BTG Global Advisory

UK INSIGHT

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Tech, tax and regulatory change

In the fourth in a series of professional practice updates, we highlight key industry trends in the UK accountancy industry. With the global economy firmly on the road to recovery, the accountancy sector largely enjoyed a return to good fortunes in 2014.

However, the prospect of regulatory upheaval has led to muted enthusiasm as firms jostle for a slice of the audit pie and increasingly turn to consultancy revenues as a path to sustained growth.

Market – UK and Global

From a global perspective, the 25 largest accountancy networks and associations reported an aggregated 6.1% increase in fee income compared with the previous year, bringing combined global revenues to $180.9bn, according to the latest survey by *Accountancy* magazine. While the prospect of a return to double-digit growth remains slim in the short term, a challenging risk environment for clients is offering new opportunities as businesses look to consultancy to boost their chances of success.

The past year has also seen a shift in the global economic balance from developed to developing countries, which has created new growth opportunities for businesses and their advisers.

Despite attempts by regulators to reduce the Big Four stranglehold on the market, they managed to secure a combined average increase in revenues over last year of 5.8%. This brings Big Four aggregated fee income to a whopping $120.34bn compared with $113.74bn in the previous year, while between them they have managed to retain a 67% share of the global accounting market.

In the UK the top ten biggest accountancy networks and associations excluding the Big Four all posted strong growth, largely on the back of consolidation. Increase in the volume of transactions was the result of confidence returning to the UK economy with some pent-up demand in the system being released. The likelihood of further M&A activity across the sector means next year's rankings of global players by UK fee income could take an altogether different shape.

With many firms bemoaning a flattening of audit revenues in developed markets, the focus is shifting to advisory services where business is growing after a recessionary slump.

Many networks are investing heavily in their consultancy offerings – by boosting service offering and pushing through strategic acquisitions. Areas of particular interest include business and data analytics, new assurance-type services and cyber security, as big businesses look to mitigate the growing threat and rising costs of malicious software attacks and staff-related breaches.

The top 25 global associations and networks collectively employ 1,043,452 professional staff, an increase of almost 60,000 on the previous year. And with the growing economy signalling a returning 'war for talent', the challenge facing firms is to make themselves attractive to the brightest and the best.

Industry Issues

Upheaval in the Audit Market

Attempts to increase competition in the large listed company audit sector appear at last to be having some impact. Tendering activity across the FTSE 350 has shot up since the FRC 'Comply or explain' regime kicked in.

Many accountancy chiefs concede that the prospect of mandatory firm rotation as a result of EU rules due to come into force in 2016 requiring listed companies to change their auditor every ten years has resulted in upheaval across the market as clients look to pre-empt the new rules. The rise in audit tendering levels is also continuing to exert fee pressure on audit services.

Nonetheless, Big Four domination across the FTSE 250 continues as audit income has picked up and the number of audit tenders has increased. For firms this means that partners are facing new stresses as they bend over backwards to retain existing clients and are forced to devote increasing amounts of time and money to finding new business.

Use of Technology to Transform Audit

The competition for bread-and-butter audit services is also forcing networks to re-evaluate their audit propositions. Upheaval across the larger company audit market is placing the onus on firms to prove the value of audit and position it as something that goes beyond compliance and a box-ticking exercise. Increasingly, auditors are expected to do more to identify risk and offer a forward-looking perspective on the numbers.

As a result, we're seeing growing automation of aspects of the audit process and use of technology to extract and analyse data replacing a lot of the less-rewarding routine audit work. Data mining and interrogation tools examine large data sets, identifying trends and exposing anomalies and risks. At the same time, predictive analytic techniques are increasingly being used to make audit more forward thinking than backward looking.

All the big firms have their own programmes for using digital and data to change what they do. That focus is predicted to ramp up going forward. For accountancy firms, technology is allowing them to both improve productivity as a means to improve their proposition, but also reduce overheads and maintain profitability on audits. And while it certainly offers the opportunity for the profession to reinvent the audit and enter a new era of greater and more obvious value for clients, the ensuing disruption will have an impact.

Complexity of the UK Tax System

There are ongoing calls for the government to make headway on simplifying the UK's 20,000-plus pages of Tax Code. Critics of the current system say this would be one key step towards reducing tax avoidance. There have been 42 changes to tax law since 2010 to deter and prevent tax avoidance.

In the light of proposals by the Organisation for Economic Co-operation and Development (OECD) for minimising tax avoidance and creating a more appropriate tax infrastructure for the internet economy, the tax transparency and tax morality debates are also driving tax revenues across the market. Clients want compliance, but they also want advice on how their tax arrangements will be perceived.

Increased Powers for the Taxman?

Calls to better define the terms 'tax avoidance' and 'tax evasion' to provide clarity and increase public understanding of the UK tax system have once again come to the fore. This has been prompted by one of the most controversial proposals by HMRC last year that it should be given new powers to deal with taxpayers who use tax avoidance schemes on a regular basis.

They include the power to recover tax debts directly from the bank accounts of individuals who owed more than £1,000 in tax and had at least £5,000 in their accounts and the 'naming and shaming' of taxpayers. The consultation also proposes the introduction of penalties for taxpayers who are challenged under the General Anti-Abuse Rule (GAAR).

Meanwhile HMRC consultation is under way on Tax Enquiries – Closure Rules. The proposals in the consultation paper are designed to give HMRC the power to refer a single issue to the Tax Tribunal to achieve resolution in complex multi-issue tax enquiries. This is in cases where HMRC believes matters are taking too long to settle, involve elements of avoidance, and where there is a significant sum of tax at stake. Concerns have been expressed that the proposal is one-sided as only HMRC will be able to follow the proposed course of action.

There is overlap between this consultation and others looking at other aspects of the UK tax system, including consultation on 'Strengthening sanctions for tax avoidance', and the Discussion Document on HMRC penalties. Scottish Institute ICAS has suggested that a roadmap approach to addressing taxpayer compliance would be preferable and would bring all of these strands together under a coherent framework.

Many remain to be convinced that further anti-avoidance legislation in these areas is either justified or necessary. The feeling among advisers seems to be that HMRC already has significant powers at its disposal to deal with taxpayers who do not comply with their legal obligations.

Challenges

Regulatory Reform

At a European level there is a push to open up the market for audit services among the biggest companies. UK legislative details are still being thrashed out across areas including transition measures and details of the non-audit services that can be provided by a company's auditor. Further details from UK regulator the FRC and the Department for Business, Innovation and Skills (BIS) are expected in the autumn.

In addition to the implementation of the EU Audit Directive and Regulation, Competition and Markets Authority (CMA) recommendations for an expansion of audit inspection will require the FRC to review its audit standards and this will broaden the scope of its audit inspection work considerably.

The FRC says its focus in 2015/16 will include:

- Corporate governance – company culture, promoting good practice and company succession planning
- Investor stewardship – supporting better engagement between boards and shareholders
- Corporate reporting – promoting reports that are fair, balanced and understandable, and also clear and concise, and continue to help smaller listed and AIM companies with the quality of their reporting
- Audit – continue to promote audit that is of a consistently high standard and meets investor needs.

Evolution of Financial Reporting and Standards

On the back of new UK GAAP FRS 102 introduced on 1 January 2015, proposals are under way for new accounting rules for micro-entities. The micro regime up until now has generally not been that popular but with small companies moving to FRS 102 recognition and measurement, many of those eligible to use the micro-entity regime might find it quite attractive.

Draft proposals suggest a lack of a requirement for deferred tax in FRS 105 and there is a potential issue in terms of overpaying dividends. But far from being merely a simplification process, the changes afoot will force firms and their clients to think carefully about the requirements and choices available.

Practice Management: Unqualified Accountants

Given the ease with which you can create your own website and start a business from home, the rise of unqualified accountants has the potential to pose serious problems for the sector. A recent survey found that when choosing an accountant to look after their affairs, only 8% of small businesses took an accountant's qualifications into consideration.

Since there are no regulatory laws in place, unlike solicitors and doctors, anyone is free to call themselves an accountant without any form of training. It's not until they pass qualification exams and join a professional body that they become subject to any kind of professional conduct rules.

Unqualified accountants often have narrow skill sets, and yet businesses are still turning to them for help and guidance. The risk that businesses take in receiving bad advice is that it could have a negative effect on their growth and development. This could, in turn, reflect poorly on the accountancy profession as a whole, leading to deterioration in the trusted and reputable status that the industry has earned.

Practice Management: Firm Consolidation

Another major issue facing the accounting industry is the nationwide trend towards firm consolidation. With rising costs in all sectors, reducing overheads and expenses, sharing resources and expanding offerings to provide a more diverse selection of services to clients, does make some sense. There are many in the accounting industry who would argue that firm consolidation is actually a solution to problems facing a number of accountants.

However, combining and consolidating two average firms is not automatically going to make a single outstanding company. The onus is on identifying what services clients want – offering anything and everything as a one-stop shop doesn't necessarily inspire confidence. Having a sector focus seems to pay off, and making sure that firms are constantly adding value to business is increasingly key.

Latest Developments

Tax Increasingly Under the Spotlight

More than 6,000 tax defaulters were referred to a special HMRC monitoring unit in tax year 2014/15, up 30% on the year before, in a sign that the taxman is getting much tougher on those who deliberately seek to default on their tax liabilities.

Recent figures published in response to a Freedom of Information request show that a total of 6,051 individuals and businesses were referred to the Managing Serious Defaulters (MSD) programme in 2014/15, up from 4,624 in 2013/14 and 1,094 in 2012/13. Under the MSD programme, HMRC closely monitors taxpayers to make sure they file all their returns and make all their payments on time.

Using existing powers more robustly, the department can also make announced or unannounced inspection visits to business premises to check business records or assets and carry out rigorous compliance checks into all or part of a defaulter's tax affairs.

While inspections are obviously cause for concern for clients, they are also an opportunity for advisers as companies struggle to manage their exposure to tax risk as well as a challenge for tax advisers who need to keep up to speed with potential risks.

International Tax

The focus on how the profession deals with international tax is likely to intensify. Criticism of PwC and its client pharmaceuticals group Shire over its use of Luxembourg's low tax regime by MPs in the House of Commons Public Accounts Committee marks the early shots in a battle that is expected to move to new fronts over the coming months.

Meanwhile, 1 April 2015 saw the introduction of the UK Government's Diverted Profits Tax (DPT), which imposes a 25% levy on profits leaving the UK. Designed to tackle the use of aggressive tax planning techniques, the DPT already seems to be having an impact after it was revealed that Amazon is changing the way it books its UK sales. From 1 May 2015, all retail sales made to customers in the UK will be recorded through the UK branch and liable for tax by HMRC. Previously, these sales were booked through low-tax Luxembourg.

Potential tax changes are also under consideration as part of the OECD's Base Erosion and Profit Shifting (BEPS) project. The changes set out to redesign the international corporate tax system following concerns that governments are losing substantial corporate tax revenue. This is because of international tax planning designed to shift profits in ways that erode the taxable base of developed and developing countries to locations where they are subject to a more favourable tax treatment.

Work on implementation of the OECD's BEPS project is due to be completed over the course of 2015. Forthcoming changes to international tax rules will have huge implications for multinational companies that go far beyond the confines of the tax department.

EU MOSS VAT Compliance Rules for Micro Businesses

From 1 January 2015, new European Union VAT rules relating to broadcasting, telecoms and electronic services came into force whereby the place of taxation is now determined by the location of the consumer. This affects the sales of digital services (broadcasting, telecommunications and e-services) from a business to a consumer (private individuals and non-business entities such as public authorities or charitable bodies).

There are two ways in which businesses can comply with the new reporting requirements. They either need to contact the relevant tax authorities in each country, or use HMRC's Mini One Stop Shop (VAT MOSS). The latter option is simpler as you only need to submit a single quarterly VAT return and payment for your EU sales, which HMRC then forwards to the relevant countries. Before you can use the VAT MOSS service, you must be registered for VAT in the UK by the tenth day of the month following your first digital services supply, even if your income is below the VAT registration threshold (£81,000 per year).

Although this sets out to create a level playing field for UK businesses by removing the current competitive advantage of EU member states with lower rates of VAT, the additional administration it creates will certainly need to be taken into consideration.

Partnership Tax Rules

Following moves by HMRC to close a loophole to avoid paying income tax on fees by using limited partnerships, the Office of Tax Simplification (OTS) in January published a final report – the third on the subject – on the taxation of partnerships. The OTS report lists 14 recommendations, including clear and comprehensive guidance for new partnerships, allowing partners to claim their own expenses, simpler HMRC administration for international partnerships, and extending gift aid to partnerships.

It also recommended the establishment at HMRC of a 'Head of Partnerships' role to help ensure proper focus of tax policy and operational work and urged the formation of an industry/HMRC liaison group to provide a forum to address issues arising from new, specialist partnership uses.

A survey of clients conducted by accountancy firm BDO found that the vast majority (80%) do not feel that the estimated increase in tax yield of £300m justifies the complexity and upheaval that implementing the tax rules applicable from April relating to partnerships proposals will cause. Even more respondents (83%) feel that, if implemented, the proposals will damage the attractiveness of using partnerships and LLPs.

Patent Box

The Patent Box tax, essentially a reduced rate of corporation tax, applies to eligible profits for companies that develop and exploit patented processes or products. It is one of the most generous tax incentives ever introduced in the corporate arena and applies to innovative high-tech companies as well as companies that develop and use patents in their trade.

The rate of tax applied to Patent Box profits is currently 12%, compared to the main rate of corporation tax of 20%. From 1 April 2016 the rate will reduce to 11% and then 10% from April 2017. Financial Secretary to the Treasury David Gauke pledged a commitment to encouraging more British businesses to perform their R&D in the UK. A new regime is due to be introduced this year based on a comprehensive round of consultation with Patent Box users.

Access to Funding for SME Clients

Despite the economic recovery and government attempts to intervene, bank lending to SMEs remains tight. Net lending to SMEs was £0.6bn in the first quarter of 2015, according to the Bank of England's data on the use of its Funding for Lending (FLS) Scheme. This compares with quarterly net lending to SMEs in 2014 Q4 of -£0.8bn and a quarterly average for 2014 of -£0.5bn.

Over the past few years credit conditions have improved for SMEs, and this has continued in 2015. According to the FSB Voice of Small Business Index, availability of credit to small businesses has risen in Q1 2015. The improvement in corporate credit conditions in part reflects the significant fall in bank funding costs that has occurred since the launch of the FLS.

However, the Bank of England's network of Agents report that some small companies continue to find it difficult to borrow from banks. The Breedon report, published by a Government-appointed committee led by Tim Breedon, the then Legal & General boss, in March 2012, said that access to finance for businesses needs to be improved or there could be a funding gap of up to £190bn by 2017.

Alternative forms of finance including asset-based lending, equity investment, venture capital and peer-to-peer lending, are becoming the new norm. In May, business lobby group the CBI launched an alternative finance guide, 'Ripe for the Picking', which indicated that high-growth medium-sized businesses could be worth up to an additional £20bn to the economy by 2020 but that, to realise this, they will need the right funding to meet their potential.