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Financial Reporting and Taxation Update

Wednesday 25th January 2012

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UK TRENDS – THE STATE OF THE NATION

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UK Hotel Trends – The State of the Nation



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2011 Review – YTD December 2011

- **Positive performance for UK hotels:**
 - rooms yield growth **+3.6%** (£65.21)
 - increased occupancy **+0.8%** (74.3%)
 - increased AARR **+ 2.7%** (£87.74)
- **London hotels led the performance:**
 - rooms yield growth **+6.4%** (£115.99)
 - decreased occupancy **-0.3%** (82.8%)
 - increased AARR **+6.6%** (£140.09)
 - driven by rate as occupancy over 80%
 - hosted successful events – Royal Wedding, Wimbledon
- **Regional hotels did not enjoy as much success:**
 - rooms yield growth **+0.8%** (£44.12)
 - increased occupancy **+ 1.6%** (70.8%)
 - decreased AARR **-0.7%** (£62.31)
 - driven by occupancy: 'staycation' remained popular however, meetings, incentives, conference and events (MICE) market remained constrained
 - regional AARR under pressure due to continuing price sensitivity in corporate and MICE markets

Regional markets – YTD December 2011

- **England:**
 - rooms yield growth **+0.5%** (£42.51)
 - increased occupancy **+1.4%** (70.2%)
 - decreased AARR **-0.9%** (£60.56)
- **Scotland:**
 - rooms yield growth **+2.6%** (£53.30)
 - increased occupancy **+1.7%** (74.4%)
 - increased AARR **+0.9%** (£71.64)
- **Wales:**
 - rooms yield decline **-2.8%** (£44.77)
 - slightly increased occupancy **+0.1%** (72.9%)
 - decreased AARR **-2.9%** (£61.41)

Regional winners and Losers – YTD December 2011

- **Winners (rooms yield growth):**
 - Reading **+11.9%** (£42.43)
 - Aberdeen **+11.3%** (£55.76)
 - Milton Keynes **+10.7%** (£45.28)
- **Losers:**
 - Birmingham **-8.2%** (£34.52)
 - Belfast **-5.9%** (£42.20)

2012 Outlook

- London to remain stable with some anticipation of growth, especially as it benefits from the build up to the Olympic Games, the Diamond Jubilee and the Champions League Final.
- The recovery of performance in the Regions will continue to be slow and much will depend on the economy and how this affects the MICE and corporate markets.

THE FUTURE OF UK GAAP ALL CHANGE (?)

**Rob Frost
Manager
Technical Department**

The future of UK GAAP – a brief history

- **9 July 2009**
IASB issues IFRS for SMEs
- **11 August 2009**
ASB issues a consultation paper for discussion: “The future of UK GAAP” which outlines a plan to remove UK GAAP from existence and replace with IFRS for SMEs
- **29 October 2010**
Draft FRSME issued – consultation period closed 30 April 2011
- **January/February 2012**
Anticipated timing of re-exposure
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- **1 January 2015**
Likely effective date

Principal amendments to expected new EDs

- **Under the previous proposals:**
- A 3 tier framework based on public accountability
 - Full IFRS
 - FRSME
 - FRSSE
- Accounting treatments required/permitted by UK GAAP or IFRS prohibited under the FRSME:
 - Revaluation of property, plant and equipment
 - Capitalisation of development costs
 - Capitalisation of borrowing costs

Principal amendments to expected new EDs

- **Under the previous proposals:**
- Subsidiaries required to comply in full with the requirements of the relevant framework
- Conflict between Companies Act presentation of the financial statements and the FRSME
- Effective date of January 2013

Expected re-exposed standards

FRS 100

Application of Financial
Reporting Requirements
(FRED 46)

FRS 101

Reduced Disclosure
Framework
(FRED 47)

FRS 102**“The FRS”**

**The Financial Reporting Standard
Applicable in the UK and Republic of Ireland
(FRED 48)**

FRS 100 – Framework to be applied

- **Full IFRS**
 - Only those entities currently required to follow full IFRS under UK company law (i.e. listed groups)
- **FRS 102 – “The FRS”**
 - Any other entity
- **FRSSE**
 - Any entity currently permitted to follow FRSSE will (at least in the med-term) continue to be permitted to do so

FRS 101: Reduced Disclosure Framework (FRED 47)

- In group entities individual accounts (including parent)
- APPLY – IFRS recognition and measurement provisions
- BUT – Disclosure exemptions
- Cost effective to maintain consistent accounting policies across group
- Disclosure requirements of full IFRS onerous
- Not IFRS accounts so still required to use Company Law formats

FRS 102: The FRS (FRED 48)

Impact on your financial statements



Previously known as 'FRSME'

Format of the financial statements

- **Balance sheet and profit and loss account**
 - All entities required to apply the Companies Act formats
 - Elsewhere in the standard these statements are referred to as 'Statement of Financial Position' and 'Statement of Comprehensive Income'
 - Operating profit sub-total not required
- **FRS 102 cross-refers to the Act to determine when consolidated accounts are required**

Format of the financial statements

- **Required to present a SOCIE**
 - In certain circumstances could present a statement of income and retained earnings instead of SOCI and SOCIE
- **Significant difference - Statement of cash flows**
 - Movements in cash and cash equivalents
 - Split between 3 cash flow groups
 - No net debt note
 - Subsidiaries exemption still available
- **Additional notes**
 - Judgements
 - Key sources of estimation uncertainty

Non-current assets

Non-current assets	Key matters and implications of the FRS
Property, plant and equipment	<ul style="list-style-type: none"> • Permitted to revalue PPE • Residual value to be determined by reference to amount entity would currently obtain • Can disclose valuations in directors report if useful • Can adopt current valuation or fair value as deemed cost on transition
Intangible assets (and goodwill): Amortisation	<ul style="list-style-type: none"> • Finite life, presumed to be 5 years unless a reliable estimate can be made

Non-current assets continued

Non-current assets	Key matters and implications of the FRS
Intangible assets: Development costs	<ul style="list-style-type: none"> • Required to demonstrate that criteria will be met in order to capitalise (but capitalisation now permitted)
Investment property	<ul style="list-style-type: none"> • Measure at fair value with changes through the profit and loss • Increased volatility of profit and loss for the year • Consider implications for distributable reserves • Group occupation, could be investment property in individual accounts

Non-current assets continued

Non-current assets	Key differences to current UK GAAP
Impairment loss	<ul style="list-style-type: none"> • Always reduce any revaluation surplus first • In a CGU allocate loss to goodwill first, then other assets pro-rata
Grants	<ul style="list-style-type: none"> • Recognise as income when specified performance obligations are met OR over the periods in which the entity recognises the related costs • The performance option may lead to far earlier recognition of grants

Financial instruments

	Basic financial instruments	Complex financial instruments
Definition	<ul style="list-style-type: none"> • Cash • Debt instruments • Commitment to receive a loan • Investment in ordinary or (non-convertible) preference shares 	<ul style="list-style-type: none"> • Anything not basic
Accounting at recognition	<ul style="list-style-type: none"> • Transaction price plus/minus transaction costs 	<ul style="list-style-type: none"> • Transaction price excluding transaction costs
Subsequent measurement	<ul style="list-style-type: none"> • Cost/amortised cost less impairment 	<ul style="list-style-type: none"> • Re-measure to FVTPL

Basic financial instruments - exception

Preference and ordinary shares that are:

- non-convertible / non-puttable; and
- publicly traded or fair value can be reliably measured

Accounting:

- **Initial measurement**
 - Transaction price (excluding transaction costs)
- **Subsequent measurement**
 - Re-measure to fair value through profit and loss
- i.e. like a complex instrument

Financial assets measured at fair value

- **Hierarchy used to estimate the fair value**
 - Quoted price for an identical asset in an active market (current bid price)
 - Recent transaction price for an identical asset providing no change to economic circumstances existing at the date of the transaction
 - Valuation technique to assess the transaction price on the measurement date in an arms length exchange

Other effects of FRED 48

Area	Key differences to current UK GAAP
Revenue recognition	<ul style="list-style-type: none"> • Similar approach to accounting for revenue • Terminology slightly different
Deferred tax	<ul style="list-style-type: none"> • FRED 48 uses a 'timing difference plus approach', in most cases same as IAS 12 • No discounting • Must provide for deferred tax on revaluations • Likely to result in more deferred tax being recognised • Deferred tax balances must be taken into account for distributable profits

Other effects of FRED 48

Area	Key differences to current UK GAAP
Retirement benefits	<ul style="list-style-type: none"> • Number of simplifications in calculation and an independent actuary need not be used • Past service costs recognised in period of change • Likely to lead to lower net profits • Deferred tax not offset
Foreign exchange	<ul style="list-style-type: none"> • FECs to be separately recognised on the balance sheet • Entity permitted to present accounts in any currency • Income and expenses of a foreign operation are translated at actual or approximate rate, closing not permitted

Other effects of FRED 48

Area	Key differences to current UK GAAP
Agriculture	<ul style="list-style-type: none"> • Biological assets measured at fair value, changes in value recognised in profit or loss • Agricultural produce measured at fair value at the point of harvest
Construction contract	<ul style="list-style-type: none"> • Simpler balance sheet presentation
Lease disclosure	<ul style="list-style-type: none"> • Disclose total future MLPs, analysed between 1 year, 2-5 years, 5+ years
Minorities	<ul style="list-style-type: none"> • Transactions with minorities, where no change in control, are accounted for as equity transactions

Business combinations model

- **All business combinations, other than combinations under common control, must be accounted for using the “purchase method” (acquisition accounting)**
 - Identifiable assets and liabilities included in the acquirers consolidated balance sheet at their fair value
 - Cost measured as aggregate of fair values in exchange for control **plus** any costs directly attributable to the combination
 - Adjust for changes in contingent consideration
 - Merger accounting permitted for business combinations under common control (group reconstructions)

Goodwill

	Goodwill	Negative goodwill (gain on bargain purchase)
Accounting at recognition	<ul style="list-style-type: none"> • Cost less amortisation • Capitalised and amortised over its useful economic life • Assumed life is 5 years • Can use a different life if supportable by evidence 	<ul style="list-style-type: none"> • Check asset and liability valuations and completeness of liabilities • Release to profit and loss in periods in which the non-monetary assets are recovered
Existing goodwill	<ul style="list-style-type: none"> • Prospective application • Practically re-living is unlikely to be required 	

Practical considerations



Practical considerations

- Framework decision
 - Are you happy with the framework you naturally fall into?
 - Do you want to move up to FRED 48 or IFRS?
 - Do you want reduced disclosure for subsidiaries?
 - What do your interested parties want you to do?
- Accounts presentation:
 - Some different presentation, format and terminology
 - What to do if something is not addressed in the FRED 48
- Tax
 - Charge may be different (deferred tax)

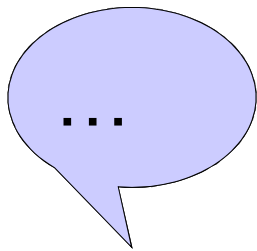
Practical considerations

- Financial systems
- Consideration of distributable reserves before paying dividends given
- Performance related bonuses
- Training and preparation
- Audit implications?
- Covenants

Effective date

- The proposed effective date of periods commencing on or after 1 January 2015 would mean a need for an opening comparative balance sheet at 1 January 2014

Comments/Questions





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TAXATION ISSUES

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Taxation issues

- Corporation tax issues
 - Capital allowances
 - Other recent changes
- Employment Tax & Rewards
- VAT

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Capital allowances

- Hotels need to work hard to maximise allowances following abolition of hotel allowances
- Maximise plant & machinery allowances
- Typically between 13% and 26%
- On a hotel worth £20m, tax relief of c £1.25m is available
- CA rate falls from 20% to 18% from April 2012

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Capital allowances

- Use short life asset regime where possible
 - At 18% per year; it takes 12 years to claim 90% of cost
 - No downside to a short life asset claim
- Can claim balancing allowance if sell/scrap within 8 years
- Important tool to help cashflow on tax

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Capital allowances

- Example – a company spends £100,000 on a new reception desk and furniture suite. It is scrapped 5 years later.

- Tax relief due:

Year	No SLA Claim £	SLA Claim £
1	4,320	4,320
2	3,542	3,542
3	2,905	2,905
4	2,382	2,382
5	<u>1,953</u>	<u>10,851</u>
	15,102	24,000

(Assumes 24% tax rate for ease of illustration)

Capital allowances

- Second hand properties
- Currently purchaser claims via
 - Joint election with vendor
 - Vendor disposal, or
 - Just apportion (valuation based)
- No time limit on claim
- This led to some very late claims
- Necessary to track back through previous owners for tax treatment
- HMRC considered that system led to over-claims

Capital allowances

- Proposed changes
 - Effectively makes it mandatory for vendor to “pool” plant & machinery in tax computation.
 - If vendor has ignored capital allowances, purchaser will not be able to make a claim.
 - When property is sold purchaser must either
 - *Enter into an election with vendor, or*
 - *Apply to a tribunal to determine value.*
 - Vendor must now determine what allowances are available (which can take considerable time) before sale.

Other changes to corporation tax

- Enterprise zones - 100% relief for plant & machinery expenditure on certain enterprise zones from April 2012
- Share capital reductions
 - Useful mechanism to simplify groups
- General anti-avoidance rule
- Debt cap rules
- Controlled foreign company rules



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INTERACTIVE PRESENTATION

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You Choose

Any two from four

1. Termination Payments
2. Real Time Information
3. Residence and Domicile Changes
4. Casual Workers

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Termination Payments

Misconceptions

- First £30,000 always exempt **Wrong**
- £30,000 limit applies to NIC **Wrong**
- Income Tax and NIC exemptions same **Wrong**
- You can get >1 £30,000 per employer **Wrong**
- Payments on retirement are exempt **Not necessarily**
- “Custom and practice” and “expectation to receive” concepts apply **Not since 2003**

Issues 1

- Contractual payments always taxable
 - No exceptions
- Redundancy always OK
 - Statutory and supplementary
- Lump sum payments are not easy
 - £30,000 available in limited cases
- Tax and NIC different
 - e.g. no £30,000 limit for NIC

Issues 2

- Ill health unlimited
 - HMRC will want proof
- Retirement trap
 - Attitude may change as retirement ages disappear
- Change payments can be exempt
 - Well worth remembering
- Seek advice!
 - The costs of getting it wrong can be substantial



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Real Time Information

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Overview

- Making life easier?
- Phased in April to October 13
 - With us in 18 months
- Monthly reporting
 - Pay
 - Tax
 - Deductions
 - Credits
 - Pensions
- Penalties for failures
- P45 and P46 replaced by Leaver Statement

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Things to Do

- Operation
 - Speak to software providers
- Get up to date staff information
 - Name
 - *Do you employ A.N.Other or Mr X?*
 - Address
 - NINO
- Think about changes to practice
 - Internal information sources
 - HR and payroll communication

Residence and Domicile



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Domicile

- Misunderstood
 - Usually gained at birth and never lost
- Beneficial tax treatment
 - Remittance basis
 - Overseas income and gains
- Additional charge
 - If UK 12 of last 14 years
 - £50,000 to get treatment
- Special reinvestment exemption

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Residence

- Proposals postponed for 12 months
- Will come in 6 April 2013
- In theory no change
- In practice more UK residents
- Factors
 - Presence
 - Home
 - Family
 - Work
- Current behaviour could be relevant
 - Last three years

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Casual Workers

Casual Staff

- Always a problem
 - Easy to ignore
 - Competition
 - Playing the system
- HMRC's favourite subject
- Tax exposure can be substantial
 - Often hard to recover too
- Ideally all staff on payroll
 - Including non-exec/overseas directors
- Remember National Minimum Wage



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Tax Treatment

- If in doubt payroll
- Get P45/P46 in all cases
- Always check self-employed claims carefully
- Get name/address/NINO
- Don't trust accountants
- Agency staff/companies usually OK

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VAT – TRANSFER OF GOING CONCERN

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VAT – Transfer of a Going Concern

- Transfer of a going concern – sale of a business not subject to VAT
 - important because SDLT due on VAT
- Are you running a hotel or a property-leasing business?
 - must be carrying on the same kind of business for a reasonable time afterwards
 - Is the hotel opted to tax?
- European Court case – *Schriever*
- Sports shop proprietor sold her business, including fittings, stock and goodwill, but retained the freehold of the premises, granting a lease to the new owner
- Court found sufficient assets were transferred to put the new owner in possession of an operable business

VAT – Room hire

- Rumoured change of HMRC policy for weddings
- Existing policy says wedding packages are subject to VAT (i.e. no split between taxable catering and exempt room hire)
- HMRC reportedly now allowing exemption for room used for wedding ceremony itself
- Law does not permit catering to take place in a room while it is set out for the ceremony

VAT – gym membership

- Gym membership contracts with 12 month lock-in period
- Member defaults during lock in period and is barred from further entry to the gym
- Membership subs recovered by debt collectors found not to be subject to VAT
- Compensation payments because member no longer has access to use the facilities. Gym no longer makes a supply of services in exchange for the payment.
- First Tier Tax Tribunal case, *Esporta* – may be appealed
- Applies to any facility – eg swimming pools, saunas

VAT – penalties

- HMRC's starting position seems to be "Careless" – penalty 0-30%
- No penalty if reasonable care taken
 - Reasonable care : the larger (or more professional) you are the higher the standard of reasonable care
- 65% of penalties imposed by HMRC in 2011 were overturned at the reconsideration stage
- If you can't have it removed, request that it is suspended
 - what controls will you put in place?

VAT – other news

- **Medhotels litigation**

- Upper Tribunal ruled that a bed bank acted as agent not principal in supply of hotel rooms
- Does agency treatment contradict policy elsewhere in Europe and cause problem with cross border charges?
- HMRC granted leave to appeal to UK Court Of Appeal – could end up in the European Courts

- **Long stay hotel rooms**

- Bills for stays beyond 28 days apportioned between exempt room hire and other services
- Legal development potentially overrides 4 year cap
- Possible opportunity to make historic recoveries of VAT where VAT charged on full value by mistake

Questions



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