MOORE Kingston Smith

PROFESSIONAL FIRMS INSIGHT

In this issue:

WELCOME TO THE SUMMER 2019 EDITION OF PROFESSIONAL FIRMS INSIGHT.

The old adage that a week is a long time in politics has certainly rung true of late – following his successful Conservative Party leadership campaign, the new Prime Minister has brought with him a fresh and tougher approach to Brexit. As each day goes by, it seems more inevitable that we will end up with a no-deal Brexit. A lot of water will pass under the bridge between now and Halloween of course but one thing that does appear certain with the new regime is that there will be no further delays to Brexit. Our professional firms clients will be grateful that at least this should bring the current period of uncertainty to an end. Only time will tell as to the long-term economic implications of the UK departure from the EU, but it will inevitably lead to change and where there is change, businesses and business-owners will rely more heavily on advice from their professional advisors.

In this issue, we examine two old tax issues facing professional firms that have reared their heads again in recent times. Firstly, following recent HMRC announcements, we look at the different ways that a partner can claim tax relief on business expenses paid out of their own pockets. Secondly, after several years of inactivity, it appears that HMRC are now checking compliance with the salaried members rules for LLPs so we set out a useful reminder of the three conditions under those rules.

Despite the Brexit uncertainty, we have found that a number of professional firms are looking to expand both domestically and internationally. We have therefore provided some initial insights into both the compliance requirements and the commercial issues facing those firms considering overseas expansion post-Brexit. Our team is finding increasing numbers of professional firms are building up a "war-chest" of cash reserves as they head into an uncertain future. When you take into account the tax reserves these firms are holding on behalf of their partners, this can add up to a considerable amount of cash. The downside to this strategy is the very modest interest that firms receive from holding these reserves in an account with their high street bank during this period of historically low interest rates. David Mitchell from Moore Kingston Smith Financial Advisers provides an insight into an innovative Cash Management Service solution to this problem.

Finally, returning to the theme of doing business overseas, Andrew Constable warns that professional services firms that take on property consultancy projects overseas need to be aware of the VAT implications which can vary considerably from country to country within the EU.

Our team is always on hand to help and we welcome any feedback or questions you may have.

I hope you enjoy reading this edition of Professional Firms Insight.

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

PARTNERSHIP EXPENSES

Many members of partnerships and LLPs personally incur expenditure for business purposes, but do not get reimbursed for this expenditure (either with cash from a partnership bank account, or by way of a credit to their current account). The relevant partners will expect to be able to claim a tax deduction for this expenditure, and for many years HMRC had a clear approach to allowing tax relief on this expenditure.

The first point to note is that any claim for tax relief on expenditure incurred for the purposes of a partnership's business must be made through the partnership's tax return. The expenditure can only be eligible for a tax deduction if it is incurred "wholly and exclusively" for the purpose of the business carried on by the partnership, and (so says HMRC) the only valid way of claiming tax relief for such expenditure is through the partnership's tax return.

Historically HMRC always accepted that, even though the expenditure must be reflected in the partnership's tax return, it was not necessary for the expenditure to have been included in the partnership's accounts.

In practice, therefore, it was always perfectly acceptable for the figures in a partnership tax return to be prepared after taking into account deductions for additional expenses (i.e. above and beyond those that are reflected in the accounts) that were incurred personally by the partners. The only requirements were that this expenditure had to have been incurred "wholly and exclusively" for the purposes of the partnership business, it had to be revenue (and not capital) in nature, and it could not be specifically disallowed (as would be the case with, say, client entertaining expenditure).

HMRC recently updated its guidance to state that, for a tax deduction to be available in respect of expenditure, the relevant expenditure had to have been "incurred" by the partnership itself, and so feature in the accounts of

the partnership. This was a significant change in practice, and caused a lot of concern to members of various partnerships.

The guidance, however, changed again in March 2019. The latest version does once again allow for tax deductions to be available even where expenditure does not feature in the accounts.

This current guidance is not, however, as clear as the historical guidance had been. While we do not believe that HMRC intends to deny deductions they would previously have accepted, the current guidance could potentially allow for this to happen in the future.

Partnerships with partners that personally bear the cost of business expenditure may want to consider changing their internal arrangements so that this expenditure is reimbursed, and so that it does therefore feature in the partnership's accounts. This would make the tax position a lot clearer. Where appropriate, profit-sharing arrangements could be changed to ensure that all of the partners are in the same economic position as they would otherwise have been. Clearly making such a change might not be desirable, but it may be preferable to running the risk ofchallenge from HMRC. If you would like to consider this approach, or discuss the issue of partnership expenses more generally, please get in touch with your usual Moore Kingston Smith contact.

SALARIED MEMBERS RULES

Legislation was introduced in 2014 to counter what was perceived as "disguised employment" of members of LLPs. Many LLPs will have become intimately familiar with these rules back in 2014, and will have regularly re-considered their implications ever since. Others, however, may have left these on one side to be looked at later.

We are seeing evidence that – five years after the rules were introduced – HMRC is starting to take a greater interest in compliance with these rules. Now might therefore be a good time to recap the rules, and to consider afresh how these might be applied in particular circumstances.

In summary, the legislation contains three conditions (A, B and C) which are considered in respect of individuals who are members of LLPs. If an individual satisfies all three conditions, they is to be treated for tax purposes as being an employee of the LLP and not as being a member of the LLP. This means that amounts paid to the individual need to be processed through a payroll scheme, and subject to PAYE and NICs in the usual way.

Condition A is met if, at the "relevant time", it is reasonable to expect that at least 80% of the amount payable to the individual during the "relevant period" in respect of their performance of services will be "disguised salary".

The legislation defines exactly what is meant by "relevant time" and "relevant period", but suffice to say that the test is a forward-looking one, based on reasonable expectation.

"Disguised salary" comprises amounts which are fixed, or which are variable but not by reference to the overall profits or losses of the LLP (such a share of the profits of a particular office or division).

Condition B requires that the mutual rights and duties of the members of the LLP do not give the member "significant influence" over the affairs of the LLP. "Significant influence" is not defined in the legislation, but HMRC's expectation is that in larger partnerships only members of some kind of executive board are likely to have this level of influence.

Condition C measures the partner's capital at risk in the partnership and compares it to the expected "disguised salary" in a period. Specifically, this condition is satisfied if the individual's capital in the LLP is less than 25% of the disguised salary which it would be reasonable to expect the individual would receive for his/her performance in a particular tax year.

An individual only needs to break one of these conditions in order to be treated as a member – and not as an employee – of the LLP in a particular period, with condition C being the most commonly broken condition in practice. The information set out previously is only a summary of the rules, and there is plenty of detail in the legislation – and HMRC guidance – which should be taken into account in determining whether the rules will apply.

Moore Kingston Smith can advise on the application of these rules to both existing and proposed LLP arrangements.

EXPANSION PLANS POST-BREXIT

We increasingly see UK professional firms providing services overseas regardless of their size.

Statistics produced by the Office of National Statistics (ONS) (released in January 2019) show that:

- Total UK exports of services (excluding travel, transport and banking) continued to rise in 2017, from £142.7 billion in 2016 to £162.1 billion, an increase of 13.6%.
- Total UK exports of services (excluding travel, transport and banking) to Europe saw the largest rise in 2017, from £70.1 billion in 2016 to £80.9 billion, an increase of 15.4%.
- Financial services continued to be the largest service product exported globally by UK businesses in 2017.
- Total UK imports of services (excluding travel, transport and banking) also continued to rise in 2017, from £68.7 billion in 2016 to £78.7 billion, an increase of 14.6%.
- Europe continued to be a prime destination for exports of services for UK businesses, increasing by £4.3 billion on 2016 to £41.0 billion in 2017.
- The total UK trade in services balance (excluding travel, transport and banking) increased from £73.9 billion in 2016 to £83.4 billion in 2017.

While we encourage our clients to consider overseas expansion, firms should think hard about the compliance requirements, particularly in the context of Brexit.

The EU (Withdrawal) Act 2018 aims to incorporate EU laws into UK law, which means that most laws will not change significantly. However, Brexit is going to mean big changes for many business relationships. That's why it makes sense to evaluate the potential impact on your commercial contracts.

Here's our guide to some of the key legal and contractual issues you may want to be considering now.

Audit your existing contracts and assess the effect Brexit may have on your rights and obligations.

Engage with your clients and suppliers to discuss possible Brexit scenarios and consider whether contracts should be revised and renewed now or in the future.

Currency fluctuations could impact your firm significantly. You may want to incorporate a price adjustment mechanism in relation to the pound's value into any new agreement.

You may need to ensure that your intellectual property continues to be protected in the EU post-Brexit.

Similarly, if you have any EC trademarks, these may need to be converted into UK ones.

As you assess regulatory and licensing requirements in EU countries, you may decide that a cost-effective solution could be to open up a subsidiary or local branch in an EU territory. However this might mean that you need to appoint a local representative based in that territory.

If your commercial agreements have the EU as their territorial scope, this may need to be re-drafted. We will have a better understanding of this once the manner of Brexit and the nature of the UK's new relationship with the EU have been decided.

If Brexit has a particularly serious impact on a contract, it may be that you want to establish grounds for terminating or renegotiating. In this event, you may seek to argue material adverse change or force majeure clauses as grounds for ending the current contract.

Moore Kingston Smith can support you through the transition and advise on any steps necessary to safeguard your business interests and maximise new opportunities, please visit our Brexit hub (**www.mks.co.uk/brexit-hub**) for more details.

CASH MANAGEMENT

Are you getting the interest you deserve from cash on deposit?

For the last decade, UK interest rates have remained at historically low levels. Insecurity over the future has led to many professional services firms holding considerable cash balances. In addition, most professional firms are holding significant tax reserves on behalf of their partners at any point in time. Unless your finance team is actively switching accounts, chances are that you are not receiving a great deal of interest on the cash you hold.

Cash management services have been around for some years, but have grown in popularity in the last decade. A cash management service enables your firm to benefit from active management of its cash, placing it in accounts that offer the most appropriate highest yield to meet liquidity preferences, i.e. how much is needed on instant access, how much can be held for three, six or 12 months, etc.

This enables deposits to earn consistently competitive interest and ensure your firm's cash is working hard while you save time, effort and worry.

SECURITY

Capital is only held in cash deposit accounts with banks and building societies from the whole UK market, providing access to over 200 institutions and 10,000 deposit accounts. All institutions are constantly monitored using data from rating agencies (e.g. Moody's) and published accounts and provides FSCS protection up to £85,000 per institute. Cash is held solely in your firm's name only, never in a third-party account.

Talk to us if you would like to speak to one of our advisers about whether a cash management service would be right for you.

VAT & TAX ON OVERSEAS PROPERTY-RELATED SERVICES

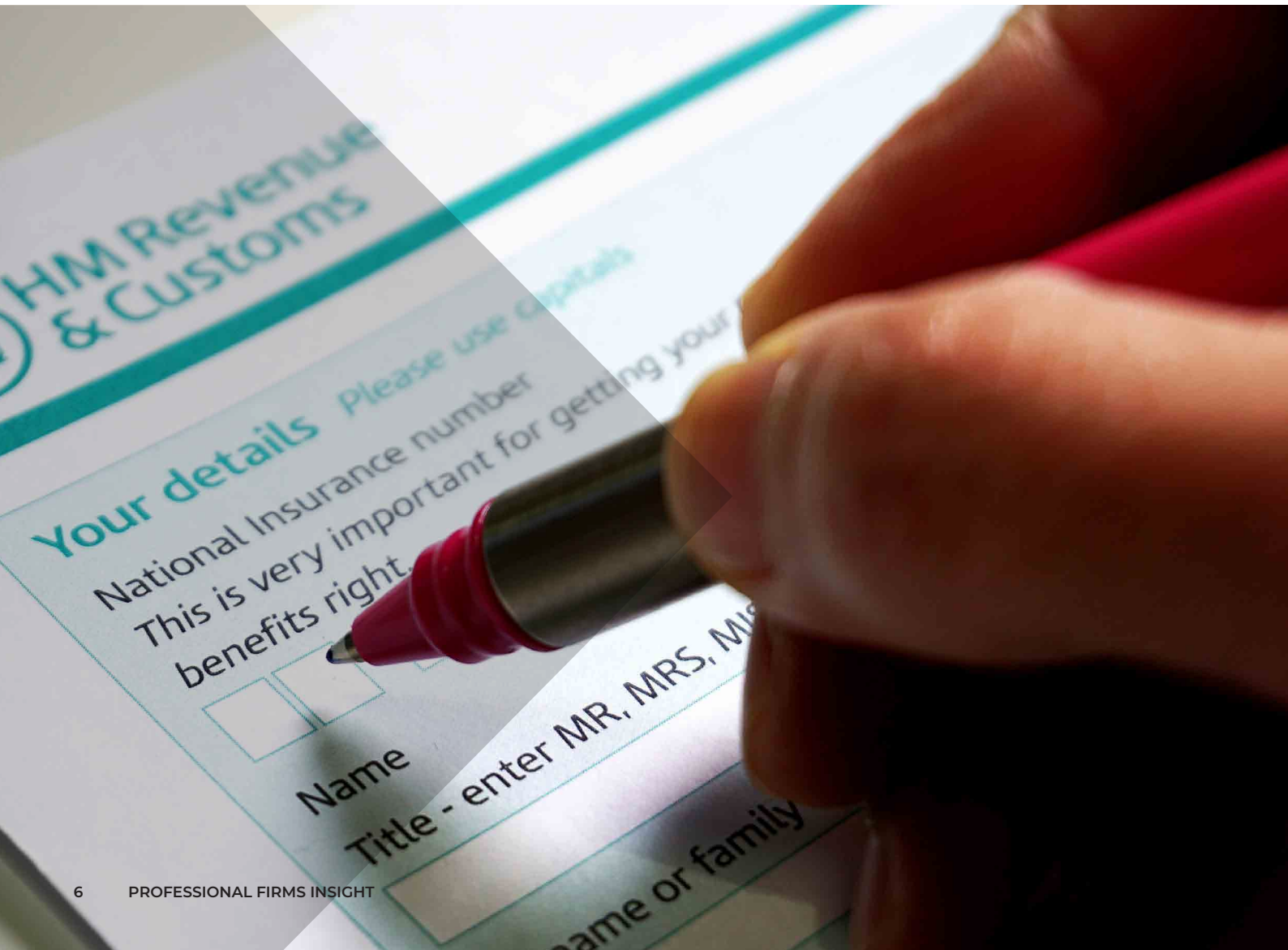
Professional services firms that take on property consultancy projects overseas, need to be aware of the VAT implications which can vary considerably from country to country, within the EU.

UK POSITION

By way of example if an overseas business provides land related services on a project that is located in the UK, VAT legislation dictates that, if the customer is established in the UK (it doesn't have to be VAT registered, but it will have to demonstrate that it is a) in business and b) using the services for a business purpose), the non-established supplier cannot register in the UK or charge UK VAT. It would treat the supply under the usual B2B rules (i.e. taxed where the customer belongs) and the customer would account for the reverse charge.

When a UK business is providing these services to the EU, on a project–by-project basis, the following should be considered:

1. If the client is established in the member state, can the reverse charge be applied or will the supplier have to register and account for VAT locally? If the client is established but not VAT-registered, would this make a difference?
2. If the client is VAT-registered in the member state, but not established, could the reverse charge be applied?
3. If the reverse charge can be applied, does it only apply to specific land-related services?
4. If the reverse charge applies, would the supplier be able to recover VAT that it incurs (it may for example employ a local subcontractor) by way of an 8th Directive/EU Refund Claim?
5. If the supplier should register, is there a registration threshold and is there a registration requirement to appoint a local agent?



VAT is not the only consideration where work is being done overseas and the following are some of the other key issues that should be considered:

- Will the UK firm come to have a "permanent establishment" in the overseas jurisdiction, the profits of which will be subject to some form of local income tax? This will depend on factors such as what kind of overseas presence the firm has, how long it will have it, the domestic legislation of the overseas country, and the terms of any tax treaty between that country and the UK. If local income tax does arise, then "double tax relief" will normally be available if the same profits are also taxed in the UK, but if the non-UK tax rate is higher than the UK tax rate there could be some tax leakage.
- If the UK firm will have employees working in the overseas jurisdiction, then will this give rise to any obligations? Such obligations could include the requirement to operate a payroll scheme, the requirement to withhold local income tax from salary payments, the requirement to make local social security contributions, and any number of other labour law requirements. Even if the UK firm has no obligations itself, will the employees have personal tax obligations that you will want to support them in?
- If the UK firm will be paying local subcontractors, will this come with any reporting or withholding tax obligations?

When considering overseas activities, professional services firms should ensure they get local advice as early as possible, as additional tax and compliance costs could have a significant impact on the commercial feasibility of the project. Please contact Andrew Constable **(aconstable@ks.co.uk)** if you would like to discuss this further.

HOW WE CAN HELP

Moore 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.

Moore Kingston Smith is a member of Moore Stephens International, one of the world's leading global accounting and consultancy networks, incorporating over 260 firms worldwide with combined fees in excess of US$ 3.06 billion and more than 30,000 people.

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

CONTACT US

Devonshire House
60 Goswell Road
London
EC1M 7AD

t: +44 (0)20 7566 4000

City

John Staniforth
jstaniforth@mks.co.uk
020 7566 3644

Jamie Sherman
jsherman@mks.co.uk
020 7566 3833

Clare Harrall
charrall@mks.co.uk
020 7566 3690

Ryan Day
rday@ks.co.uk
020 7566 3641

Becky Shields
bshields@mks.co.uk
020 7566 3634

Offices also in:

Heathrow
Jonathan Seymour
jseymour@mks.co.uk
020 8848 5500

Romford
Steve Rushmer
srushmer@mks.co.uk
01708 759 759

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

Redhill
David Montgomery
dmontgomery@mks.o.uk
01737 779 000

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

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www.mks.co.uk

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