Infocus

Experts Update

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UK200Group expert panels and forum comprise of skilled technical advisers who work independently or as part of a multi-disciplinary business team to achieve the best possible solution for members and their clients. Each adviser brings experience from the different disciplines of tax, corporate finance, forensic accounting & dispute resolution, business strategy, business recovery & insolvency and international business.

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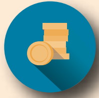

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Watch out for washing up

Businesses often have to collect tax and forward it to HMRC. The most obvious example is PAYE, but others include:

- Construction Industry Scheme
- Non-Resident Landlord's Scheme
- Paying interest on loans

It is vitally important to operate these schemes correctly, as getting it wrong may mean that you effectively have to suffer the tax yourself.

The crucial thing to be aware of is that although in every case you are paying the tax over on behalf of someone else – so strictly it's not your tax liability - the cashflow has to come from you. If you get it wrong HMRC may well demand the cash from you anyway, and they are often very hard-nosed about this.

In theory you can recover the cost from the other person; in practice, this is often impossible.

For example: if you pay £100 to a CIS subcontractor and fail to deduct 20%, then the subcontractor will eventually have to pay £20 tax on that £100 in their self-assessment return. With £20 tax paid on £100 income it's all come out in the wash, so you might expect there to be no problem.

However, although HMRC will happily take £20 from the subcontractor, the person who should suffer the tax, they will also demand it from you, the person who should pay it. They will point out that this is fair, because if the subcontractor repays you the £20 they can claim it back from HMRC.

So: to fix the problem, a subcontractor needs to voluntarily put himself out of pocket and tell HMRC his own tax return needs to be looked at, all for your benefit…

Note that HMRC's enquiry could be several years after the event, so even contacting the subcontractor could be tricky.

Similar principles apply to VAT, although VAT is due on receipts rather than payments. If you under-charge VAT, HMRC will take the correct amount from you and leave you to reclaim it from the (former) customer.

The theory is fine: things can come out in the wash. The practice is different: no-one wants to do the washing-up.

Be very careful calculating other people's tax liabilities!

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Potential changes to reduced rate VAT

Installation of energy saving materials

At present, under UK law, the installation of energy saving materials in residential accommodation is subject to VAT at the reduced rate of 5%.

The materials themselves can also be reduced rated if they are supplied by the person who installs them.

Anyone who acts for plumbers, builders, or electricians will be familiar with the list of items in VAT notice 708/6 which qualify for the reduced rating such as controls for central heating systems, wood fuelled boilers, solar panels, and insulation.

In 2012, the European Commission began infraction proceedings against the UK as they considered that we applied the reduced rate too widely and that the majority of the transactions should be standard rated. The European court published its decision in June 2015 and found in favour of the European Commission.

In accordance with EU law, the reduced rate should be introduced as part of a social policy and targeted at certain areas of the population whom the policy is intended to help. By allowing the reduced rate to apply to all residential installations, rather than just to certain sectors of the community deemed to be in need, we are seen to be acting outside the EU regulations.

At the present time, UK law has not been changed and HMRC have indicated in Revenue and Customs Brief 13 (2015) that if there are to be any legislative changes, they will not be implemented before Finance Act 2016.

Whilst this does give us some leeway to continue treating installation of energy saving materials as reduced rated, we should be contacting any clients who deal in this industry and making sure they are aware of the potential changes and have proper systems in place to deal with the changes if and when they arise.

As this relates to residential properties, the vast majority of customers will not be able to recover the VAT they are charged and so prices will usually be quoted as VAT inclusive. Suppliers will need to reconsider their pricing structure to ensure they are not out of pocket should the VAT rate of 20% apply.

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Corporate Finance

Minority Discounts

An interesting aspect of the case of Foulser & Foulser v HMRC was the level of discounts to be applied in valuing minority shareholdings in companies. The case itself focussed on other matters, but the continuation hearing held earlier this year dealt with determining the market value of a 51% and a 9% shareholding in a private company.

Experts for both sides suggested very different valuations (£6.0m and £17.5m for the 51% shareholding, £0.2m and £2.1m for the 9%) and the court decided to go back to first principles in selecting a suitable valuation methodology. As a result, the court determined an entirety (whole company) value of £39.0m.

Discount for a 51% shareholding
HMRC's expert suggested a 15% discount, based on a range of 10% for mature companies to 15% for expanding companies. The claimants' expert suggested a 20% discount, based on a range of 20% to 25%, due to the specific facts of the case – there was a 40% shareholder who had effectively prevented a previous proposed disposal. The court decided to apply a 20% discount, pretty much following the approach of the claimants' expert.

Minority Discount for a 9% shareholding
The claimants' expert did not suggest any discount as he had valued this parcel of shares on a dividend yield basis. HMRC's expert suggested a 40% discount based on a 'normal' discount for a shareholding of this size of 50%, but reduced by the facts of the case (essentially that the company was in expansion phase and had received bid approaches). The court decided to apply a 50% discount, based on the latter expert's asserted normal level, without further adjustment as these factors had been taken into account in arriving at a suitable valuation multiple.

Conclusions
Obviously the facts of each case are unique and a 'one-size-fits-all' minority discount can't be deduced from this case alone. However, as a rule of thumb, and ignoring the specific facts of the case, I would have suggested that a 20% discount is generous for a majority shareholder. I would also have suggested a 50% discount for a 9% shareholder is on the low side and certainly would not have suggested this is the 'norm'.

It will be interesting to see the extent to which this case is referred to on the level of minority discounting (though being a first-tier tribunal case the decision does not constitute a legally binding precedent) or whether another case with completely different facts will go to court, resulting in a different range of minority discounts being determined.

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How to advise a client NOT to sell?

Two months ago our firm completed the sale of 100% of the shares in a company for c£2.5m. This was against the backdrop of an initial offer of c£1.8m – a reasonable result from negotiations one might surmise – why is it then I felt the right result had not really been achieved?

Our clients (two 50% shareholders) came to us and said they had received an unsolicited offer for purchase from a company that they knew well in the industry, but notably did not rate highly. From the outset it was clear that one shareholder was ready to sell and the other was not, something we discussed at length and provided a potential solution through the potential use of Purchase of Own Shares. Despite this, the younger shareholder understandably had reservations about the ability to run the company on his own but we talked about potential organisational restructures and development of further key staff to support him as a sole shareholder.

The negotiation process became more convoluted due to the lack of unified vision on the part of the directors. Not only was I dealing with the sale negotiation between vendor and purchaser, but I was negotiating between two vendors who had different ideas, agendas and motivators and even worse had ideas which changed from one week to the next. These differences ultimately became divisive in the obtaining of 'best price'.

With the lack of clarity as to 'what a good deal looked like' came my words "If you have reservations and don't feel ready to sell then it's not the right thing to do".

However, with pound notes on the table and the wearing effect of the constant internal differences the 'easy option' was to accept the offer and 'walk away' and ultimately that is exactly what the directors did.

Did the directors feel they had achieved a good deal? Yes. Could they have got a better deal? With an initial, informal broad value of c£3-4m, then probably.

Did we do the right thing telling the client not to sell? Yes. But sometimes we have to accept that we are Advisors and we can only do so much.

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Forensic Accounting & Dispute Resolution

The instructing professional

An important aspect of forensic work is to take instruction from the instructing professional such as a solicitor and to get this element right. Get it wrong and a lot of problems can ensue.

I am sure that none of the lawyer members of the Group are guilty of any of the difficulties I draw attention to below! However, perhaps where you are working with a legal practice for the first time or have had difficulties in the past, addressing the issues highlighted below should ensure the instruction has every chance of being a successful one for all concerned.

One has to establish at the very outset whether one is an expert representing one side in the dispute or whether the employment is that of a single joint expert. In the case of the latter there will be a joint instruction from both sides and one has to make sure that it is a joint instruction, with both sides singing from the same hymn sheet.

If it is a single joint expert witness appointment, then one has to ensure absolute neutrality and make sure any communication with one side is duplicated scrupulously.

I am wary about accepting SJE appointments at the best of times but particularly so where one party to the dispute is choosing to represent themselves rather than seek professional representation. They may not know or appreciate the processes particularly in the case of an SJE witness appointment and they can tend to ride rough shod over protocol, when passion gets the better of the professional's dispassionate approach. The result is that we can finish up being put into a difficult position.

We have had instances where we have received a professional instruction and then been subject to what I call mission creep. For example, imagine we take an instruction from a solicitor. We deliver what a solicitor has asked for but then the solicitor comes back for more information under the auspices of the original instruction and on the basis that the extra work is covered by the original fee quotation.

To protect all sides I always insist on written instruction. I always set these out in my own letter of engagement and in my covering letter I stress that my fee only covers my time up to submission of my report. Any additional work, such as follow up questions on the report or attendance at court, is subject to a further fee note. This is covered in the letter of engagement to avoid the need for a further letter of engagement.

Another problem is where the instruction is too ambiguous. Disappointment then arises when the professional receives the report and then asks questions which perhaps could have been addressed in the initial instruction. Sometimes this can be out of lack of experience of the valuation process where a business valuation is concerned. We as the expert can add value, guide and help one's solicitor in an expert witness appointment but not where one is appointed as a single joint expert.

Do make sure that you establish who is actually giving the instruction and who is paying the fee. The engagement could be with the client rather than the solicitor. The client may also be responsible for payment. Personally I always prefer it if payment is the responsibility of the solicitor and the instruction is coming from the solicitor as well.

One needs to make sure that one is given sensible reporting deadlines. The difficulty is normally in securing all of the information to execute and deliver one's report. We always stipulate delivery within so many weeks of receiving the last element of information needed.

One often finds that the solicitors have scheduled a court hearing which can seem reassuringly in the future but this can breed a false sense of security and this temporal safety net can be eroded with the solicitor needing a report at the eleventh hour. Some solicitors often with best of intentions may impose almost impossible deadlines on their reporting accountant to avoid judicial censure so one needs to be clear and assertive at the very outset where the proposed reporting time frame is not credible or achievable.

Other professionals can sometimes set unrealistic requirements in their summary of instructions. This could, for example, be if they were to ask about how a business might perform in the future. A valuer cannot speculate, but has to go on the facts. Whoever is instructing you needs to be advised and the instructions recast into a form which can be executed.

Nigel Whittle, another Partner in our Forensic Team, always says that you have probably done your job as a single joint expert witness if you have pleased neither party. If one party is elated and the other incandescent, then you may perhaps have got it wrong – but not necessarily.

Generally I have been very lucky in the quality of the professional instructing me but hopefully my experiences of where there have been issues will help you in completing this type of work to everyone's satisfaction, including your own!

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Business Strategy

"How to boil a Frog" - Disconnecting with strategy

Most businesses put their initial success down to a unique strategic positioning, one that usually involves trade-offs.

Its activities were almost certainly aligned with that position at the start.

The passing of time and the pressures of growth usually lead to compromises. A succession of almost imperceptible, incremental changes (each of which seemed sensible at the time) which lead to established businesses being homogenous with their competitors. I am not referring to the issue with businesses whose historical position is no longer viable. Their challenge is to start again. What is the issue here is the far more common situation; an established business failing to maintain a clear strategy and achieving mediocre returns or even being forced to cease trading. One frog nicely cooked. (Goose, even!)

The compromises occur in a variety of ways. Incremental additions to products; incremental efforts to service new customer groups; emulating competitors' activities. These all help lead to the business losing its competitive advantage. Typically the business ends up matching what its competitors offer, and their working practices, and attempts to sell to most customer groups.

How can you help a business reconnect with strategy?
Take a careful look at what it does. With most well established businesses there are things that are core and give the business its uniqueness. They can be identified by asking certain questions:

- Which products or services are the most distinctive?
- Which are most profitable?
- Which of our customers are most satisfied?
- Which of our customers are the most profitable?
- Which of our activities are the most different and most effective?

Around this core things get added incrementally. They need to be removed to reveal the underlying strategic positioning. The challenge is to refocus upon the core and realign the businesses activity with it. Customers and products/services at the periphery can be dealt with as appropriate - sale; priced out or simply allowed to fade away.

In case it was too obtuse, the "boiling frog" anecdote's most common metaphorical use is a caution for people to be aware of even gradual change lest they suffer eventual undesirable consequences.

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Succession planning

Succession planning in business starts with recruitment strategy, so; right back at the start. CEO's are often not ready with an un-stretching culture , poor profits and salary levels, and with roles inhabited by reasonable managers who are not succession material. The cry goes up "Oh, today's generation, it's not motivated like we were!"

Good companies don't think the same and have plenty of succession ready people to pick up the pace. Good recruitment processes, excellent delegation and on the job training, commercial responsibilities being shared at the right times, and a motivating, stretching environment are attractive to people who like that sort of thing. Plan from the start, plan clearly and communicate your intentions well, and you should find candidates ready, when you are, for your retirement.

If you have not done this and it is too late or too daunting, look for a bigger company where your clients and work are a good fit, and with whom you get on. Think about goodwill, but know that any payment will depend on the quality and transferability of your clients or some uniqueness about the business, ideally a protected or defendable uniqueness. This is evidenced by profit, by repeat work and referrals among other things, or by intellectual property and super-profit.

The size of your goodwill payment depends on these factors being right. You may need to work on them for a couple of years at least before retiring to get things in good order, or be prepared to accept a lower offer knowing that your business, team and customers are being looked after. Don't leave it too late, as finding the right buyer at the right time is tricky.

Retirement taxes generally conflict with short term tax planning so in general we advise against complex short term tax planning structures in the business as they are often more trouble then they are worth, and can prevent you getting valuable tax reliefs if you can sell your goodwill. Keep it simple! As always take advice. We can help with developing the culture and leadership skills, finding a buyer or handling a management buy out, and on your tax options.

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Business Recovery and Insolvency

Director Disqualification – a new era?

New measures came into force on 1 October 2015 to strengthen the company director disqualification process with the aim of providing a greater deterrent towards directors acting improperly.

An office holder in an insolvent liquidation, administration or administrative receivership will, if appropriate, continue to submit conduct reports to the Secretary of State on each person who was a director or shadow director of the company at any time during the preceding three years. However, these reports must now be submitted within a much stricter time frame of three months of the date of insolvency.

The Secretary of State must then decide whether to instigate disqualification proceedings within 3 years (increased from 2) of insolvency. The new legislation has introduced further grounds for disqualification such as convictions abroad or for being a person instructing an unfit director. The Secretary of State will also consider other matters such as breaches of laws or regulations and whether the person concerned has a track record of being involved in failing companies. From 1 October 2015 the Secretary of State can also use information obtained from other regulatory bodies.

These amended provisions will create a further degree of uncertainty for directors as it may not be known for an extended period of time whether disqualification proceedings are to be commenced against them, and certainly directors cannot consider themselves to be 'in the clear' until at least the 3 years since insolvency have elapsed.

In addition and perhaps more concerning for directors is a new compensation procedure that has been introduced to provide financial redress to creditors for any losses suffered as a result of the directors' conduct. A disqualified director can now be required by the court, upon the application of the Secretary of State, to pay compensation to creditors for unfit conduct occurring after 1 October 2015.

Before making any order the court must be satisfied that the person is disqualified and that their conduct has caused loss to one or more creditors. The court may make a compensation order that an amount be paid either to the Secretary of State (for the benefit of a creditor or creditors specified in the order) or as a contribution to the assets of the company. Directors may be requested to provide a voluntary undertaking along similar lines.

These compensation orders or undertakings are independent of the office holder's work, who retains the right to pursue claims against directors and/or others under existing insolvency legislation. This means that a director could face an 'attack' on two fronts and it will be interesting to see how these independent regimes interact and develop under case law.

In summary, when advising your client on insolvency whether in general terms or specifically on whether to agree to a disqualification undertaking you will need to consider whether the Secretary of State is likely to bring a subsequent compensation claim as this will undoubtedly have an impact upon your clients' decision.

For further information and impartial advice please contact a member of UK200Group Business Recovery & Insolvency Forum.

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International

Closing the International GAAP?

New UK GAAP is now with us and the first full year accounts will be required for December 2015 year ends. These recent changes to the accounting framework are the result of a long-term plan for the UK to move to EU adopted International Financial Reporting Standards ('IFRS') or International Accounting Standards (as they were then called).

The journey to convergence has been difficult however, and there remain many key differences between new UK GAAP and IFRS. Transition to new UK GAAP will be time consuming and a distraction for management, and many of our clients will question the merits of having to make these changes, when there are many other "more important" commercial and financial priorities.

In an attempt to find justifications to make these changes, I thought it would be useful to understand the international context, and the success or otherwise of IFRS. The initial objective of adopting IFRS was to improve the efficient functioning of the EU capital markets, and since 2005 the consolidated financial statements of listed EU companies have been prepared in accordance with IFRS.

This summer the European Commission published the results of a review, which assessed the implementation of IFRS, since the adoption of Regulation 1606/2002 ("IAS Regulation").

The Commission found many postive results of IFRS which included:

- It has increased the transparency of financial statements through improved accounting quality and disclosure, leading to more accurate market expectations including analysts' forecasts;
- It has led to greater comparability between financial statements within and across industries and countries;
- The quality of financial statements prepared under IFRS is good
- There have been improved capital market outcomes such as higher liquidity, lower costs of capital, increased cross-border transactions, easier access to capital at EU and global level, improved investor protection and maintenance of investor confidence.
- Over one hundred countries now accept IFRS and the standards are supported by international organisations, such as the G20, Financial Stability Board (FSB), World Bank and the International Monetary Fund
- Overall, the evidence from the evaluation showed that the benefits of the implementation of the IAS Regulation outweigh the costs.
- Companies largely supported IFRS which implies that they find the costs commensurate with the benefit

The Commission recognised significant ongoing issues however, with the most important being that the United States does not permit its domestic companies to use IFRS. Furthermore it was also noted that the cost of adopting IFRS may represent an obstacle for an initial public offering, especially for small and medium size companies (SMEs).

So whilst UK GAAP finally moves a step closer to IFRS, it would appear at least that the main objectives of adopting IFRS in the EU, have been largely achieved. Further amendments to UK GAAP are of course inevitable however, as IFRS continues to evolve, and further changes will be required in order to achieve any meaningful comparability with IFRS.

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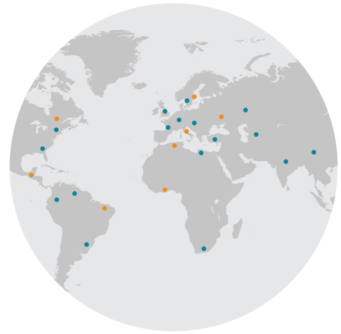

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Member listings correct as at November 2015