Winter 2017

Kingston Smith

In this issue:

Professional Firms Insight

Editorial

Welcome to this edition of Professional Firms Insight.

Looking back over 2017, we are pleased to report the majority of our professional firm clients have had a good year. They achieved solid growth and, while 2017 saw some fluctuations in the markets as the political decisions of 2016 come into play, we believe that most of our professional firm clients in London and the South East are still continuing to expand and grow.

The Chancellor of the Exchequer, Philip Hammond, gave his first autumn Budget. First-time buyers will be happy with a reduction in Stamp Duty. The older generation who were expecting to foot the bill to fund giveaways to the younger generation will be pleased there were no specific measures to rebalance wealth as feared, and no changes to pensions.

The Chancellor also indicated that more changes are to come with the announcement of future consultations. While there were no major announcements, there were small changes that could affect some professional firms. For example, the much talked about changes to the taxation of partnership profits which will, in future, need to be split between partners in the same proportions as accounting profits. Our article in this issue will take a further look at how these changes may affect you.

In this edition, we focus on the upcoming changes which will affect professional firms in the first half of 2018 including the introduction of the General Data Protection Regulation and the first period of reporting of payment practices and performance for some professional firms. Kingston Smith Financial Advisers also help to clarify some of the practicalities of the tapered annual allowance for pension contributions.

I hope you enjoy this edition of Professional Firms Insight. Our team is always on hand to help and we welcome any feedback or questions you may have.

Wishing all our professional firm clients and contacts a happy and prosperous New Year!

John Staniforth
Head of Professional Firms
jstaniforth@ks.co.uk

Draft legislation affecting partnerships

The tax rules affecting partnerships and LLPs have been changed over the past few years, with more changes to be introduced in next year's Finance Act. The government anticipates that the new changes will only affect a small minority of partnerships, however all partnerships would be wise to at least consider the new rules.

The change that might have the greatest impact is the allocation of profits and losses for tax purposes. For periods of account beginning on or after the day the Finance Act becomes law (expected to be March or April 2018), taxable profits will need to be split in the same proportion as accounting profits.

If a partner is entitled to 10% of the accounting profits, under the proposed new rules they will always be subject to tax on 10% of the taxable profits (which might be higher or lower, depending on what adjustments are required). Similarly, if a partner is entitled to a fixed profit share of £100,000, and profits in the year total £500,000, the partner will be subject to tax on 20% of taxable profits.

This could affect a number of the sorts of arrangements that are currently in place. It is often the case that fixed share partners do not share in any tax adjustments, such that their taxable profits are always equal to their accounting profits. Under the new rules, they will have to take their share of the tax adjustments.

As another example, expenditure associated with cars that are partly used for private purposes may be allocated to the partners who use the cars. This ensures that the relevant partners suffer the tax impact of the private use. Under the new rules, this sort of allocation will not be possible.

Another proposed change will affect partnerships of which one (or more) of the partners is itself a partnership. In such cases, the obligations of the 'bottom partnership' in preparing its partnership tax return will depend on whether it provides details of the partners in the 'top partnership'.

If it does, it will only need to account for the characteristics of the 'ultimate partners'. If they are all UK residents, it will only need to calculate its taxable profits using the rules for UK residents.

If it does not provide this information (for example, because it doesn't have access to it), it will need to calculate taxable profits on four different bases (to account for companies and individuals, and residents and non-residents). Often there will be little difference between these bases, but in some cases this will make preparing the partnership tax return much more onerous.

Partners mostly take the figures in the partnership tax return and slot them directly into their own tax returns. Where partners dispute a figure on the partnership tax return, it is currently unclear what they should do. Should they ignore the partnership tax return, or use a figure they believe to be incorrect? Under the proposed new rules, the figures on the partnership tax return will be 'conclusive'. However, there will also be a formal procedure whereby partners can appeal to a tribunal for a determination of the correct position.

The change that might have the greatest impact is the allocation of profits and losses for tax purposes.

Other proposed changes relate to partners acting as nominees, and investment partnerships (where it will in the future be permitted under certain circumstances to file partnership tax returns without taxpayer reference numbers for all partners).

If you would like to see how the proposed changes could affect you, please contact your usual Kingston Smith contact.

The General Data Protection Regulation (GDPR) – are you compliant?

On 25 May 2018, the General Data Protection Regulation (GDPR) will become law. It will seriously affect how firms communicate with their audience and process personal data, and who they share personal data with. The GDPR is the first major review of data protection for 20 years and is intended to protect data subjects by giving them powerful new rights.

What is the GDPR and how will it affect your firm?

The GDPR aims to give clearer guidelines for communications using consent-based preferences for data subjects. You won't be able to communicate with your clients without a good and lawful reason.

There will also be hefty financial penalties to discourage offenders from taking any chances with personal data. Fines will increase from the current maximum of £500,000 to £17 million.

The supervisory authority in the UK, the Information Commissioner's Office, will have new powers, such as the right to enter your premises, audit your firm and reprimand your firm. As a principles-based legislation, it's not a black-or-white regulation; it's more various shades of grey.

How can you ensure your firm is GDPR-compliant?

Your firm needs to start preparing now to ensure you comply by May 2018. The first step is to build policies for your organisation that comply with the GDPR.

To be GDPR-compliant, your firm should take the following steps:

1. Ensure data is up to date and correct. The GDPR Article 5 states that "every reasonable step must be taken to ensure that personal data that are inaccurate […] are erased or rectified without delay".
2. Ensure the opt-out clause is adhered to. Clients will have the right to opt out of marketing and it is vital that you immediately cease all marketing to them. Update your CRM and data systems accordingly.
3. Ensure that client data is easily accessible. Clients have the right to request all data you currently hold on them.
4. Ensure you have consent. Client consent is at the heart of the GDPR. Your firm is obliged to make clients understand at all times what data is being collected and how it will be used. Start now so you have plenty of time to contact your clients and update their preferences.

Applying the rules to your circumstances is vital for your firm to maintain growth. This is particularly true when you examine the conditions for data processing.

There will also be hefty financial penalties to discourage offenders from taking any chances with personal data.

There are several situations when your firm will lawfully be able to communicate with your clients, however you will only need to comply with one. There is already considerable debate over which can be used the most effectively.

The best premise is 'consent'. This is where your subject has clearly, specifically and unambiguously demonstrated their wish to be contacted. Another is 'necessary for contract'. This is where you are required to service the contract that is in place at the time. The client has the right of legal recourse against you if you don't. 'Legitimate interest' is a third premise. This is your interest in regularly communicating with your clients for a specific cause, as long as this doesn't override the subject's rights and freedoms.

The data subjects will get some new robust rights too. These include the right to be forgotten, or erased, and the right to object to marketing. Ignore these rights and you'll almost certainly be fined. Data subjects will also have enhanced rights to make access requests for a copy of their data. If you operate CCTV for crime prevention purposes and capture images of people, you'll have to find a way of identifying people and then sharing the images on request.

Subjects will also have the right to judicial remedy if you cause them material or non-material loss. If their data is stolen, shared or otherwise abused, they will be able to sue you. It's widely anticipated that law firms will bring affected data subjects together in a series of class actions against offenders.

Finally, the GDPR will give guidance on the profiling of data. Profiling is where information is electronically processed in an automated way to reach a conclusion about a person. It might be financial status, behaviour, likes and dislikes.

For example, banks frequently profile their customers to ascertain financial status. Credit rating agency Experian does it all the time on every citizen in the UK. Without people's express consent, this will become unlawful.

The GDPR is here to stay. How it will change the way you market your services is yet to be fully realised, but it will be very different. By May 2018, you will need to be processing data lawfully. As a professional firm handling, storing and often processing personal data for UK or EU subjects, you can't ignore the GDPR or you could suffer the consequences.

Reporting of payment practices and performance

On 6 April 2017, new regulations came into force which require large UK companies and LLPs to report to the government on a half-yearly basis on their payment practices. The information must be published through an online portal provided by the government within 30 days of the end of each six-month reporting period, and will be available to the public. The report must contain detailed information covering a wide range of areas and must be approved by a named company director or, for LLPs, a designated member.

Failure to publish a report within the specified time period or providing false information in a report is a criminal offence and the company/LLP and its directors/members will be liable to a fine.

The new requirements aim to promote prompt payment to smaller suppliers and to increase the level of transparency around payment practices.

Which companies are required to report?

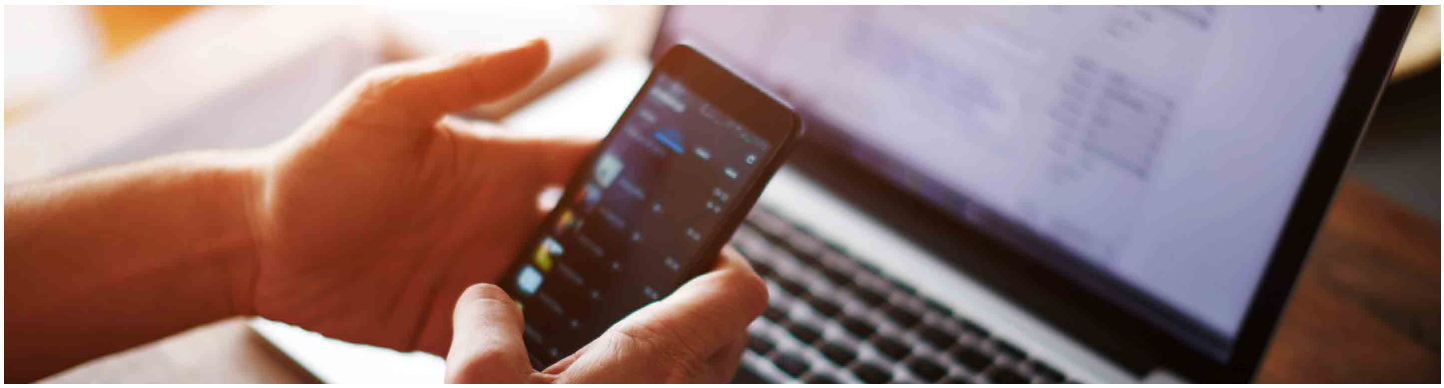
Businesses are within the scope of the requirement for a financial year if, on their last two balance sheet dates, they exceeded two or all of the thresholds for qualifying as a medium-sized company (see flowchart overleaf).

Not all companies are required to report. Companies in their first financial period and businesses incorporated outside of the UK are not generally required to report. However, UK subsidiaries with an overseas parent company are required to report if the size requirements are met.

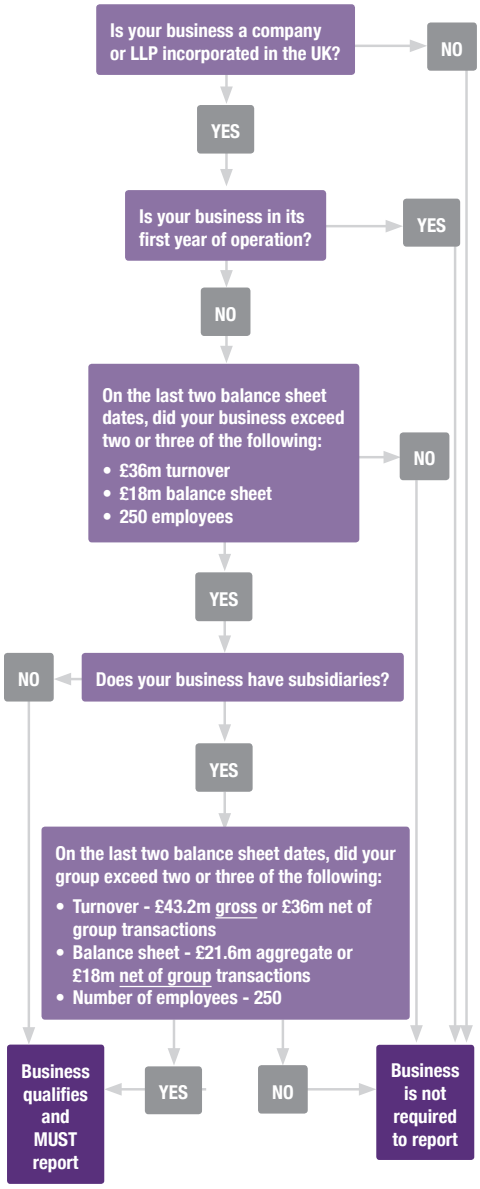
The new reporting requirements are also imposed on charitable companies (including companies limited by both shares and by guarantee) and community interest companies if the size requirements are met. Otherwise charitable bodies, for example Royal Charter bodies, are not companies incorporated under the Companies Act 2006 so do not have to report unless they own a subsidiary company which meets the above criteria.

The information required to satisfy the reporting requirements should be prepared on an individual company or individual LLP basis, not at a group level.

The new requirements aim to promote prompt payment to smaller suppliers and to increase the level of transparency around payment practices.



This is set out in the flowchart below:



A parent company only needs to report on its own payment practices and performance if it exceeds the size criteria after ignoring intra-group transactions, unless its gross turnover and gross balance sheet value exceed £43.2m and £21.6m respectively.

When is the business required to report?

The legislation came into effect on 6 April 2017 and applies to qualifying companies and qualifying LLPs in financial years beginning on or after 6 April 2017. The report must be produced for each reporting period in a financial year.

If the business has a period of account less than nine months, only one report is required but if a business has a long period of account, three reports are required for that period. The information required must be published within 30 days of the end of the reporting period.

See the table below for example reporting periods and due dates.

Financial Year ended	First reporting period	Due date for reporting	Second reporting period	Due date for reporting
31 Mar 2019	1 Apr 2018 - 30 Sep 2018	Oct 2018 - 30 Oct 2018	1 Oct 2018 - 31 Mar 2019	30 Apr 2019
30 Apr 2018	1 May 2017 - 31 Oct 2017	30 Nov 2017	1 Nov 2017 - 30 Apr 2018	30 May 2018
30 Sep 2018	1 Oct 2017 - 31 Mar 2018	30 Apr 2018	1 Apr 2018 - 30 Sep 2018	30 Oct 2018
31 Dec 2018	1 Jan 2018 - 30 Jun 2018	30 Jul 2018	1 Jul 2018 - 31 Dec 2018	30 Jan 2019

What must be reported?

Every six months the qualifying businesses will be required to publish detailed information in relation to qualifying contracts. A qualifying contract is a contract that satisfies all of the following:

- It is between two (or more) businesses
- It has a significant connection with the UK
- It is for goods, services or intangible property, including intellectual property
- It is not for financial services.

The report must include:

- Descriptions of the standard payment terms including:
  - the standard contractual length of time for payment of invoices
  - maximum contractual payment period
  - any changes to the standard payment terms in the reporting period including how suppliers have been notified or consulted on these changes
  - the business's process for resolving disputes related to payment.
- Statistics on:
  - the average number of days taken to make payments
  - the proportion of invoices paid in 30 days or less; paid between 31 and 60 days; and paid beyond 60 days
  - the proportion of payments due within the reporting period which were not paid and amount of late payment interest owed and paid.
- Statements in relation to whether:
  - suppliers are offered e-invoicing
  - supply chain finance is available to suppliers
  - the business's practices and policies cover deducting sums from payments as a charge for remaining on a supplier's list, and whether they have done this in the reporting period
  - the business is a member of a payment code.

How to report?

The government has provided a web service for businesses to publish the report and the information provided will be made public on the website immediately. Qualifying businesses must be registered with the Companies House Single Service and have been provided with an authentication code in order to publish reports.

How can we help?

It is important to determine whether your business meets the criteria to report under the new regulations as soon as possible in order to ensure that systems of data collection are in place before the beginning of the period for which a report is due. Systems may also need to be updated to automate the collection of the data to be reported so far as possible, as the information that must be included in the report can be very difficult to obtain at a later date. Payment practices and contract performance should be reviewed before the beginning of the reporting period in preparation for reporting of this data.

If you think your business may be affected by the new regulations, we can help. We can also review your systems and help in the preparation and analysis of your data that must be reported on. For further information, speak to your usual Kingston Smith contact.

The practicalities of the tapered annual allowance for pension contributions

Since our recent article on the tapered annual allowance we have continued to see a number of queries, especially concerning 2016/17 tax returns, on this complex planning issue.

To recap, from 6 April 2016, individuals who have a 'threshold income' in excess of £110,000 in any tax year will have their adjusted income tested to see if this is in excess of £150,000 in that tax year.

Should both tests be met then the standard £40,000 Annual Allowance (AA) is reduced by £1 for every £2 of adjusted income over £150,000 in a tax year. This restricts the level of tax-efficient pension funding which high earners and their employers can make into pension schemes.

The maximum AA reduction is £30,000, so those individuals who have an adjusted income of £210,000, or more, will have an AA of £10,000 from 2016/17 onwards.

The two tapering tests are:

Threshold Income includes all taxable income and salary sacrificed for pension contributions (unless the arrangement pre-dates 8 July 2015). The gross value of personal pension contributions where tax relief has been given at source is deducted from this figure and employer pension contributions are ignored.

If an individual's threshold income is less than £110,000 then there are no further tests required and the full AA of £40,000 is available.

The threshold income assessment provides some protection for lower earners who may have significant one-off bonuses or a sizeable ad hoc employer pension contribution.

Adjusted Income is the individual's taxable income from all sources *plus* personal pension contributions via net pay arrangements and employer contributions.

For individuals who have defined benefit schemes, AA is calculated by the notional employer contribution to fund the additional benefit accrued and excludes any element of personal contribution into the scheme. Contributions into any other scheme or an AVC are included.

Carry forward

It is possible to carry forward unused allowances from the previous three tax years if you had been a member of a registered pension scheme. The carry forward of unused AA from previous tax years still provides higher earners the opportunity to maximise tax-relieved contributions into pensions.

The following provide some examples of when taper does and doesn't apply and potential solutions to these issues:

Example 1. Tapered annual allowance does not apply:

- Income is £120,000 (£100k salary and £20k investment income) in the current tax year
- Employer pension contributions = £20,000
- Employee gross pension contributions = £20,000
- Adjusted income = £140,000
- Threshold income = £100,000 i.e. £120,000 - £20,000 gross personal pension contribution
- As threshold Income is below £110,000 there is no tapering.

Example 2. Taper will apply

- Salary is £130,000 and investment income is £10,000
- Employer pension contributions = £30,000
- Employee pension contributions = £10,000
- Adjusted income = £170,000 i.e. £140k re salary and investment Income + £40k total pension contributions - £10k personal pension contributions
- Threshold income = £130,000 i.e. £140k re salary and investment income - £10k personal pension contributions
- As both adjusted income and threshold income are above the relevant limits, taper applies
- The £20,000 excess income reduces the AA by £10,000
- As total pension contributions are £40,000,the AA charge will be applied on the £10,000 excess at the individual's marginal tax rate unless carry forward is available.

Example 3. Making personal contributions to reduce Adjusted Income.

- Self-employed income £180,000
- Maximum pension contributions in 2014/15 and 2015/16. No pension contributions were paid in 2016/17
- Wants to maximise pension contribution using carry forward from 2016/17
- Make a personal contribution of £80,000.
- Adjusted Income would be £100,000
- Therefore, there would be no taper
- Possible tax relief due is £38,100 so an effective tax relief rate of 47.6%.

This calculation covers the nil, 20% (basic rate), 40% (higher rate) and 45% (top rate) tax bands and the proportion of the contribution that falls into each band; the personal allowance (£11,500 in 2017/18) and the gradual loss of personal allowance between an income of £100,000 and £123,000. However, other factors may affect how much tax relief can be claimed.

Example 4. How can carry forward help?

- Self-employed earnings are £180,000 in 2016/17 and a tapered annual allowance of £25,000 applied. £23,000 gross was contributed into pensions
- In 2017/18 total earnings increased to £250,000 and a tapered annual allowance of £10,000 applies
- The table below shows the pension input amount for the last few years, and demonstrates how much could be carried forward into 2017/18 to minimise the effects of the taper:

Pension Input Period ends in Tax year	Annual Allowance	Tapered annual allowance	Pension input amount	Amount available for carry forward
2014/15	£40,000	N/A	£40,000	£0
2015/16 Pre-alignment tax year	£80,000*	N/A	£25,000	£40,000 to Post-alignment tax year only
2015/16 Post-alignment tax year	£40,000 carried forward from Pre-alignment tax year only*	N/A	£35,000	£5,000
2016/17	£40,000	£25,000	£23,000	£2,000
2017/18	£40,000	£10,000	Up to £17,000	

All pension input periods were automatically closed on 8 July 2015 and were tax-year aligned after this. The maximum AA for the pre-alignment tax year was £80,000. This refers to all contributions paid in pension input periods that ended between 6 April 2015 and 8 July 2015, rather than just the contributions paid between those dates.

The AA for the post-alignment tax year is technically nil, but up to £40,000 of the unused AA from the pre-alignment tax year can be carried forward and used in the post-alignment year.

It is possible to carry forward £5,000 from 2015/16 and £2,000 from 2016/17, so a contribution of up to £17,000 could be made in 2017/18 without suffering an AA tax charge.

Summary

Pensions are a very tax-efficient way for UK individuals to save for their retirement; however the tapering rules are complex and impact many of our professional firm clients. We have the expertise and sector knowledge to pick through the complexity and advise on appropriate planning strategies.

Professional advice should always be sought and any changes to your financial plan and strategy require consideration to ensure that it assesses and addresses all of the risks. The details of any advantages or disadvantages are beyond the scope of this article.

Tax and legal advice should be taken to ensure that any benefit changes or alterations to earnings do not potentially fall foul of any anti avoidance rules.

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Kingston Smith has been helping clients build their businesses for more than 90 years.

As chartered accountants and business advisers, we work with clients to understand their potential and ambitions, and provide all the information and support they need to achieve them.

Most of our commercial client businesses are managed by the people who own them. We have over 60 partners and more than 500 professional staff focused in and around the London/South East region, where our commitment to the more entrepreneurial types of business has created long-lasting successes. Our sector focus provides us with the insight our clients need to deliver strategic and practical advice.

Our founder membership of international accountancy association, Morison KSi, offers our clients the strength and experience of offices in 88 countries to support their international reach. That combination of geographic knowledge, commercial expertise and client empathy has given us a great track record in helping clients grow their business.

More information about Kingston Smith LLP and our services can be found at **www.ks.co.uk**

Kingston Smith LLP
Devonshire House
60 Goswell Road
London EC1M 7AD
T 020 7566 4000

City
John Staniforth
jstaniforth@ks.co.uk
T 020 7566 3644

Jon Dawson
jdawson@ks.co.uk
T 020 7566 3748

Heather Powell
hpowell@ks.co.uk
T 020 7566 3811

Jamie Sherman
jsherman@ks.co.uk
T 020 7566 3833

Becky Shields
bshields@ks.co.uk
T 020 7566 3634

Mark Twum-Ampofo
mtwum-ampofo@ks.co.uk
T 020 7566 3648

Offices also in:

Heathrow
Jonathan Seymour
jseymour@ks.co.uk
T 020 8848 5500

Redhill
David Montgomery
dmontgomery@ks.co.uk
T 01737 779 000

Romford
Dan Martine
dmartine@ks.co.uk
T 01708 759 759

St. Albans
Silvia Vitiello
svitiello@ks.co.uk
T 01727 896 008

West End
John Staniforth
jstaniforth@ks.co.uk
T 020 7566 3644

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