

The Engine Issue 6

Keeping You Up To Date With Manufacturing & Engineering Insight
November 2019

Now, for tomorrow



The Engine Issue 6

Welcome to the sixth edition of
The Engine, our Manufacturing
& Engineering Newsletter.

At MHA, we're passionate about UK manufacturing and engineering. MHA members act for thousands of businesses across the country, including OEMs, those in the supply chain, as well as engineering companies and tech businesses. As we head towards the post Brexit UK, we think it's more important than ever to champion our sector, which is why we look to share best practice right across our client base. As well as delivering accounts, audit, tax and Wealth Management solutions, we also support skills initiatives, run forums and hold insight events, all aimed at helping our clients in the sector to do better.

Along with others such as Lloyds Bank, Innovate UK, the High Value Manufacturing Catapult and Autodesk, we're a member of the Future of British Manufacturing Initiative (FOBMI).

FOBMI is a collaboration between leading UK industry organisations focused on increasing the competitive advantage of UK Design and Manufacturing companies, by removing the barriers to true productivity and innovation.

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The missing link:

Why we have so few
engineers and even
fewer female engineers

Back to basics

For a very long time, the UK has been suffering from a severe shortage of skilled recruits into the engineering/manufacturing sector. Many respected bodies including Parliament itself have bemoaned the fact for decades but nevertheless, the UK continues to struggle against its international competitors (especially the emerging economies in the Far East and India) and is failing to make the most of its undoubted opportunities around innovation and wealth creation. Put simply, we need more engineers (55,000 a year more) and the glaringly obvious fact is that as a nation, we are pretty abysmal at synchronising the outputs of our educational system with the needs of business – to the detriment of our economy and to the cost of the many and able young people who are seduced into following a non-vocational path in their education, which leads nowhere in particular. There are, of course, some fine local initiatives that serve as exemplars, but generally the evidence would suggest that the UK fails to align education with employability and if the UK is to continue as a going concern (irrespective of Brexit), that is just not good enough.

The question of women in engineering

At the moment, according to Engineering UK's 2017 study, just 16% of engineering and technology undergraduate entrants are female. In terms of apprenticeships, the picture is even worse. Females accounted for just 8% of engineering apprenticeship starts (in England). The reasons for there being so few female students going into engineering are many and varied but as with the broader picture, the solution has to be a national one. By focusing on putting right one of our major failings we could start to dramatically reverse the decline. We need to inspire female students at secondary school or earlier to want to become engineers and we should make this a national priority based on achieving a given target by a certain date. The evidence shows that in too many cases, female students ditch all important STEM subjects after their GCSEs and their choice of A Levels is, in most cases, fatal to the cause.

Problems and solutions

Perceptions about engineering generally, but especially amongst female students

Targets for schools –
the GATSBY initiative is a real positive, but needs to go further

Funding for FE colleges –
this has been slashed over recent years, which makes it all the more difficult to put on expensive engineering courses and find enough tutors

Knowledge around T Levels –
these launch in 2020 but little information is available and employer engagement is problematic

Apprenticeships –
there are continuing concerns over the administration and use of the levy

Here at MHA, a common theme from our annual Manufacturing and Engineering reports has been the skills gap and we have been banging the drum for many years and yet, despite the much-heralded UK Industrial Strategy, little has happened to initiate the sea-change that is needed. We would advocate that government sponsors a non-political policy forum to produce a national engineering strategy for education, the terms of reference being that it looks at all of the things that have worked here and elsewhere, to meld a coherent and integrated UK approach to producing the engineers we need (female, as well as male), which government (whatever its hue) needs to follow through on.

New VAT Rules on 'Energy Saving Materials' are now in force.

Are you ready?

What is happening and when?

From 01 October 2019 the scope of the VAT reduced rate (5%) for energy saving materials is being restricted to comply with EU law. The UK rules were found to go beyond what is permitted under EU law. Supplies which would previously have qualified for the reduced rate, will now only qualify if they meet the new and more restrictive tests which are noted below. This is not good news for sector or the environment.

The new rules affect supplies of installations of energy saving materials that are made on or after 1 October 2019. Supplies that are paid for before 1 October 2019, and supplies made to a contract in line with the law entered into before that date, are not included.

60%

New 60% test

Where one of the above social policy conditions is not met, it is necessary to look at the new 60% test for materials. If the open market value purchase price (excluding VAT) of all goods supplied to the customer (as part of the installation which remain in place once the job has been completed) is greater than 60% of the total value of the supply to a customer (excluding VAT), an apportionment is now required between materials (which will become standard rated) and labour (which will be reduced rated).

Sounds complicated....

What are the changes?

New social policy conditions and 60% threshold

From 1 October 2019, the reduced rate will only apply to the installation of energy saving materials (and energy saving materials supplied with installation), where the supply meets one of the new social policy conditions noted below, or a new 60% test is met in relation to materials.

Who is impacted?

Any contractor or subcontractor installing energy saving materials including:

- Controls for central heating and hot water systems
- Draught stripping
- Insulation
- Solar panels
- Wind turbines
- Water turbines
- Ground source heat pumps
- Air source heat pumps
- Micro combined heat and power units
- Wood-fueled boilers

Social Policy Conditions

Condition 1:

The supply of the installation is to a 'qualifying person' and in the qualifying person's sole or main residence.

A qualifying person is a person who is:

- Aged 60 or over; or
- Is in receipt of certain benefits (e.g.) Child Tax Credit (other than the family element), Council Tax Benefit, Disability Living Allowance, Disablement Pension, Housing Benefit, Income-based Jobseeker's Allowance, Income Support, War Disablement Pension and Working Tax Credit.

Condition 2:

The supply of the installation is to a 'relevant housing association' which includes registered social landlords and registered housing associations.

Condition 3:

The supply of the installation in residential accommodation is in a building or part of a building used solely for a 'relevant residential purpose'. This includes children's homes, care homes etc.

Note: Subcontractors are unlikely to meet Condition 1 or 2 due to who they supply i.e. a main contractor and may need to rely on the 60% test below for reduced rating.

Example 1:

A contractor pays £500 (excluding VAT) for material and charges its customer £1,000 (excluding VAT) for the installation. Since the cost of materials is only 50% of the value of the total supply, the contractor can charge the reduced rate of 5% on the total supply i.e. 5% of £1,000 = £50.

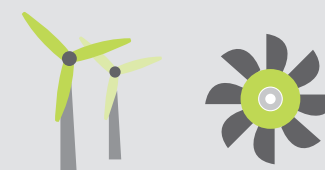
Example 2:

A contractor pays £7,500 for materials (excluding VAT) and charges its customer £10,000 (excluding VAT) for the installation. Since the cost of the materials is 75% of the value of the supply, the supplier will need to separately identify the value of the materials and charge VAT at the standard rate on the supply of those materials to its customers. The labour element of the supply will continue to qualify for the reduced rate.

Supplies where the material cost is likely to be a high proportion of the value of the supply e.g. solar panels, will not generally be eligible for reduced rating unless one of the above social policy conditions is met, which could have a significant impact.

It is important to note that, despite HMRC having the opportunity to bring the reduced rating of energy saving materials in line with other reduced rate reliefs, HMRC have not done so. If the supply of energy saving materials is only a part of a wider standard rated supply (rather than a separate supply) no apportionment is allowed for energy saving materials and the whole supply will still be a single standard rated supply. Where the energy saving materials are not the predominant element of the supply e.g. insulation installed as part of the construction of a residential extension, this will be standard rated.

The reduced rate has been removed for:



Wind turbines and Water turbines

From 1 October 2019, the installation of wind turbines and water turbines is subject to VAT at the standard rated (20%). Although originally intended for removal as part of the new measures, solar panels have been retained in the scope of the reduced rate.

National Living Wage / National Minimum Wage

The debate around the rates at which the National Living Wage and National Minimum Wage should be set continues to make headlines.

However, there are wider issues for manufacturing and engineering employers to be aware of when considering whether they are compliant with the rules, as well as the potential impact of non-compliance.

At the time of writing, the National Living Wage (NLW) – the rate payable to those aged 25 and over – is set at £8.21 per hour. However, both the Conservative and Labour parties have recently announced important changes they would seek to make to the NLW.

For its part, the Conservative Party has recently confirmed its intention to raise the NLW to £10.50 by 2024. It intends to combine this with a lowering of the age threshold at which the NLW becomes payable, from age 25 down to age 21. The Labour Party has said it will seek to increase the rate to £10 per hour and make this applicable to all workers aged 16 and over. This would effectively abolish the lower 'youth rates' of National Minimum Wage (NMW) that currently apply to those aged under 18 (£4.35 per hour), aged 18 to 20 (£6.15 per hour) and aged 21 to 24 (£7.70 per hour).

Ultimately, whatever the precise details of any changes going forward, it's likely that the NLW (or an equivalent replacement) will be payable to many more workers in our sector in the near future. Recent steps to scale up enforcement of the NLW / NMW across all sectors of the economy also point to a more challenging compliance environment. HMRC enforces NLW / NMW on behalf of the Department for Business, Energy & Industrial Strategy (BEIS). Over the past four years, BEIS has more than doubled the budget it provides to HMRC for NLW / NMW enforcement – from £13.2m in 2015/16 to £27.4m in 2019/20.

In 2018/19, HMRC recovered NLW / NMW arrears across employers in all sectors totalling £24.4m for 220,000

workers, a substantial increase on the £15.6m it recovered for 200,000 workers in 2017/18. HMRC can impose penalties on employers of up to 200% of the total NLW / NMW underpayment. In 2018/19, total penalties were £17m, up from £14m in 2017/18.

The combined financial impact of NLW / NMW arrears and penalties for non-compliance can therefore be significant. Whether an individual employer is complying with the NLW / NMW rules is determined by a complex interplay of factors.

The experience of employers in our sector who have undergone HMRC NLW / NMW reviews is that they often focus on strict technical breaches of the rules. In practice, this can mean that employers, who in no way set out to deliberately underpay workers, can still find themselves in a non-compliant position. For example, taking a deposit for a locker key has been interpreted by HMRC as reducing a worker's NLW / NMW pay in the pay period in which it is deducted. When at the end of employment this amount is returned to the worker, the nature of that payment has also been debated – is it correcting an earlier underpayment, or new additional pay?

Once HMRC feels it has identified a technical breach, the impact of this can often turn on a question of fact. For example, it might perhaps be conceded that changing time at work, before an employee 'clocks on' and starts getting paid, is working time for NLW / NMW purposes.

The question then arises: how long does it actually take employees to change at the start and at the end of a shift? Employers' experience is also that HMRC's view of these facts can differ from the reality of working practices, and so their view can be challenged if supported by robust internal analysis.

Capital Allowances Update What next?

Given economic uncertainty surrounding Brexit and inbound investment, it has never been more important to ensure your tax reliefs are being maximised at each available opportunity.

Business rely on the capital allowances regime as their form of obtaining relief for their capital expenditure. In the Autumn 2018 budget the annual investment allowance (AIA) was temporarily increased to £1 million, the structures and buildings allowance (SBA) was introduced and the government announced the scrapping of the Enhanced Capital Allowances (ECA) regime. All of these have significant implications for clients of all sectors, the one which will most significantly feel the impact is manufacturing.

Increase in the AIA

The government announced a temporary increase in the AIA from £200,000 to £1 million in the Autumn 2018 budget lasting until 31 December 2020 after which it will revert to £200,000. Given current uncertainty surrounding the future longevity of the increase, if your business is planning a significant capital project it is best to discuss this with your advisor and carry out the project sooner rather than later. It may be that following this year's general election, the new government opt to extend the increase to further encourage growth in British industry.

From a manufacturing perspective, the increased AIA is very much welcomed and has accelerated relief for numerous businesses across the UK. As we are unsure of the future of the increased relief, our recommendation to clients at present is to bring forward any large capital projects, and where possible span multiple years to further accelerate and maximise the relief available. As always, if you are considering carrying out any significant projects, or acquiring new plant and machinery, we are able to provide advice in all steps of the process.

Addition of the SBA

The government also announced a new regime labelled the Structures and Buildings Allowance (SBA), which operates under a similar basis as the now defunct Industrial Buildings Allowance (IBA). This regime provides relief for capital expenditure incurred on all non-residential structural and building works which are not covered under the general plant and machinery allowances. This attracts a 2% writing down allowance on a straight line basis over 50 years. From an investors perspective this can be a double-edged sword as, through claiming the allowance, you are reducing the base cost of the building and increasing the potential chargeable gain on disposal. However, from an owner occupier's perspective, this is something which would normally be unobtainable and a welcome source of relief. For most of our manufacturing clients who tend not to relocate frequently, this source of relief is very much welcomed and is something which should be discussed with one of our specialists.

Abolishing the ECA regime

The most significant change to the regime over the coming months is the scrapping of accelerated relief for environmentally beneficial plant and machinery. The Enhanced Capital Allowances regime (ECA) provides 100% first year allowances for the purchase of environmentally beneficial assets, or assets which contain environmentally beneficial components. The relief will cease to exist for companies on 31 March 2020 and individuals on 5th April 2020. This means any expenditure incurred before these dates will qualify, so if you are considering the purchase of new machinery which may contain components which qualify for the accelerated relief, it is advisable to speak to us about your purchase and we can provide advice from the outset.



Our advice

If you are considering any significant capital projects over the coming months, please do reach out and speak to us. We are able to assist as much or little as you require and are able to provide advice on maximising claims on expenditure which qualifies for ECAs, structures and buildings, and the timing of plant purchases to obtain the maximum relief available.

Off-payroll working from April 2020

From April 2020, new rules apply to businesses who engage off-payroll workers. In many cases, they will be required to deduct PAYE/NIC.



Who is affected?

The new rules apply when a business engages a worker who supplies his personal services through an intermediary, such as a personal service company (PSC), where the worker would be treated as employed if he was engaged directly. It is the responsibility of the business to decide whether the worker would be treated as employed under these rules. Public sector bodies are already caught by similar rules.

Small company exception

Small companies are exempt from the new rules. A small company is one which can satisfy two of the following three conditions:

- Turnover for the year not more than £10.2 million
- Total assets on the balance sheet not more than £5.1 million
- Average number of employees in the year not more than 50

Where the company is part of a group or there are companies under the same control, these companies must be taken into account. Unincorporated businesses are treated as small if their turnover is less than £10.2 million.

New requirements

From April 2020, businesses will have the following responsibilities in respect of off-payroll workers who provide personal services:

- They must determine the status of such workers, categorising them for this purpose only as 'employed' or 'self-employed.'

- They must provide a written statement of the status determination and the reasons for reaching it, to the company to whom it makes payments, and to the worker himself;
- They must deduct PAYE/NIC from the payment to the PSC, and pay employer's NIC. The PAYE and NIC must be accounted for to HMRC via the Real Time Information (RTI) service.
- They must also operate an appeal process, to enable the worker to dispute the status determination and to respond within 45 days. This process does not involve HMRC.

Determining a worker's status for tax purposes

It is not a straightforward matter to determine employment / self-employment status, as is evident from a long string of cases that have reached the courts over the last 50 years, and there are a myriad of factors to take into account.

To assist with this, HMRC has provided an on-line tool called CEST – Check Employee Status Tool - which can be found on by an on-line search for 'HMRC CEST.'

The advantage of using CEST is that HMRC will stand by its conclusions, provided the user has entered the correct information. However, in some borderline cases, the CEST tool will not determine the status either way. In such cases, a judgement will be required to be made or professional advice will need to be taken.

A new version of CEST is expected to be launched by the end of 2019.

It should be noted that determining the worker's status as 'employed' for tax purposes does not mean that he is actually employed by the end-client. The worker's actual, contractual position is unchanged.

Agencies

In some cases, businesses will pay an agency, who will in turn pay the PSC. The business must then pass the status determination to the agency as well as to the worker. Where the engaging business determines the worker's status as 'employed,' the agency will be responsible for the PAYE/NIC. The agency will also bear the cost of employer's NIC. However, they will have no say in the determination of the worker's status.

Non-resident agencies

An agency that is not resident in the UK and has no place of business in the UK is not required to operate PAYE/NIC. In such cases, the engaging business may become liable to operate PAYE/NIC.

Non-compliant agencies

Where an agency fails to account for PAYE/NIC, HMRC will have powers to seek payment of that liability from the engaging business. The relevant legislation has not been published, but thus far HMRC have stated that it would not propose to use these powers where the engaging business has taken reasonable care in applying the rules, or where the non-payment of PAYE/NIC was due to a genuine business failure. Clearly, HMRC is expecting businesses to carry out some degree of due diligence where there is a chain of intermediaries, to ensure that PAYE/NIC is being operated where appropriate.

Further implications for PSCs

Where a worker's status is determined as 'employed' for tax purposes, the PSC will be unable to make tax-free travelling and subsistence payments to the worker, or to pay tax efficient dividends to the worker and his/her spouse. Off-payroll workers are therefore likely to be financially worse off, and may seek to increase their charges.

Action required

Companies who do not qualify as 'small', should consider whether they have any workers who provide personal services, and are not on the payroll. If such individuals are expected to be paid after April 2020, it will be necessary to determine their status for tax purposes. This is the case whether or not an agency is used.

Where a worker's status is deemed to be 'employed' for tax purposes, consideration should be given to reviewing the contractual arrangements, and entering into a dialogue with the worker to agree mutually acceptable terms.

Companies should ensure that copies of the status decision and the reasons for it are communicated before April 2020, and that they retain copies. The reasons for the status decision may be in the form of the printout from the CEST tool where it is used.

Where agencies are used, businesses should satisfy themselves that they comply with the new rules. Where agencies fail to account for PAYE/NIC, liabilities can fall back on the engaging business.

Concluding note

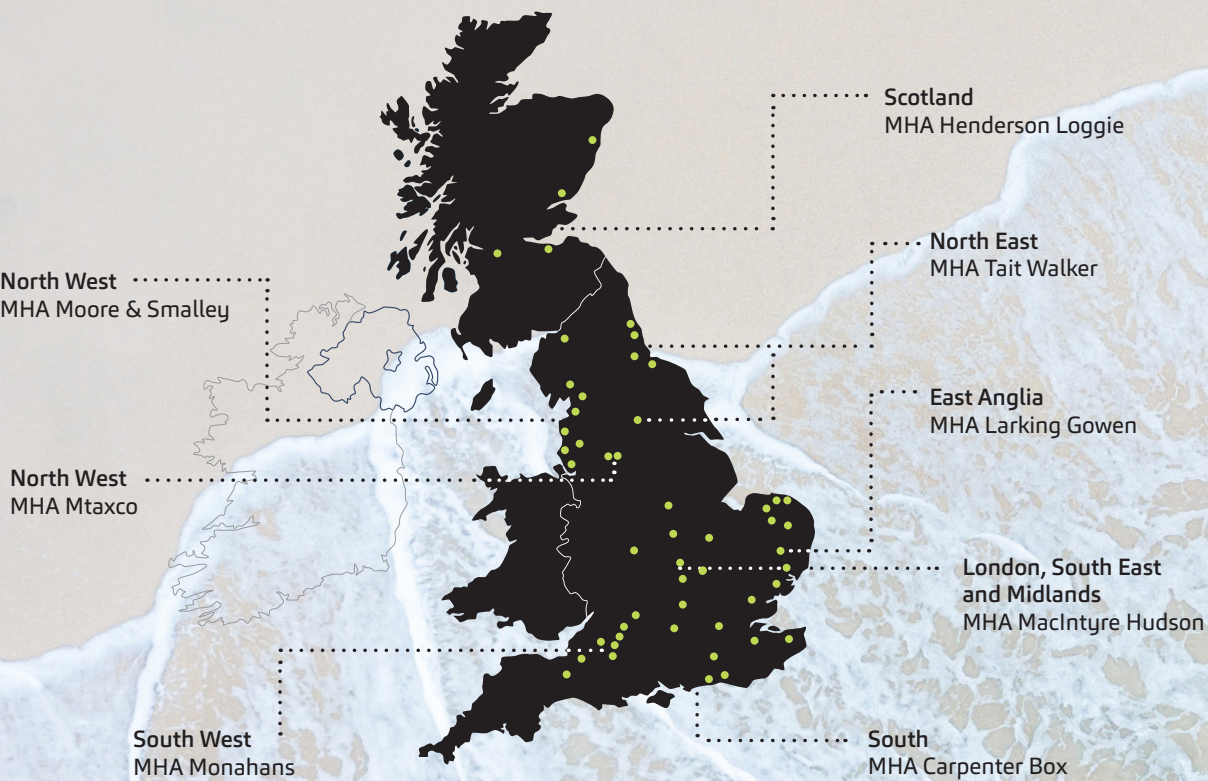
HMRC expects to raise £1.3 billion from the introduction of these new rules. Clearly, it is the view of HMRC that there are a huge number of PSCs who will become subject to deduction of PAYE and NIC.

It should also be stressed that there are no planned changes to the rules for paying freelance workers who do not operate via PSCs. Businesses should continue to check whether their status for tax purposes is employed or self-employed.

About MHA

MHA is an association of progressive and respected accountancy and business advisory firms with members across England and Scotland.

Our member firms provide both national expertise and local insight to their clients. MHA members assist clients with their needs wherever they are in the UK, as well as globally through our membership of Baker Tilly International, which has a network of trusted advisors covering 145 territories worldwide.



Our Services

Our Sector Approach:

MHA allows clients to benefit from in depth sector knowledge in addition to specialist accountancy services and expert business advice. Manufacturing and engineering is a key sector for MHA, and we are committed to assisting both our clients and the sector as a whole by promoting manufacturing and engineering throughout the UK.

As we head towards the post Brexit UK, we think it's more important than ever to champion our sector, which is why we look to share best practice right across our client base. As well as delivering accounts, audit, tax and Wealth Management solutions, we also support skills initiatives, run forums and hold insight events, all aimed at helping our clients in the sector to do better.

Services

- Compliance: audit compliance, accounting and financial reporting. Our audits reassure stakeholders and identify risk.
- Taxation: particularly around international tax, employment issues, R&D Tax Credits, Patent Box, Capital Allowances and tax mitigation.
- Business planning and support.
- Accessing public and private funding.
- Maximising the efficiency of your supply chain: reducing costs and improving margins.
- Mergers & Acquisitions: We have advised on many engineering transactions, including a number of cleantech investments.
- Due diligence ahead of funding and grant applications.
- Risk management: We advise on both governance issues in order to best attract investment and on minimising fraud and corruption risk.

National Reach

8

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145



Territories

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Contact Us

If you require any further information or advice regarding these topics, then please feel free to contact your local MHA member firm.

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