ADVICE FROM THE MANUFACTURING TEAM AT
ENSORS CHARTERED ACCOUNTANTS

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MANUFACTURING MATTERS

A New Horizon

By **Chris Barrett** – Manufacturing Partner

It has been close to 12 months since our last edition, and whilst unfortunately COVID-19 regained its grip on the country during the winter, resulting in further lockdowns, it is great to see measures beginning to ease and a sense of normality starting to return.

The effects of the Pandemic will continue to be felt for some time to come. Whilst some manufacturers in specific areas, such as food & drink and pharmaceuticals, generally returned positive figures during 2020, many manufacturers' outputs fell along with investment, and unfortunately employment – though regionally it seems our figures were not as affected as other parts of the UK.

With COVID continuing to hinder many manufacturers during Q1 2021, the industry appears to be gathering pace once again as the economy reopens. Whilst other challenges continue to be faced, there seems renewed optimism amongst the sector. The Bank of England recently updated their forecasts, expecting the UK Economy to recover stronger than previously expected, and it is hoped 2021 will show strong performance figures fuelled by pent up orders and demand.

This however brings with it other challenges which are being felt across the sector. As the UK formally withdrew from the EU on 1 January 2021, the protocols and administrative burden has been far greater than anyone predicted and led to delays both on import and export, particularly during Q1 2021.

Continued overleaf ➤

Ensors

Making you more than just a number

A New Horizon *continued*

Although the sector has begun to get to grips with this, issues continue to remain, along with the cost impact.

The largest challenge which now appears to be facing the sector, is both the supply line and due to demand, a spike in costs. With each country returning to full production at differing times and rates, due to the impact of COVID, the demand is leading to huge rises in material costs, and shipping charges. The struggle in available resources is impacting turnaround times to meet demand, and in some cases has become unaffordable.

Exceptional circumstances such as the Ever Given ship, which was stuck on the Suez Canal, and led to a 3-month delay docking at Felixstowe, has only enhanced these issues – particularly shipping charges due to the backlog impacted by its blockage.

The unknown is how long these costs will remain. As inflation continues to rise, expecting to be over 4% in the next few months according to industry experts, it is unclear if this is due to the "transition" of the economy fully reopening and if it will fall back to lower predicted levels, or whether it will remain high longer term.

In any case, despite these issues, the manufacturing industry appears confident it will be able to overcome these obstacles and has begun to build back for the future.

Leading on from these challenges, included within this edition, is an overview by our VAT Consultants Stewart Henry and Krisztian Santa on the impact of Brexit within the VAT regulations, touching upon postponed accounting. Corporate Tax Partner, Robert Leggett, takes us through two of the major announcements from the most recent Budget – Super-Deduction Relief and Extended Loss Carry Back. Finally, Simon Martin, Corporate Finance Director, covers off the rise in Employee Ownership Trusts as an exit strategy for business owners.

I hope you enjoy reading this edition and are seeing a brighter future ahead.

VAT, Brexit and Postponed VAT Accounting

By **Stewart Henry** & **Krisztian Santa** – VAT Consultants

BREXIT

On 31 January 2020 the UK officially left the EU. The transition period ended 31 December 2020 and the new rules came into effect on 1 January 2021.

Following the transition period, the domestic VAT rules have remained the same. It is imports and exports to and from the EU that are affected. Following the transition period, Great Britain now treats EU member states as it previously treated countries outside the EU. Trade with EU businesses, previously referred to as acquisitions and dispatches, are now imports and exports.

IMPORTS

Goods with a value over £135 are subject to import VAT. This can be paid at import and a monthly C79 certificate should be obtained from HMRC to reclaim VAT paid, and is subject to the usual rules, on the subsequent VAT return.

Businesses can make use of the new postponed VAT accounting mechanism (PVA) which is covered further below.

In addition, the UK introduced measures for overseas goods arriving into Great Britain:

- Exemption from import VAT for goods with value below £15, known as Low Value Consignment Relief, is no longer available.
- Imports with value of £135 or lower will have VAT applied at the point of sale instead of having import VAT.
- Online marketplaces facilitating sales are responsible to collect and account for VAT.

EXPORTS

Since 1 January 2021, goods arriving in the EU from Great Britain are not dispatches but exports and are zero rated for UK VAT purposes. 0% rate VAT will be applied but the transaction will still need to be reported in VAT accounting records.

EORI NUMBER

An Economic Operator Registration and Identification number (EORI) is now required for any business in Great Britain that imports and exports goods. The EORI number is used to complete customs formalities. It is also used to identify the business that is importing or exporting. Any business which has not already received an EORI, that is involved with imports and exports of physical goods across borders, should apply online to receive it.

SERVICES

Since 1 January 2021, VAT rules applying to supplies of services between UK and EU member states is, broadly, the same as the rules before Brexit applying to UK and outside the EU. Some of the main changes to services supplied from the UK to the EU are as follows:

- Services falling under use and enjoyment rules, effectively used and enjoyed outside the UK, are outside the scope of UK VAT.
- UK businesses are no longer required to complete an EC sales list when supplying services to business in the EU.
- Digital services: EU VAT will be due on all supplies of digital services to EU consumers regardless of value, and digital services from the EU to the UK will be subject to UK VAT.

POSTPONED VAT ACCOUNTING (PVA)

PVA allows a business to account for import VAT on its VAT return instead of paying VAT immediately at the port of entry. Businesses should declare VAT on the same VAT return on which they also reclaim VAT. Businesses will complete Boxes 1, 4 and 7 of a VAT return to include the import VAT. PVA offers a cash flow benefit as VAT is declared and reclaimed at the same time and on the same VAT return, subject to the usual rules regarding the recovery of VAT incurred.

When the UK left the Union on 1 January 2021 then, without this rule change on import VAT, all shipments from the Union would become subject to VAT at the time of arrival (and possibly duty), which would mean a significant immediate and permanent cash flow drain on businesses importing goods from the EU to the UK.

To ensure fairness for all VAT registered UK businesses, in addition to making the change for imports from the EU27 member states, the rules were widened to encompass imports from anywhere in the world, which up until 31 December 2020, were subject to import VAT at the time of the goods arrival. This change represents a cash flow improvement for businesses.

For further detail on postponed VAT accounting please visit **www.ensors.co.uk/postponed-vat-accounting**

Super-deduction and the Extended Loss Carry Back

By **Robert Leggett** – Corporate Tax Partner

On the face of it, the March Budget gave businesses several valuable new reliefs, to help cashflow and to incentivise investment through the latter stages of the pandemic. For many businesses these will indeed be valuable, but think before you claim, as the increase in corporation tax to 25% from April 2023 will have an impact.

THE PLANT & MACHINERY SUPER-DEDUCTION

The "Super-deduction" will give companies (not unincorporated businesses) a Capital Allowance of 130% on their qualifying "main pool" plant and machinery expenditure. This is much better than writing down allowances at 18%, and still an improvement even if you were able to claim a 100% deduction under the Annual Investment Allowance (AIA).

With a Corporation Tax rate of 19%, this means that a profitable company spending £100,000 on new machinery would find it only costs them £75,300, whereas under the AIA it costs them £81,000. (Note: the temporary £1m AIA has been extended until 31 December 2021, before it is, theoretically, due to revert to £200,000 per annum).

There are restrictions to consider:

- The relief will only be available for expenditure incurred from 1 April 2021 until 31 March 2023. Apportionments apply for periods that straddle 31 March 2023...
- Any expenditure under a contract entered into before 3 March will not be eligible...
- Only new assets are eligible; second-hand purchases will not qualify...
- The relief will not apply to cars, long-life assets, assets for leasing out, in the period of cessation, or in certain tax avoidance scenarios.

All well and good, but what's the catch?

Ordinarily, when an asset is disposed of that has been subject to a Capital Allowance claim, the disposal price is deducted from the Capital Allowances pool (the residue of Capital Allowance expenditure on which writing down allowances are claimed each year). It is only if that pool has been exhausted, that a balancing charge will be crystallised; taxing so much of the disposal value as exceeds the pool.

With the Super-deduction, the expenditure will need to be kept separately, so a balancing charge will always arise on disposal. But of course, chances are the disposal will take place after the rise in corporation tax, and the balancing charge will be taxable at 25%. If it doesn't, then the balancing charge will be multiplied by a factor of up to 1.3 to reflect the additional tax relief claimed on acquisition.

Example 1 looks at the effect of the change in tax rate and the balancing charge. As can be seen, upfront in 2021, the super-deduction is more beneficial than claiming under the AIA. However, if there was a substantial Capital Allowances pool to offset the balancing charge, then a claim this year under the existing AIA rules could actually be more tax efficient over the four year ownership period of the asset, as £6,250 of the £24,700 upfront saving under the super-deduction, is clawed back because of the balancing charge, giving an overall saving of £18,450 compared to £19,000 under the AIA.

More stark is that if the expenditure is delayed until 2023 when the new tax rate comes in, then a claim under normal AIA will save more tax than the super-deduction even in year 1. This is because the higher corporation tax rate actually outweighs the 130% deduction. By the time a balancing charge is factored in, waiting for the AIA in 2023 looks much more generous.

So why hasn't the super-deduction been made available to unincorporated businesses? Because no income tax rises have been announced, there is no reason for unincorporated businesses to defer capital expenditure.

50% FIRST YEAR ALLOWANCE FOR SPECIAL RATE POOL EXPENDITURE

Special rate pool expenditure, which would receive a lower level of writing down allowance of just 6%, is not eligible for the super-deduction. However, a 50% First Year Allowance will instead be available for a two-year period from 1 April 2021.

This would cover items such as integral features in a building, including electrical installations, plumbing, heating and air conditioning etc.

EXTENDED LOSS CARRY BACK

Businesses can normally carry back trading losses to the preceding year. The temporary extended loss carry back allows both companies and unincorporated businesses to carry back remaining losses to the preceding three periods.

For Corporation Tax, the extended relief applies where the loss is made in a period ending between 1 April 2020 and 31 March 2021, or between 1 April 2021 and 31 March 2022.

For Income Tax, the extended relief applies where the loss is reportable in either the 2020/21 or 2021/22 tax years.

A £2m cap applies in respect of losses arising in each of those two periods, and losses must be used against the earliest years first. This is slightly unfortunate, as where both periods are loss making, one will often find that the earlier loss-making period has used up all of the profits which might otherwise be available for the later losses.

For unincorporated businesses who are eligible, an extended carry back claim will almost certainly be the right thing to do in order to claim a refund as soon as possible.

For companies, we must once again bear in mind the 2023 increase in Corporation Tax rates. In that case, some companies may find that by carrying the loss forward rather than using the carry back rules, they will relieve the loss at 25% rather than 19%, receiving a bigger refund. Of course, if cashflow right now is critical, then a refund may be preferable, even if it doesn't give the best long-term result.

For groups of companies, the £2m cap applies across the whole group, and the nominated company will need to submit an allocation statement to HMRC.

However, a £200,000 deminimus threshold allows each company to claim up to that amount without being subject to the group cap or the allocation statement.

A claim will normally need to wait for the completion of the tax return for the loss-making period. However, in cases where the loss can be proven to be large enough, (for example, using management accounts), a claim up to the deminimus amount can be made at an earlier point in time.

Overall, the new reliefs are welcome temporary measures to help businesses through the current economic climate.

However, they may not be as good as they initially appeared, and companies need to think carefully before making a claim or changing their investment plans.

Time to sell?
Time for an EOT?

By **Simon Martin** – Corporate Finance Director

An Employee Ownership Trust (EOT) is a form of employee ownership where a Trust acquires a majority stake in a business on behalf of all employees. Over recent years the EOT has become a much more widely used tool to sell a business (tax efficiently) and has also become a valuable way to engage the workforce.

EOTs were already on the rise pre-pandemic, fuelled in part by a generous 0% tax structure for transactions of this nature, and in the last year, their popularity has continued to soar.

Not all businesses will be suitable for an EOT. There needs to be a genuine desire for long term employee ownership. If this is embedded in an organisation, then an EOT can provide a controllable, tax efficient vehicle to sell, as well as providing a great catalyst for fresh optimism, commitment and, most importantly, engagement from staff.

EOTs have more benefits for vendors than just the very attractive 0% tax rate on proceeds. Although some older EOTs were structured as gifts, it has become more the norm for the sale to take place at a market rate determined independently by accountants. An initial valuation can provide the vendor with an idea of the consideration which they would achieve, allowing this option to be assessed before advising staff and letting the proverbial genie out of the bottle.

Although the market for buying and selling businesses remains buoyant, there has been a noticeable shift in their characteristics, with many deals now comprising of elements that require harder negotiations. One of the more common and more challenging characteristics being 'deferred consideration' – that is money paid after the deal is done.

An EOT exit is generally a less stressful method to realise the value of a business compared to a trade sale, and comfort is drawn from the fact that it is the trusted management and employees of a business that will be given the opportunity to share ownership in the business that they have helped to build.

The deal needs to be fair and affordable, with the independent trustees needing to be satisfied that the deal is in the interests of the employees. Clearance regarding the tax implications is also required from HMRC.

If you would like further information on how an Employee Ownership Trust could help you realise the worth of your business, please contact our Corporate Finance team. They have a proven record in advising on successful EOTs, including structuring the deal and securing funding.

For more information contact
simon.martin@ensors.co.uk

Meet the team

Chris Barrett
PARTNER

01284 722340
chris.barrett@ensors.co.uk

Barry Gostling
PARTNER

01473 220080
barry.gostling@ensors.co.uk

Jayson Lawson
PARTNER

01223 428317
jayson.lawson@ensors.co.uk

Robert Leggett
TAX PARTNER

01473 220008
robert.leggett@ensors.co.uk

Katie Varney
TAX PARTNER

01284 722315
katie.varney@ensors.co.uk

Shelley Minns
SOFTWARE SPECIALIST

01473 220075
shelley.minns@ensors.co.uk

"Kalsec is an ingredient supplier for the food and beverage industry and have worked with Ensors for the last 20 years. We have found their service and advice professional and efficient, particularly valuing how Ensors know our business and people. We are a private and sustainable business operating in complex financial environments. In recent years, our European trading activities have increased, and we now work under several European jurisdictions. Ensors have provided comprehensive advice on several key areas such as corporation tax planning, joint venture incorporation and VAT compliance. As a thriving UK-based international business with strong capital investment and robust future growth planned, we firmly believe Ensors' continuous support as the independent and dependable financial adviser and auditor plays an important part in our ongoing success."

James Smith – Managing Director, Kalsec Europe Ltd

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