Tax Talk

Simplifying the complexities of Tax

June 2021

PKF

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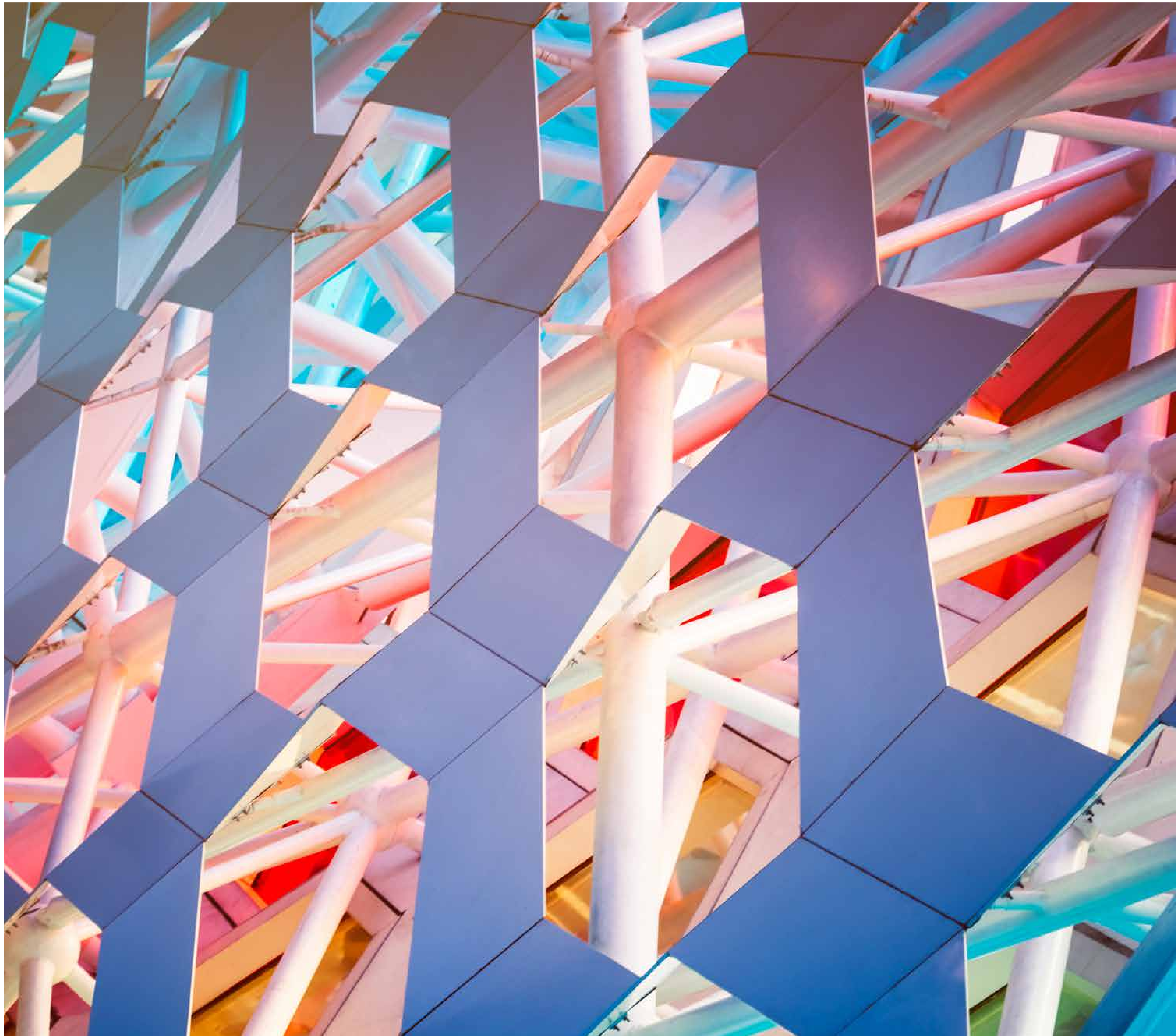
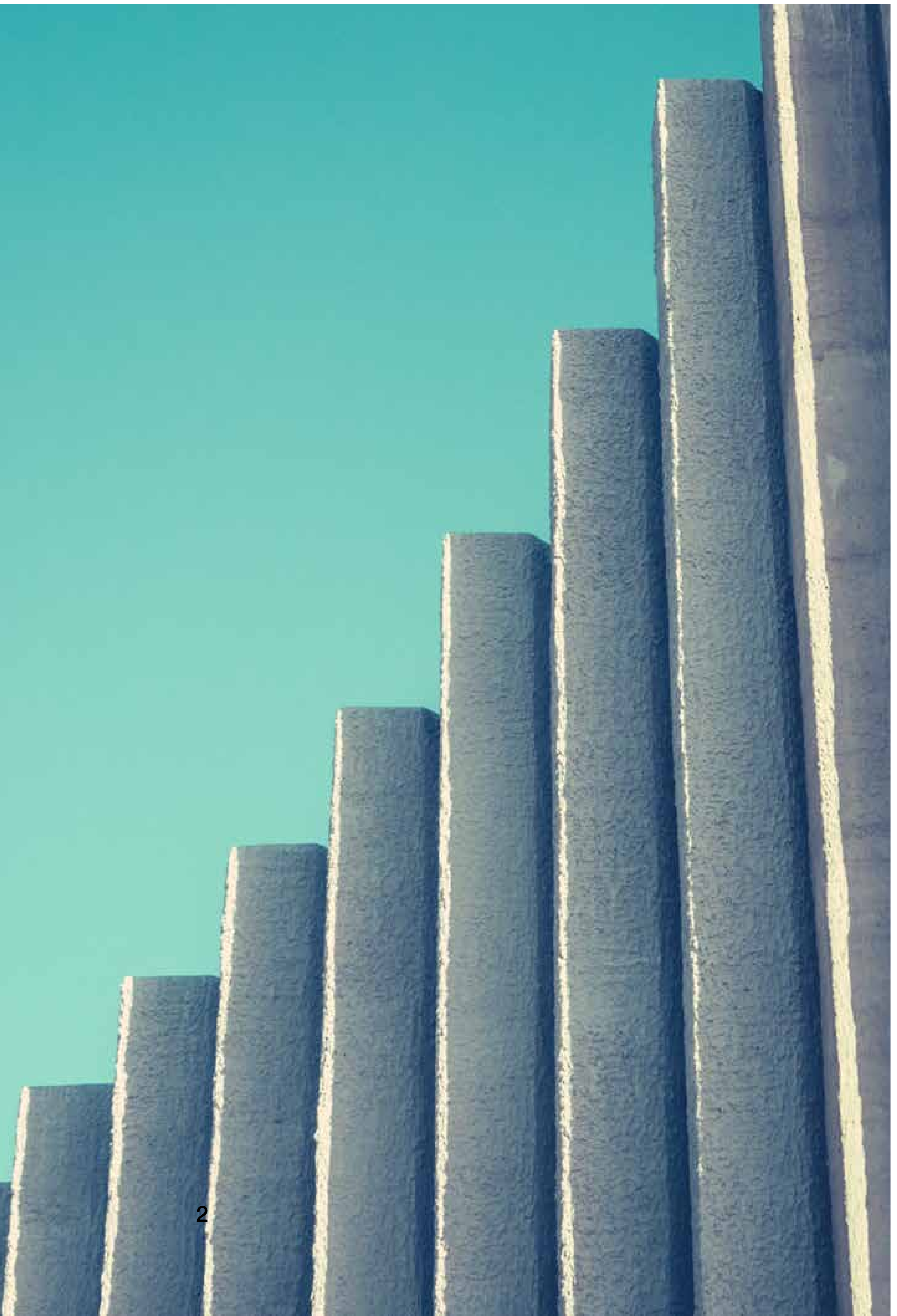
Tax Talk: June



Corporate debt restructuring in COVID-19 times



Over the past 15 months many businesses have been adversely impacted by the economic disruption caused by COVID-19. While the Government has provided significant financial aid to the business sector, companies of all sizes have needed to review their debt burden to ease the economic distress caused by the pandemic.

This has led to companies reorganising their debt via interest and capital payment holidays, debt equity swaps or debt forgiveness. Nonetheless, these measures can have unforeseen tax consequences. Therefore, it's crucial to understand the situations which can result in a tax liability and how available exemptions can be accessed before making changes to debt terms or structures.

This article covers some of the more common issues that can arise and how they can be managed without unnecessary tax expense.

Debt releases

Releases between third parties

Generally, when a third-party lender releases the borrower from their debt for no consideration a tax liability can arise as a credit will be recognised in the borrowers accounts. If a taxable credit does arise there may be losses available to shelter the potential tax liability. However, this will use up a relief which may have been applied to group profits or against profits generated by the company in the future.

There are provisions that prevent such a credit from being taxable in a distressed borrower. Under the corporate rescue exemption, where it can be reasonably assumed that if the release hadn't been entered into there would be a material risk of the borrower not being able to repay their debts within the following 12 months, the credit arising is not taxable. This doesn't require the borrower to be in an insolvency procedure, but HMRC guidance does require the company to be in significant financial distress and so advice is recommended to establish whether this requirement is met.

It's possible to obtain advance clearance from HMRC that an exemption applies in certain circumstances when for example, there's some doubt about an exemption applying.

An alternative approach to debt forgiveness is a debt for equity swap, where the lender takes company shares in exchange for the debt it holds. A release in these circumstances is normally tax free provided a number of conditions are met.

Releases between connected parties

It's important to point out that when the lender and borrower are connected debt forgiveness will not normally be taxable, although there are circumstances in which this exemption doesn't apply.

For these purposes, a borrower is connected with a lender, if the lender 'controls' the borrower. Control is normally determined by the lender holding more than 50% of the share capital, together with voting rights in the borrower. This exemption will normally apply where, for example, a company has borrowed from its parent.

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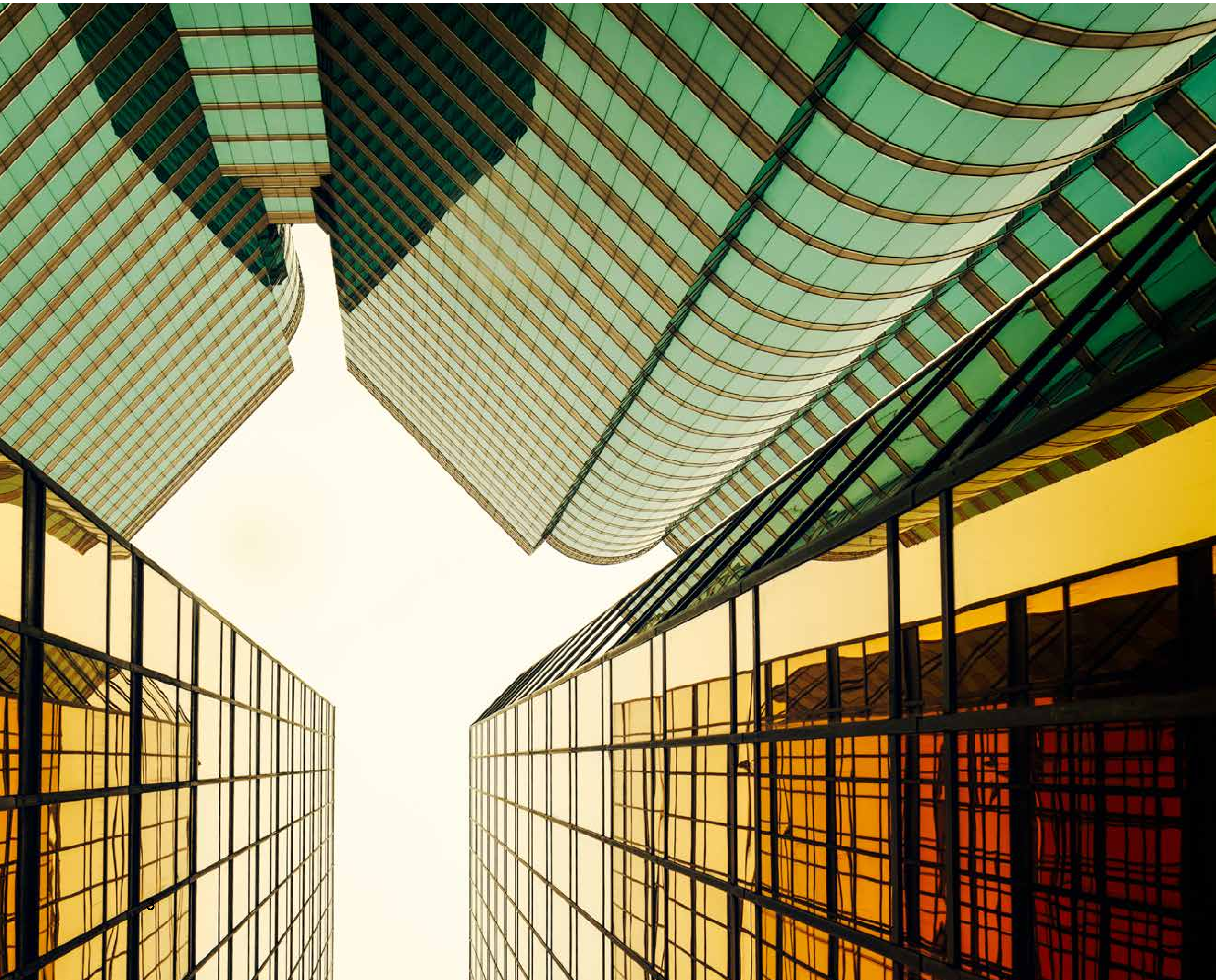


Debt modifications

Under current circumstances debt modifications rather than an outright release are more common.

They can occur when the lender formally agrees to a reduction or postponement of interest payments and can also give rise to a tax liability. Whether such a liability arises will depend on the accounting treatment applied in respect of the modification. If the modification triggers a credit in the profit and loss account under general principles this will be taxable. By contrast, simply not enforcing the payment of interest when it falls due, shouldn't in itself normally give rise to a tax charge. However, all circumstances causing such a suspension of payment should be investigated to confirm the tax treatment.

The accounting treatment for modifications can be complex under FRS 102 or IFRS 9 and, if a modification is classified as 'substantial' an accounting adjustment can occur which may be taxable. If an accounting profit does arise under a modification, the corporate rescue exemption mentioned above can still apply without taxing the profit.

Refinancing

Normally a refinancing of debt at maturity shouldn't result in adverse tax consequences. taxation. The borrower will simply be repaying existing debt with funds from a new finance provider and no profits or gains should be recorded in the company's accounts. Where such refinancing takes place with an existing lender, care should be taken to ensure whether there's been some form of release or modification of the original debt.

Summary

When a company is experiencing financial difficulties and is looking to reorganise its debt it's essential to ensure the solution doesn't result in an unforseen tax charge. Addressing potential tax issues as early as possible in the process is key to ensuring the timely implementation of any reorganisation.

Tom Gareze
Partner

+44 (0)20 7516 2212
tgareze@pkf-l.com

Import One Stop Shop (IOSS)

IOSS will be introduced on 1 July 2021 with the aim of simplifying the importation and customs process for e-commerce businesses importing low value goods into the European Union (EU).

This will apply to those that make distance sales into the EU and online marketplaces that enable the sale of goods located outside the EU at the point of sale to EU consumers. Following the UK Exit from the EU from 1 January 2021, this will apply to all e-commerce businesses selling goods to EU customers.

At present, goods valued up to €22 can be imported into the EU free from import VAT. However, under IOSS this relief will be withdrawn and shipments valued at €150 or less, excluding VAT, can be imported into the EU without being charged import VAT or customs duty.

Instead of import VAT, sales VAT would be charged by the seller, based on the VAT rate of the goods in the country in which they are sold. For example, if selling to a customer in Germany, VAT of 19% would apply. This should prove beneficial for the buyer, as it gives them some certainty on the VAT rate they can expect to be charged for their goods and removes the risk of any unexpected costs upon import and delivery.

The IOSS isn't compulsory, so should a business decide not to register, Incoterms will need to be considered. This could result in an EU VAT registration obligation for the business in the countries it sells to, including paying the import VAT when the goods enter the EU. Alternatively, the customer may be required to pay the import VAT when the goods arrive in the EU, which may not be ideal from a commercial point of view. Accordingly, IOSS is likely to give significant commercial and operational benefits for businesses who meet the criteria.

Businesses that meet the criteria can register for IOSS in either an EU member state of their choice, or in the UK. Once registered, they will be required to submit a monthly IOSS return via the portal of the country of IOSS registration, which will record the total VAT payable and the VAT rate applicable for sales made in all EU member states. In addition, they will need to retain their IOSS records for ten years.

Conditions of entry

The following conditions will need to be met in respect of sales to qualify under IOSS:

- The total consignment value must not exceed €150;
- The goods sold into the EU must not be subject to excise duties, eg alcohol, tobacco; and
- The goods must be dispatched or transported from outside of the EU at the time they are sold.

Online marketplaces

If goods are sold to EU consumers through an online marketplace, it's the online marketplace that's deemed to have made the sale and is liable for EU VAT. Therefore, the online marketplace will need to register for IOSS and account for EU VAT due on the sale. The business selling through the online marketplace will be making a zero-rated supply to the online marketplace and therefore isn't required to register for IOSS.

Import One Stop Shop (IOSS)

Points to consider

It's likely non-EU established businesses will need to appoint an EU-established intermediary to comply, and this intermediary will be jointly and severally liable for the payment of VAT under the IOSS. However, an intermediary isn't required if the business is established in a country with which the EU has concluded an agreement on mutual assistance. Currently, Norway is the only jurisdiction which meets this condition, but it's possible that similar agreements could be reached for countries such as the UK.

It's also worth noting that businesses that import goods into the EU valued at more than €150 won't be able to take advantage of the IOSS scheme. Consequently, the goods will be subject to import VAT upon entry to the EU member state, including the usual customs procedures and VAT registration requirements.

At the time of going to press, HMRC has confirmed that the UK IOSS registration portal won't be ready for the 'go live' date of 1 July 2021, and further HMRC guidance is expected towards the end of June. Therefore, businesses keen to register for the scheme from its introduction will need to select an alternative jurisdiction to register in.

How we can help

PKF is a global network operating in over 150 countries across five regions. Our indirect tax experts across Europe specialise in providing high quality VAT advisory and compliance services to businesses that make distance sales into the EU. We have ample experience to advise and guide you on EU VAT requirements to ensure that your business is compliant, as well as recommend appropriate schemes to simplify your indirect tax reporting obligations.

Claire Gillings
Manager

+44 (0)20 7516 2448
cgillings@pkf-l.com

Tax on separation and divorce

As a relationship begins to break down, tax is unlikely to be at the front of anyone's mind. Nontheless, it's worth considering the potential tax liabilities when negotiating financial settlements. Your lawyer will need to work closely with your tax adviser during this process to avoid any unexpected tax obligations.

Capital Gains Tax (CGT) principles

The general rule for Capital Gains Tax (CGT) purposes is that when an individual makes a gift of a capital asset to another, it's treated as having taken place at Market Value (MV). However, when the transfer is between spouses or civil partners living together, a special rule deems these transfers to take place for a consideration that gives rise to no gain and no loss.

CGT in the tax year of separation

A couple may be separated by agreement or by a Court Order, or simply in circumstances that are likely to be permanent. They can still be 'separated' while occupying the same home if they're living their lives free of each other's marital control.

For CGT purposes no-gain-no-loss rules continue for the tax year of separation,ie until 5 April following the date of separation.

With an amicable divorce, where there's agreement concerning asset transfers, it may be possible to complete the transfers before 5 April ensuring the no-gain-no-loss treatment is available. This ensures that no CGT would be due by the donor of the asset.The recipient of the asset will inherit the donor's base cost for any future disposal.

CGT after separation

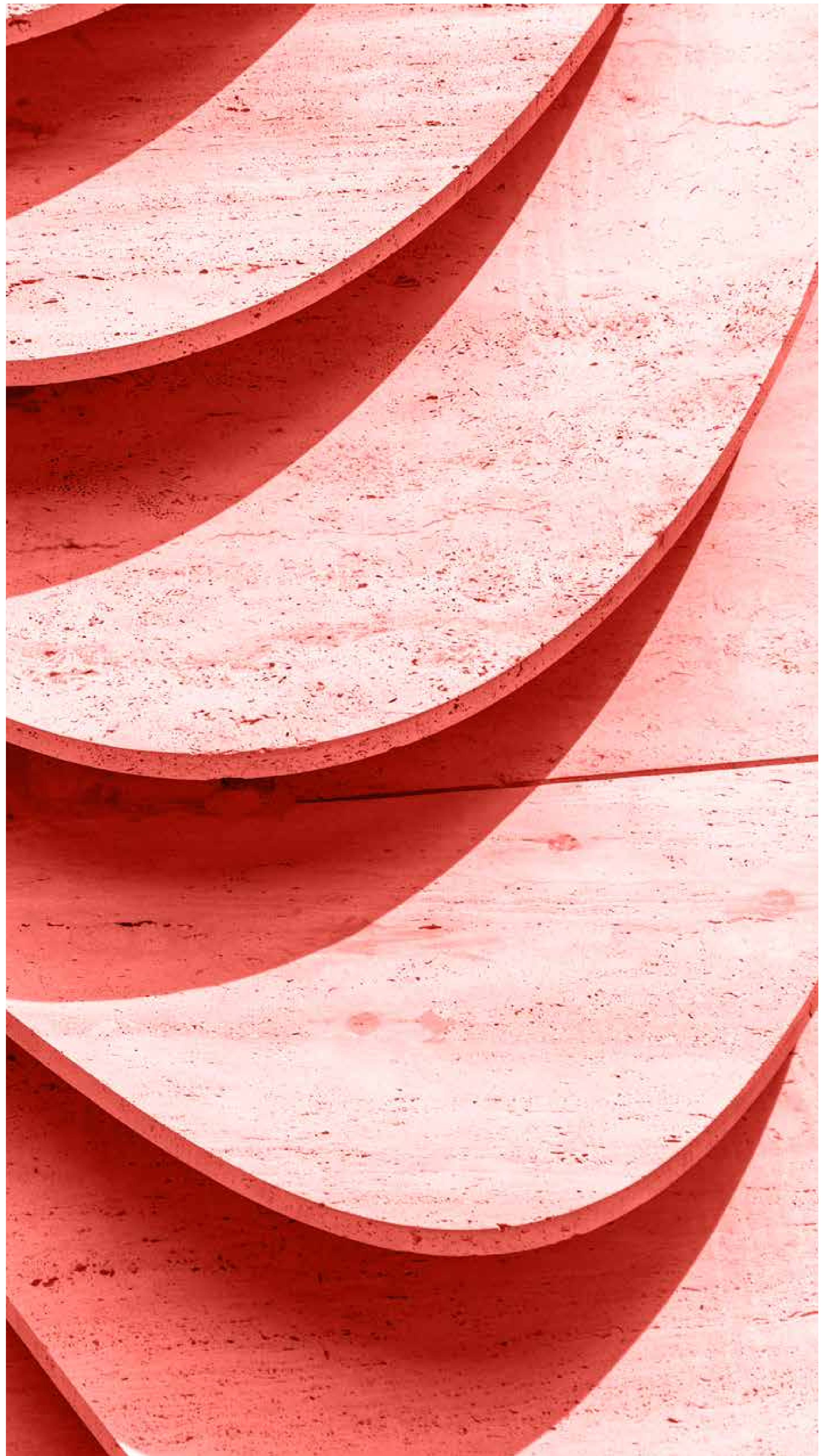
In practice, such early transfers of assets are unlikely, even in an amicable divorce. Separated couples remain 'connected persons' up to the date of the Decree Absolute,which means that transfers between them will take place at market value until then. The donor will therefore be liable to CGT on any gains and the set-off of any losses made will be restricted to future gains in transactions with the same person.

After the Decree Absolute, transactions between them that result from agreement of a financial settlement will be treated as made for consideration. Outside of that, transactions may be treated as arising for market value to the extent that they're not bargains at arms-length.

The sale of the matrimonial home

For many couples, the main asset will be the matrimonial home which may need to be disposed of as part of the divorce with the proceeds divided between them. The key concern here will be if one of the parties has left the property and is living in new accommodation.

Tax on separation and divorce



A normal disposal of the matrimonial home would likely have the availability of Principal Private Residence (PPR) relief. However, this could be restricted by the size of the grounds or by having multiple properties. There are various rules to qualify for PPR relief, this is then based on periods of occupation, deemed occupation and other qualifying periods. Full PPR relief would mean there isn't liability to CGT on the disposal. In addition, a qualifying PPR property will also have the availability of deemed occupation for the final nine months of ownership.

An individual can only have one qualifying PPR property at one time (an election can be made where more than one property is held). Where one party moves out of the matrimonial home into a new property, and the marital home is not sold within nine months, there may be tax implications for that party on the disposal. Conversely, where the other party remained in the home up until the disposal, they may not be liable to CGT on any of the disposal.

The transfer of the matrimonial home

As part of the divorce proceedings, one partner may receive full ownership of the matrimonial home. It's likely that this transfer of the interest in the property would take place at market value, however, it could be treated as for actual consideration in a financial settlement.

It's generally established that where a transfer of a share in a property which includes the right of occupation of the residing spouse a 15% discount can be applied to the value.

For example, if the property was valued at £1m, the MV of the half share would be £500,000. Discounting this by 15% would mean a taxable transfer value of £425,000. If this was transferred within nine months of moving out of the matrimonial home, this disposal could be covered by PPR relief. Should this be longer, an election can be made for the matrimonial home to be treated as their PPR, however, this may affect future PPR relief available if they've moved into a second property.

Inheritance Tax (IHT)

The transfer of assets between spouses and civil partners is exempt for IHT purposes up until the Decree Absolute.

After this date, any transfers between these parties may qualify for other reliefs but, if not, are treated as Potentially Exempt Transfers and there can be IHT consequences should the donor die within seven years.

Summary

If working through an amicable separation, it will be in the best interest of both parties to agree on at least some of the assets that need to be transferred before 5 April. Where this isn't possible, it's essential to be aware of the various tax implications of transferring assets and seek professional advice.

Phil Clayton
Senior Manager

+44 (0)20 7516 2412
pclayton@pkf-l.com

Taxation of Cryptocurrency

The popularity of cryptocurrency has exploded over recent years with many jumping onto the bandwagon in the hope of making a quick profit. Being a comparatively new form of asset, there's a misconception that they're a form of tax-free gambling. However, this is simply not the case. Like any form of asset, the purchase and sale of cryptocurrencies can create various personal tax implications that you should be aware of.

HMRC doesn't consider cryptocurrency to be legal tender and has identified three types of crypto assets:

Andrew McCready
Associate

+44 (0)20 7516 2272
amccready@pkf-l.com

- Exchange tokens: These are intended to be used as a method of payment and cover most cryptocurrencies such as Bitcoin . The value of the tokens exist as a means of exchange or investment and, unlike utility or security tokens, they don't provide any rights or access to goods or services.

- Utility tokens: These give the holder access to specific goods or services. A business will normally issue the tokens and commit to accepting them as payment for the goods or services in question. Utility tokens issued by Golem are one example.

- Security tokens: These provide the holder with a particular interest in a business, for example a debt due by the business or a share of profits in the business. Polymatch is one such supplier of security tokens.

Depending on the nature of trading cryptocurrency, the profits generated may attract Capital Gains Tax (CGT), or in some circumstances, Income Tax and National Insurance (NI).

Capital Gains Tax

The buying and selling of cryptocurrency would normally be considered an investment as opposed to trading.

A disposal for CGT purposes includes the following:

- Selling cryptocurrency for a profit or loss;
- Selling one type of cryptocurrency for another, eg selling Bitcoin and purchasing Ethereum;
- Using cryptocurrency to pay for goods or services; and
- Gifting cryptocurrency to another person.

In order to calculate a potential CGT liability, you must convert the value of your cryptocurrency to Pounds Sterling, using the relevant exchange rate at the date of disposal and keep a record of your calculation. Certain costs are allowable against tax, including the purchase cost of the asset, transaction fees and any valuation costs.

If you realise a gain on the transaction, you may be liable to CGT on the amount above the Annual Exemption (currently £12,300). CGT is chargeable at either 10% or 20% dependent on whether you are a basic-rate or higher-rate taxpayer.

A realised loss on the sale of a cryptocurrency investment can be used to reduce your capital gains in either the current or future tax years. However, you must report the capital loss to HMRC in order for it to be allowable. You must claim the loss within four years following the end of the tax year in which the loss was realised, ie a loss in the tax year ended 5 April 2021 must be claimed by 5 April 2025.

Taxation of Cryptocurrency

Income Tax and NI

In a number of circumstances, you may be liable to Income Tax and NI on your crypto assets which is determined by a number of factors.

If you're buying and selling cryptocurrency through day trading, ie multiple transactions on a daily basis, HMRC may consider your activities as 'trading' and you could be liable to Income Tax and National Insurance on the profits.

When determining if a trade is taking place, HMRC will likely draw upon existing case law on trading in shares and securities. While there's no set limit of transactions which may amount to a 'trade', the average individual is unlikely to be affected by this. If your activities do amount to trading, any realised trading losses may be available to offset against other income received in the year. In addition, if you receive cryptocurrency as a form of employment pay, you may be liable to Income Tax and NI on the amounts received.

Cryptocurrency mining

Cryptocurrency mining has become increasingly popular over the past few years. Mining uses computers to solve complex maths puzzles in order to generate cryptocurrencies. The level of mining may not be sufficient to be considered a trade by HMRC; however, any cryptocurrency awarded through mining will be taxable as income with any appropriate expenses reducing the amount chargeable to Income Tax. What's more, if the mined cryptocurrency is kept, their future disposal may be liable to CGT.

Further points to consider

Non-domiciled individuals – When calculating your tax liability on the remittance basis you should treat income and/or profits of cryptocurrency as UK source income. HMRC considers that while you're a UK resident, the exchange tokens you hold as a beneficial owner are located in the UK.

Inheritance Tax – HMRC views cryptocurrency as 'property' for Inheritance Tax purposes, which means it will form part of your estate on death.

If you have a company, you would be liable to corporation tax on any gains or trading activity undertaken.

The rules regarding the taxation of cryptocurrency can be complex. If you're unsure of the UK tax treatment of your cryptocurrency, it's important you seek appropriate tax advice. Please feel free to reach out to us for further information.

A welcome ‘marginal’ change in corporation tax

For those who remember Marginal Relief (MR), you were probably excited when the Government announced the changes to the rate of Corporation Tax (CT) in the 2021 Budget.

From 1 April 2023, there will be a ‘Small’ profits rate of 19% for profits up to £50,000 and a ‘Main’ rate of 25% for profits above £250,000. Between these two limits there will be a ‘Marginal’ rate of 26.5%. This is to ensure that those with profits over £250,000 are taxed at 25%. Let’s take an example of a company with profits of £250,000: the first £50,000 is taxed at 19% and the next £200,000 at 26.5% meaning a total liability of £62,500 (£9,500 plus £53,000) resulting in a rate of 25% with the relevant MR fraction being 3/200ths.

These limits will be apportioned for both short accounting periods and associated companies. There’s an exclusion for property investment companies, while close investment holding companies and non-resident companies will pay the full rate of 25%.

A welcome ‘marginal’ change in corporation tax

To work out the MR we need to know the augmented profits. These are the profits chargeable to corporation tax plus any exempt distributions received by the company that aren’t excluded. This includes: regular dividends; other distributions in respect of shares; the transfer of assets or liabilities treated as distributions in specie; and bonus issues following repayment of share capital. Dividends received from subsidiaries or other group companies of which the recipient is a 51% group company are excluded.

The MR is calculated as:

(MR fraction x (Upper profit limit – Augmented profits) x Taxable profits)/Augmented profits

Let’s look at an example:

PKF Limited is a standalone company, with a year end of 31 March 2024. It has chargeable profits of £170,000 and dividend income from a non-UK group company of £70,000.

This means that the profits chargeable to corporation tax are £170,000 and the augmented profits are £240,000. Therefore the corporation tax liability can be calculated as follows:

£170,000 x 25%	42,500.00
Less: (3/200) *((£250,000 - £240,000) x £170,000/£240,000)	(106.25)
	42,393.75

Foreign dividends mean that the marginal rate of tax on the excess profit above £50,000 is greater than 26.5%.

£50,000 x 19%	9,500.00
£120,000 @ 27.411%	32,893.75
	42,393.75

It should be noted that the profit limits will be divided by the number of associated companies (not the number of 51% group companies) and they’re also reduced if the chargeable accounting period is less than 12 months.

Perhaps it’s time to review group structures for consolidation and elimination of surplus companies where appropriate?

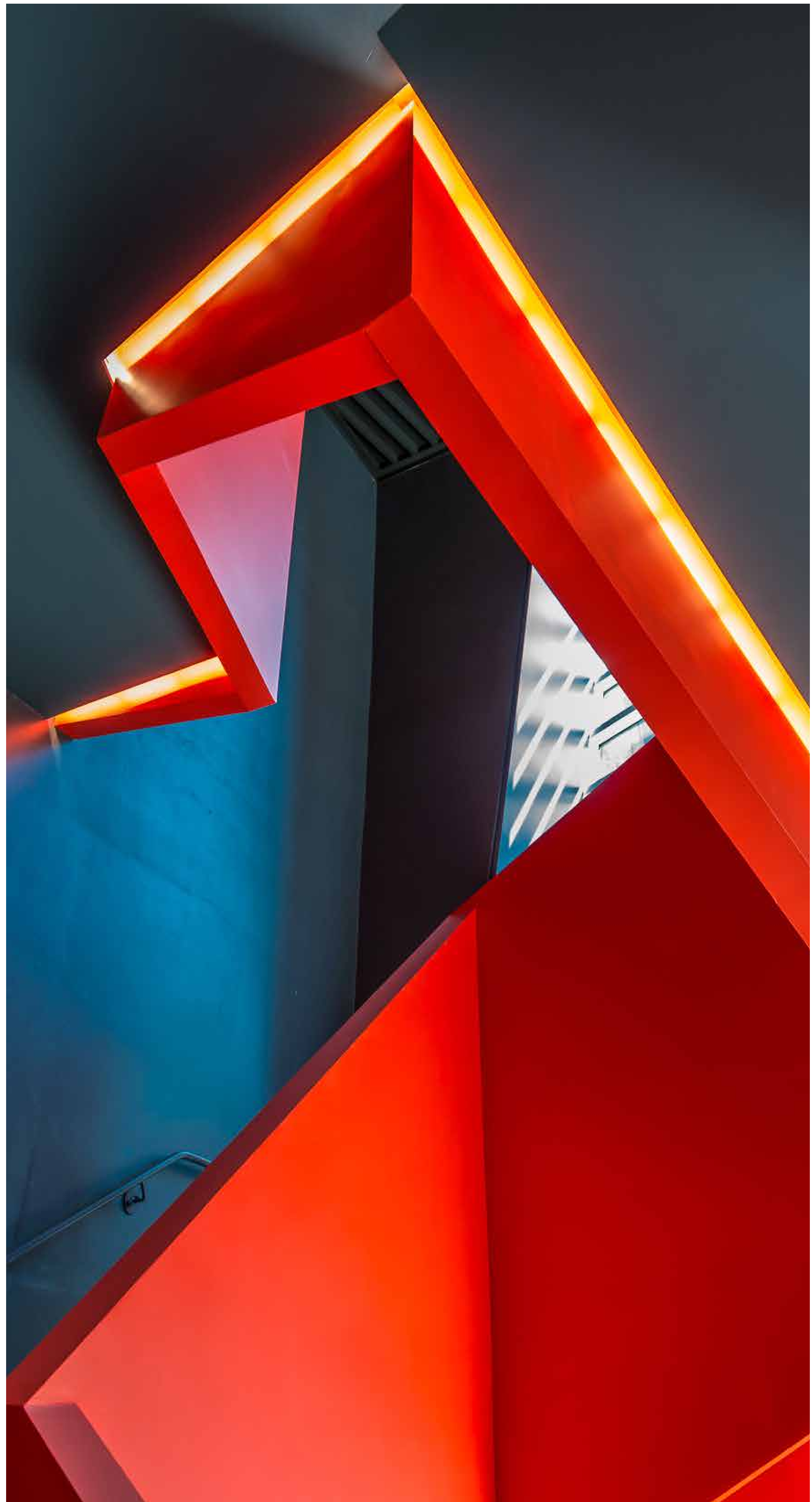
A company (whether UK resident or not) is associated with another company at a particular time if, at that time in the chargeable accounting period one company has control of the other, or both companies are under the control of the same person or group of persons. Control exists where a person exercises, or can exercise, or can acquire direct or indirect control over a company’s affairs. This includes reference to share capital, voting rights, distributable profits and assets available for distribution. However, if there’s no substantial commercial interdependence between the companies, these rules are ignored. Companies that haven’t carried on a trade and passive holding companies are also ignored.

What’s the impact of these changes?

- Profit extraction strategies will be impacted with the increase in corporation tax rates and these should be reviewed;
- There will be an increase to tax charges in the profit and loss of financial statements, which could be significant if distributable reserves are stretched; and
- The overall strategies of groups should be reviewed to ensure tax efficiency.

Catherine Heyes
Partner

+44 (0)20 7516 2237
cheyes@pkf-l.com



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 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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8th largest Audit practice in the UK in the latest Accountancy Daily rankings

£150 million annual fee income

2,030 UK partners and staff

6th 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, 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.

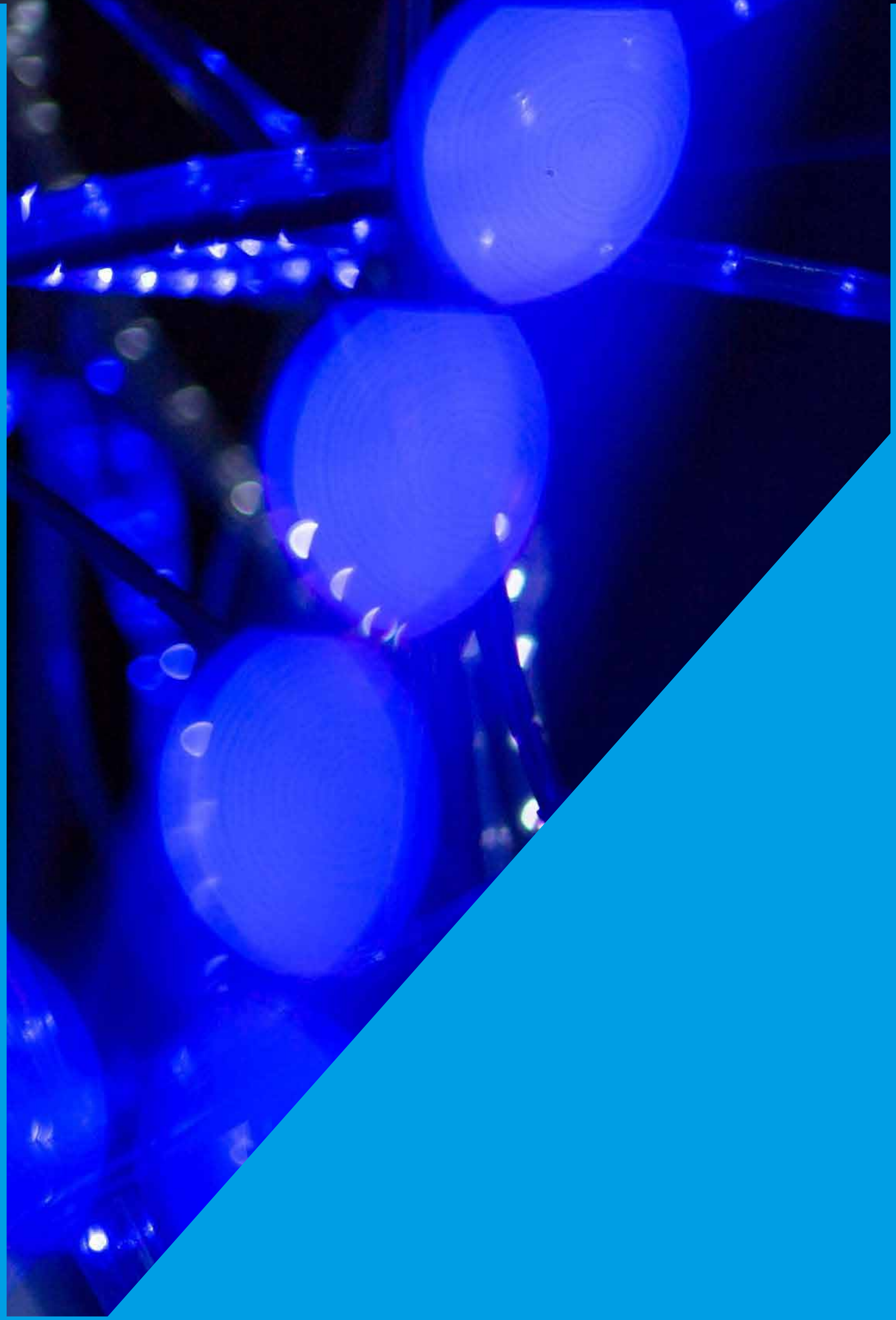
Read more

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



PKF Littlejohn LLP,
15 Westferry Circus,
Canary Wharf,
London E14 4HD

Tel: +44 (0)20 7516 2200
www.pkf-l.com