Generally accepted accounting practice

When it comes to the crunch, what is correct accounting practice is a matter to be determined by lawyers, not accountants.

I was interested to see a recent advertisement for the latest edition of a guide to UK GAAP by one of the 'big four' accounting firms. I am sure that there are other guides written by the other three – all of which are hugely authoritative. Indeed, what could be more authoritative than guidance from the big four on what represents generally accepted accounting practice in the UK? Who would argue with that? Well, actually, HMRC for a start.

In the First-tier Tribunal case of *Ball UK Holdings Ltd v HMRC* [2017] UKFTT 457, the taxpayer company prepared its accounts in accordance with UK GAAP. At least, it thought so. The details do not really matter – at least not here – but the principle is important because compliance with GAAP is a statutory requirement for tax purposes under CTA 2009 s 46, subject to any adjustment required or authorised by law. FRS 23 was the appropriate accounting standard, and the company believed that its accounts were prepared in accordance of FRS 23 and therefore complied with UK GAAP.

The company had good grounds for their belief. PwC said it was compliant, Deloitte prepared a report in support, and the company also had two experts from KPMG. Sounds pretty good. However, HMRC said they were all wrong.

The tribunal agreed with the conclusion of HMRC, saying that 'no accountant could reasonably have read FRS 23 in that manner'. This was an interesting point of view, given the number and stature of the highly experienced accountants who did exactly that.

Following an appeal by the company, the Upper Tribunal has now considered the position further ([2018] UKUT 407). Although the UT expressly distanced itself from the above comments of the FTT, it did not reverse the decision of the FTT. The UT upheld the decision on the grounds that the meaning and application of FRS 23 are questions of fact and not law; and of course, an appeal lies only on a point of law. The FTT had heard the expert witness evidence on which it based its conclusion; it was entitled to reach its conclusion, which was a matter of fact, and there was no error of law which could be overturned by the UT. End of story.

A possibility arises that the UT might have been able to take a different view and to have 'remade' the decision of the FTT under the authority of the Tribunals, Courts and Enforcement Act 2007 s 12(2)(b)(ii). If this had applied, and been followed by the UT, it would have been able to:

- make any decision which the FTT could make if the FTT were remaking the decision; and
- make such findings of fact as it considers appropriate.

It is clear that the UT considered that this power did not apply (or was not appropriate) in this case.

However, it did make the most beautifully phrased observation that when one is reading the FTT judgment, it is necessary 'to avoid an incorrect impression being obtained that the FTT was expressing legal views about the correct accounting approach, rather than making findings of fact'.

Despite this elegant disclaimer, the UT decision reinforces an uncomfortable truth – that when it comes to the crunch, what is correct accounting practice is a matter to be determined by lawyers and not by accountants. ■

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Death of a trust salesman

New government statistics show that the number of trusts submitting UK tax returns is declining year on year, with trusts paying £500m less in income tax than in the previous year.

In newly published statistics, the number of trusts and estates in the UK preparing a self-assessment tax return has fallen in the 2016/17 tax year to 156,500. Given that in 2003/04, the equivalent number was approximately 225,000, that means the number of such trust and estates has decreased by around 30% in 13 years. It is the third year in a row where there has been a significant decline in the number of such trusts and estates, with the number reducing by 7,000 in the 2016/17 tax year alone.

So, what is driving this demise of trusts? This may be a lack of understanding and familiarity of trusts. A research report was recently undertaken by the Ipsos MORI Social Research Institute which explored the motivations for establishing trusts. It was found that whilst the individuals surveyed had a high basic awareness of trusts prior to establishing one, any detailed knowledge was varied and depended on factors such as prior experience of trusts, professional advice taken and knowledge through their own work.

It seems that trusts may be subject to a vicious circle: individuals are put off establishing trusts as they do not understand them whilst a key source of such understanding, the prior experience of trusts, is becoming more limited each year as the number of trusts in self-assessment falls.

The future of trusts seems, more than ever, to be in the hands of professional advisers advising their clients to establish and retain them. Trusts still have an important role to play and remain appropriate in many family scenarios.

In their recent consultation on The Taxation of Trusts, HMRC outline that 'trust taxation should be neutral: their tax treatment should neither encourage nor discourage the use of trusts'. However, in the analysis accompanying the recent national trust statistics, a number of reasons have been cited for the potential decline and they largely point to changes in the tax treatment of trusts making them less attractive.

The analysis accompanying the statistics points to two main changes in the taxation of trusts over the last 13 years that have had an impact on their numbers. Firstly, in 2006, significant changes were brought in by the then chancellor Gordon Brown, relating to the taxation of trusts. In particular, nearly all trusts were made subject to IHT rules that can result in a 20% tax cost upfront for settling assets on trust.

Secondly, trusts now pay income tax at the very highest tax rate for individuals (currently up to 45%). The effect of income tax rates can be seen to be a correlating factor on the number of trusts and estates in self-assessment. The analysis highlights that when, in 2010/11, the personal and trust income tax rates went up to 50%, the numbers of trusts fell even more sharply. Likewise, the only rise in trust numbers in the 13 years to 2016/17 was when that 50% income tax rate was reduced to 45%. It seems there are now very few trusts in the UK with significant levels of income and only 3,000 trusts in the UK had income over £100,000.

There are a number of different factors at play in the decline in the number of trusts, with some of the onus on professional advisers to stem the tide by helping their clients understand the benefits. Based on the statistics, it seems reasonably clear that elements of the current taxation rules have made them less attractive with families now exploring other means of achieving similar objectives such as family investment companies.

It will therefore be interesting to see HMRC's response to the consultation on trusts in due course and whether it acknowledges that elements of its tax treatment may have led to a reduction in trusts. There is still a proper place for trusts, and it is hoped that tax treatment will not drive them out of existence. ■

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