been charged if the transactions were between unrelated entities, the so-called 'arm's length principle'.

In the UK, legislation allows for a transfer pricing adjustment, in order to increase taxable profits or reduce a tax loss. This also applies to transactions between any connected UK entities. There are certain exemptions that may apply for UK entities that qualify as small and medium-sized enterprises.

Failing to make transfer pricing adjustments: the risks

The absence of appropriate transfer pricing adjustments for financial and tax reporting purposes can trigger significant risks:

- Disputes with tax authorities and penalties: Non-compliance can lead to scrutiny and transfer pricing adjustments by tax authorities, with additional exposure to penalties.
- Double taxation in overseas entities: If the profits have already been taxed in another country, the adjustments can result in double taxation. Relief may only be available under an applicable international tax treaty.
- Reputational damage: Groups may receive adverse publicity if not seen to be paying their fair share of tax.

Reviewing transfer pricing before the year end

To mitigate these risks, groups should take steps to review transfer pricing before year end. They need to:

- Identify related party transactions: Look at all material transactions that have taken place between related parties during the year. These include new transactions and ceasing ones.
- Determine arm's length price: For each of these transactions, decide the arm's length price. This typically involves a comparability and benchmarking analysis of independent comparable companies. Current practice is a new benchmarking analysis every three years, with annual financial updates of comparable companies.
- Manage transfer pricing adjustments: If the price charged in a related party transaction is different from the arm's length price, it will be wise to make an adjustment.

Transfer pricing in a turbulent economy

- **Maintain records and transfer pricing documentation**: The calculation of related party transactions and transfer pricing adjustments should be supported by proper record keeping. Keep transfer pricing documentation in line with local country rules, mindful of potential risks and best practice. For example, large UK-based multinationals must maintain, every year, an OECD-compliant Master File, Local Files, Country-by-Country Report and, potentially, a Summary Audit Trail.

Next steps

It's important to note that the rules and methods for making transfer pricing adjustments can be complex and vary by tax jurisdiction. Failure to comply can result in penalties and other consequences.

A transfer pricing review should be a key part of a multinational's year end process. Appropriate management will help to avoid unwanted financial and compliance consequences. Best practice is transfer pricing planning and monitoring throughout the year in order to mitigate issues at the year end.

For further guidance, please contact Farhan Azeem in the UK. He collaborates with local experts across PKF Global.

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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 Global, an international network of legally independent accounting firms that gives us an on the ground presence in 150 countries around the world.

PKF in the UK

11th largest Tax practice in the UK

£153 million annual fee income

1450+ UK partners and staff

5th 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, transfer pricing, 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.

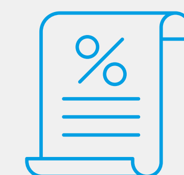
Read more

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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