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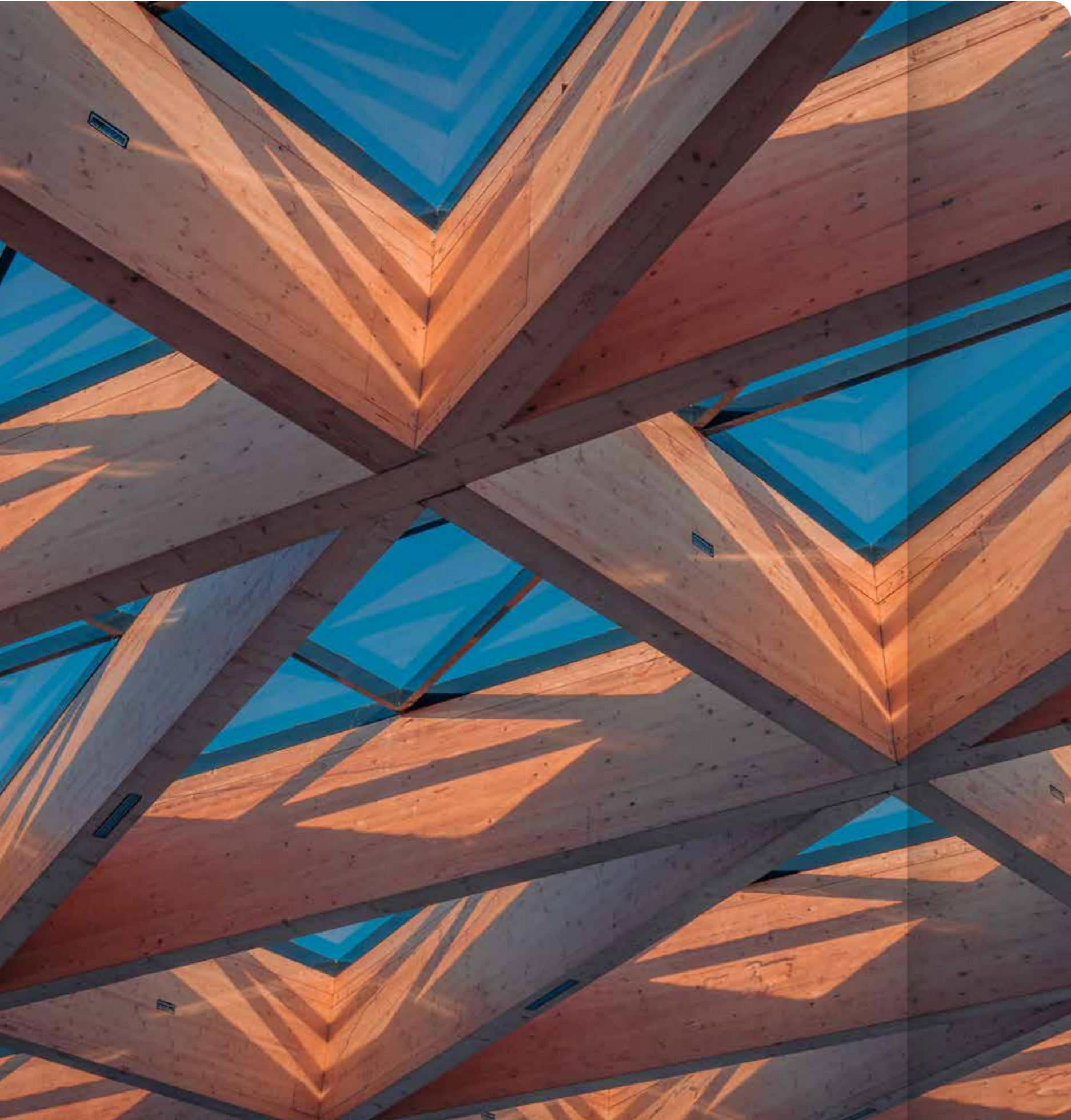
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Welcome to our latest issue of Broking Business...

With the amendments to FRS 102 just a few months away, Michael Marslin, Director in our Financial Accounting Advisory Services team, delves into the world of profit commission accounting, exploring PC structures and how the new accounting standards could impact them. You can access other articles on FRS 102, including our detailed revenue guide, and information on how to account for leases, on our [FRS 102 hub](#).

Submitting your Retail Mediation Activities Returns accurately is a key element of every insurance intermediary's ongoing FCA compliance. Getting it wrong can have serious consequences for the firm, both in terms of attracting unwanted regulatory scrutiny as well as being potentially costly. Senior Manager, Andy Brown explains how to avoid the most common pitfalls.

At our latest bi-annual meeting with the FCA in June, we discussed various hot-topic CASS issues that have been raised by clients during their 2025 audits. Director, Charles Drew summarises the key points from our bilateral discussions and highlights what insurance intermediaries should take into account for future audits.

With the date for the Autumn Budget now set at 26 November 2025, there is mounting speculation about what tax changes the Chancellor will announce. Corporate Tax Partner, Tom Golding discusses the Chancellor's options and what they would mean for the insurance intermediary sector.

And finally, VAT Partner Mark Ellis explains how HMRC is increasing its revenues from insurance brokers without raising headline tax rates.

As always, please contact any of the team to discuss how we can support your business.



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Navigating profit commission arrangements amidst FRS 102 amendments

With the recent amendments to FRS 102, revenue from profit commission ('PC') arrangements may need to be recognised earlier than current practice as the amendments might require a minimum amount to be recognised at inception. This article delves into the world of PC accounting and explores PC structures and how the new accounting standards could impact them.

Understanding performance-based remuneration

Performance-based remuneration is a key part of the remuneration of an insurance intermediary, aligning the intermediary's interests with that of the insurance carrier. Simply put, these arrangements ensure the intermediary has 'skin in the game' with the intermediary sharing in the underwriting profit (or sometimes loss) of the insurer.

These arrangements can take many forms, and the principles we describe below, using PC as an example, can be applied to other types of remuneration.

The ground rules of PC arrangements

PC arrangements are designed to incentivise MGAs and intermediaries by sharing a portion of the profits (or loss) generated from the policies they manage and/or originate. These commissions are typically calculated based on the underwriting result, loss ratio, or combined ratio of the business underwritten, incentivising intermediaries to focus on quality business. The better the carriers do, the more PC becomes payable.

Common structures

PC structures can vary widely, and so, the terms and conditions of measurement and payment triggers are likely to differ in each agreement. Common examples include:

- **Fixed percentage:** A set percentage of the underwriting results after adjustments eg UW expenses
- **Sliding scale / tiered structures:** The percentage varies based on the level of profitability.

PCs might vary based on the cumulative performance over several years rather than just a single financial year or underwriting year to ensure longer term alignment of interests.

Summary of FRS 102 key changes

There are several amendments to FRS 102, effective from 1 January 2026. Those that are most significant align revenue recognition and lease accounting more closely with the respective IFRS standards (IFRS 15 and IFRS 16). Early adoption is permitted if all the amendments are adopted early.

The key change to revenue recognition is the introduction of a single comprehensive **five-step** model for revenue recognition for all contracts with customers broadly aligned with IFRS 15, but with some simplifications. The five steps are:

- Identify the contract(s) with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations
- Recognise revenue when (or as) the entity satisfies a performance obligation.

For more information on the five steps and the potential impacts for insurance intermediaries, please see our [revenue recognition guide](#).

Impact on PC arrangements

Whilst most intermediaries accrue for PC using estimation techniques, there are still many in the market that account for PCs on a cash receipt basis or when the lead carrier has accepted the PC calculation, as this is more convenient and less likely to result in reversals and volatility in the results. The new revenue recognition model could significantly impact the timing and calculation of PCs based on the nature of the arrangements and the current revenue recognition policies.

Under the amendments, revenue is recognised when performance obligations are met, which may differ from current practices. The standard requires an entity to recognise revenue as goods and services are transferred to the customer, using the amount that it expects to be entitled to in exchange for the goods and services. The amendments may result in earlier recognition of commission revenue, which as a minimum amount must now be recognised at inception – provided it is highly probable and unlikely to lead to a significant reversal in future periods. Management will need to ensure that there is sufficient data to support the calculations. This will be more challenging to calculate and may require the use of specialists such as actuaries and earlier engagement with carriers on loss projection.

The steps that are likely to pose the greatest challenge for insurance intermediaries are steps 2 and 3.

1. Identify the contract(s) with a customer
2. **Identify the performance obligations in the contract**
3. **Determine the transaction price**
4. Allocate the transaction price to the performance obligations
5. Recognise revenue when (or as) the entity satisfies a performance obligation.

So, let's consider these further.

Identify the performance obligations in the contract

- Contracts can contain multiple performance obligations. In addition to introducing new clients to the insurer, an intermediary might perform additional services.
- Insurance intermediaries will need to ensure that they have a clear understanding of the nature of each performance obligation, so that they can assess when each obligation is satisfied and the related revenue is recognised.

Determine the transaction price

- The transaction price might include 'variable consideration', ie an element of consideration that is variable or contingent on the outcome of future uncertain events, such as policy cancellations, volume of business, lapses or renewals, and / or claims experience.
- The amendments introduce two methods for estimating the value of variable consideration.

1. **The expected value method:** The expected value is the sum of probability-weighted amounts in a range of possible consideration amounts.
2. **The most likely amount method:** The most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract).

The method that is selected should be the method that provides the best prediction. Variable consideration is also subject to a constraint, and it is included in the transaction price only when it is highly probable that the resolution of the uncertainty will not result in a significant reversal of revenue.

Significantly, management will need to determine if there is a minimum amount of PC that is **highly probable** and will not result in a significant cumulative revenue reversal. If so, that portion of PC will need to be included in the transaction price, even if the variable amount is not included in its entirety. This is likely to be a change from current practice and will require more judgement than is exercised today.



Example

Consider an intermediary that has delegated authority from an insurer. The insurer pays a commission for placement and PC based on underwriting profit. This example considers the first evaluation period of the underwriting year.

For many lines of business, PC is not finalised until several years after the initial policies are written, particularly certain Lloyd's of London business, professional indemnity and medical malpractice books. An intermediary needs to consider whether there is a minimum amount that is not subject to significant reversal that should be recognised sooner.

The steps that are likely to pose the greatest challenge for insurance intermediaries are steps 2 and 3.

The 5-step process:

1. Identify the contract with the customer: ABC Intermediary has a contract with XYZ Insurance Company to provide intermediary services. The contract specifies that ABC Intermediary will earn:

- Policy Placement Fee: ABC Intermediary earns 10% for every policy underwritten.
- PC: ABC Intermediary earns a tiered PC based on the underwriting profit:
 - Loss ratio < 50%: 15% of underwriting profit
 - Loss ratio 50%-70%: 10% of underwriting profit
 - Loss ratio 70% – 80%: 5% of underwriting profit

2. Identify the performance obligations in the contract:

- Initial underwriting only (ie no post placement services).

3. Determine the transaction price:

- The transaction price includes:
 - Commission: 10% of GWP.
 - PC: Tiered based on the loss ratio.
- Assume:
 - Number of policies underwritten: 1,000 generating £1,000,000 GWP
 - Projected underwriting profit: £100,000 equivalent to say 45% loss ratio

4. Allocate the transaction price to the performance obligations

- The total transaction price of £115,000 is allocated to the single performance obligation:
 - Commission: $10\% \times £1,000,000 = £100,000$
 - PC: $15\% \times £100,000 = £15,000$ (since the loss ratio is expected to be 45%)

5. Recognise revenue when (or as) the entity satisfies a performance obligation

- Commission is recognised when the policies are underwritten.
- Assume that the underwriting history of the last 5 years shows on average the PC paid has been 10%, with loss ratios ranging between 55-68% and in no single year has the loss ratio exceeded 70%. A minimum amount of 10% would be booked ($10\% \times £100,000 = £10,000$) with a further £5,000 subsequently booked at a future date when the PC is determined or becomes reasonably certain.
- This is because £10,000 would be considered highly probable and is not expected to be subject to significant reversal. This would result in an acceleration of the recognition of PC for an entity that today recognises all PC when this is determined/paid/approved.
- For more uncertain and volatile lines of business with longer tails, there might still be an argument to constrain the initial recognition of PC further based on supporting data.

Next steps

We can anticipate several challenges for intermediaries, such as the need for detailed contract reviews so that finance teams fully understand PC arrangements. Finance teams will need to better track PC arrangements going forward and may need to adjust financial reporting systems. This might involve training staff, updating internal controls, and engaging with external advisors and carriers to navigate the complexities of the new requirements.

These changes could affect your profit margins, reward schemes, cash flows, ability to meet financial covenants and pay dividends. The Corporation Tax impact should also not be overlooked, including any transition adjustments. So, it is important to understand the changes and to start planning for the transition now. To ensure compliance, intermediaries should start by conducting a thorough impact assessment. This includes reviewing existing contracts and financial reporting practices to identify the potential impact to the timing of PC recognition.

Whilst 2026 might seem some time away, judging by the implementation costs and challenges IFRS reporters faced with IFRS 15 and IFRS 16, it would be wise to ensure these amendments are on your finance team's agenda. For calculations that require more judgement it is worth engaging with your auditors earlier to agree the method and approach that will be applied going forward. Giving yourself sufficient lead time is vital for a successful implementation.

How we can help

Our **Financial Accounting Advisory Services** team is well-equipped to support insurance intermediaries in navigating the complexities of the amended FRS 102 standards. With deep performance-based remuneration structures, we can help you:

Assess the impact of the new revenue recognition model on profit commission arrangements. Review and unbundle customer contracts to identify performance obligations and variable consideration. Provide guidance on accounting for variable and contingent commissions, including minimum recognition thresholds.

Advise on the implications for key metrics such as EBITDA, tax, and financial covenants. Support with accounting papers, policy updates, and financial statement disclosures. Collaborate with actuaries and other specialists to develop robust estimation models and documentation.

Early planning and expert guidance are key to a smooth transition. We're here to help you prepare with confidence.

If you would like advice on any of the issues raised in this article, please contact our experts.



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Avoiding RMAR pitfalls: how errors can cost your firm

Submitting your Retail Mediation Activities Returns (RMAR) accurately is a key element of every insurance intermediary's ongoing FCA compliance. The regulator routinely screens RMAR information in its data warehouse to analyse and spot trends within individual firms and across the market as a whole. It is therefore important to ensure your returns are correct to safeguard your firm from regulatory scrutiny. Andy Brown explains how you can avoid the most common pitfalls.

Getting a Retail Mediation Activities Returns (RMAR) submission wrong can have serious implications for a firm. Unintentional mistakes can raise questions about governance and overall compliance, with even an innocuous error potentially triggering closer supervisory attention from the FCA. Any regulatory intervention runs the risk of reputational damage, harming trust and relationships and impacting your firm's standing in the market.

In addition, RMAR errors and the process to rectify these can create additional work for compliance teams, diverting resources away from core operations. At the very least, errors identified by the FCA may prompt requests for additional evidence to satisfy the regulator that your firm remains compliant.

Common RMAR errors

Based on our experience, there are a number of common errors made by firms in completing their RMARs, any one of which can lead to scrutiny by the FCA and potential reputational damage.

The incorrect calculation of fees entered in RMA-J is the area where firms consistently get it wrong. Where RMAR data is used to calculate a firm's annual regulatory fees, errors in reported regulated revenue, can lead to under/over payment of fees on RMA-J, potentially costing your firm hard earned cash.

Report	Common errors	Consequences
RMA-A	<p>Insurance assets Insurance/client assets, being amounts due from clients, client money bank accounts and amounts due to insurers, which should all balance down to £Nil should be excluded from RMA-A on the assumption that they do not belong to the firm.</p> <p>Intangible assets Firms reporting intangible assets should deduct these amounts when calculating their total capital resources in RMA-D. These cannot be realised instantaneously so cannot be included as part of a firm's capital resource.</p>	<p>You may appear to meet/exceed regulatory capital requirements. Overstating assets can conceal potential capital shortfalls appearing compliant when the firm is actually under-capitalised. Where this is the case, misstated capital resources, (particularly that of a deficit) must be remediated and the FCA notified immediately with information on your remediation plan.</p> <p>At its core, inaccuracies of this nature undermine confidence in your solvency position leading to intensified scrutiny, supervision and reputational damage.</p>
RMA-D	<p>In calculating the firm's capital resources, interim profits should only be included if verified by the firm's external auditor. Interim profits that have not been externally verified should be excluded, unless the firm is eligible for audit exemption under the Companies Act 2006.</p>	
RMA-B	<p>Appointed representatives (ARs) ARs are not FCA authorised entities so are not required to separately report their results to the FCA under RMAR. Instead, as they remain the responsibility of the principal authorised firm, the income from the AR should be included in the authorised firm's RMA-B1 Regulated Business Revenue. Additionally, and in order to ensure that the figures reported in RMA-B agree to the underlying statutory or management accounts, there is an equal and opposite adjustment to the firm's expenses figure to agree to the underlying results.</p> <p>For the purposes of calculating the 'annual income' as part of a firm's capital requirement on RMA-D, it is only the regulated business revenue that is taken into account, not all reported revenue. These amounts should also include AR regulated income.</p>	<p>Failure to correctly include AR income can lead to an understatement of regulated revenue, resulting in an under-calculation of the firm's capital requirement. This exposes the firm to non-compliance with capital adequacy rules. Additionally, discrepancies between reported income may trigger FCA queries and potentially lead to supervisory intervention.</p>



Report	Common errors	Consequences
RMA-D	<p>Subordinated loans A subordinated loan can be included as part of a firm's capital resources if it meets the detailed requirements set out in MIPRU 4.4.7 and 4.4.8. These include, but are not limited to:</p> <ul style="list-style-type: none"> a maturity date of 2 years (or 2 years notice of repayment if it does not have a fixed term). the subordinated loan agreement is set out in writing and has been prepared using the FCA standard template; and the amount of subordinated loan in the capital resource calculation cannot exceed four times net assets of the firm (and whereby net assets excludes redeemable preference shares and intangible assets - but not goodwill up to 14 January 2008). This restriction does not apply where no client money is held. 	<p>Inclusion of subordinated loans that do not meet FCA criteria can artificially inflate a firm's capital resources, giving a false impression of solvency. This misrepresentation may result in regulatory breaches and require immediate correction. The FCA may demand removal of the non-qualifying capital and reassessment of the firm's financial position, potentially triggering capital shortfall notifications and remediation plans.</p>
RMA-D	<p>A firm's capital requirement is set at the higher of the base requirement and:</p> <ul style="list-style-type: none"> 5% of annual income (for firms that hold client money) or; 2.5% of annual income (for firms that do not hold client money) <p>It should be noted that 'holding client money' refers to having a 'client money permission', irrespective of whether client money is actually held or not.</p>	<p>Misinterpretation of the definition of 'holding client money' can lead to underestimating the firm's capital requirement. Firms with 'permissions' that do not account for the higher percentage may fall below required capital thresholds, risking non-compliance. This can prompt FCA scrutiny and reputational damage, especially if the firm is perceived to be operating with insufficient financial safeguards.</p>
RMA-J	<p>Calculation of incorrect income figures by the firm in respect of the FCA, the Financial Ombudsman Service (FOS) and the Financial Services Compensation Scheme (FSCS). Firms are supposed to provide 'annual' figures for the fees calculation in respect of the below:</p> <p>FCA – Annual income A firm needs to calculate the 'annual regulated income' and where the firm has an AR, the 'annual income' of the AR should be included and calculated on the same basis as the firm. Any commission sharing arrangement between the firm and the AR must be identified and excluded from the calculation to avoid duplication of the same income.</p> <p>FOS – Relevant annual income 'Relevant annual income' should include only income received from 'consumers'. The rules were changing from 1 April 2025 to include income from commercial eligible complainants (this previously only included personal complaints). The FCA has now extended the consultation to 1 April 2026.</p> <p>FSCS – Annual eligible income 'Annual eligible income' should include only commission and fees earned in respect of individuals, businesses with a turnover of under £1 million and 'statutory insurance' – i.e. compulsory classes of insurance only.</p>	<p>If you get this wrong, it can prove costly in that incorrect figures may result in a higher fees bill being levied on your firm (and it may then prove time consuming and difficult to correct with the FCA).</p>

It is important to mitigate the potential risks of inaccurate RMARs, ensuring you embed clear ownership in your firm's RMAR procedures, regularly review controls, and make sure that your team is sufficiently trained on RMAR requirements and guidance.

How we can help

Our team has considerable experience of helping insurance intermediaries prepare and submit their RMAR submissions and ensuring they have the appropriate training and robust procedures in place to ensure they do not fall foul of potential pitfalls as part of their submission process. We support firms in the following way:

End to end RMAR submission support

Ensuring full FCA compliance in collating and extracting the required financial RMA information to submit to the FCA on your behalf.

Optimised data capture and controls reviews

Improving information capture systems, ensuring smooth data collection for RMAR submissions, including internal process, controls and procedure reviews and health checks to minimise errors and regulatory risk.

Targeted RMAR training

Essential RMAR training tailored to FCA rules and SUP 16 Annex 18B guidance, helping internal teams stay up to date with regulatory changes and to avoid common pitfalls.

Direct regulatory insights

Through our bi-lateral meetings with the FCA, we ensure our clients gain exclusive, benchmarked insights and best practices on all RMAR issues to help keep firms compliant.

For more information or further support on RMAR submissions, reporting and training, contact our specialist team.



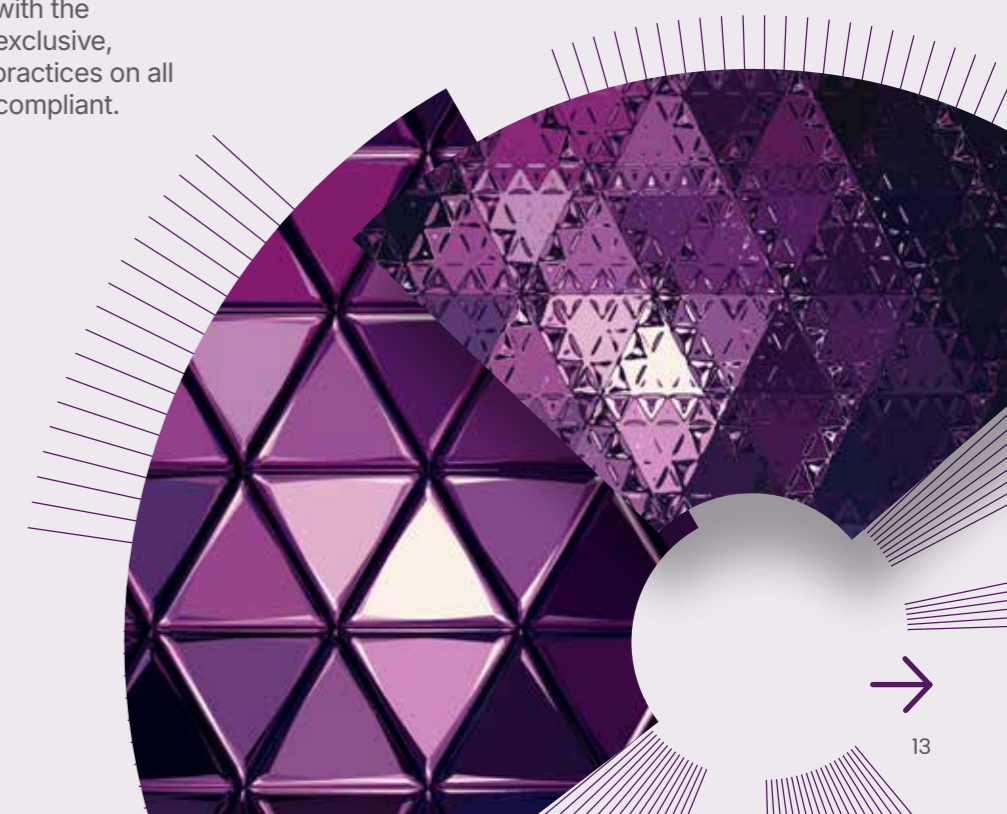
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Focusing on CASS 5: key insights from the FCA

At our latest bi-annual meeting with the FCA in June 2025, we discussed various hot-topic CASS issues that have been raised by clients during their 2025 audits. In this article, Charles Drew summarises the key points that insurance intermediaries should take into account for future audits.

Cancellation of permission letters

Earlier this year, the FCA changed the expected format of reports that could be accepted when firms apply to cancel their client money permissions. The FCA confirmed that firms should obtain a limited assurance report as an ad hoc requirement for this specific purpose, while acknowledging that this not entirely consistent with the SUP rules. This assurance gives comfort that the scope of work set out and performed by auditors is appropriate.

At PKF, we have developed a negative assurance report that the FCA finds acceptable. We discussed this in detail in our recent article on [deauthorisation which you can read here](#).

Designated investments

In a higher interest rate environment, many brokers are using money market funds to optimise returns from the client money they hold in trust. Firms often query whether this means they need to amend their client money permissions or opt into the CASS 7 rules.

The FCA clarified that that the use of money market funds is permitted under CASS 5 and that they are seen as lower risk for insurance intermediaries where any fall in value is assumed by the firm.

Intermediaries should still ensure that they are considering whether any investments are in the interests of their clients and that they are not introducing additional risk based on asset volatility (i.e. whether diversification might be necessary).

Payment service providers

Firms often query how best to assess their use of payment service providers (PSPs) in the operation of their CASS 5 environment. In particular, we are frequently asked how firms should manage PSPs that might introduce a delay in the receipt of client money.

The FCA expects firms to review their relationships with third parties to determine whether they are an Other Agent and how they sit within the existing requirements. They must also document the firm's rationale for use of third parties in line with CASS 5 and in the context of their business model.

More generally, firms should document their approach to any circumstance where receipt of client money is delayed in line with segregation rules.

Credit writebacks

Consolidator groups are continuing to streamline and rationalise to avoid the unnecessary cost and effort of operating too many regulated firms. This can lead to the identification of legacy balances where a credit writeback might be considered.

The FCA does not expect any credit writebacks to take place and views any instance as a breach of fiduciary duties and trust law. They are aware of the common approach of identifying and adjusting historical accounting errors that create a false liability. However, the FCA wants firms to prioritise the cleaning of IBA ledgers, by identifying and adjusting historical accounting errors that create a false liability, before considering options to clear any residual balances from firms' ledgers.

The FCA also noted that it understands that issues do inevitably arise and that a pragmatic and common sense approach, with appropriate documentation, should prevail. Ultimately, the regulator does not expect legacy balances that cannot be settled to be held indefinitely.

Transferring client money

When a firm intends to transfer client money between CASS environments, whether from a statutory trust to a non-statutory trust or between firms, the usual approach has been to obtain explicit consent from more than 85% of clients before applying to the FCA to transfer any client money.

The regulator explained that this is not prescriptive and is often nuanced and specific to the individual firm. It might, for example, still reject applications where over 85% client consent has been obtained if the arrangements in place indicated that a transfer wasn't in the interest of the firm's clients.

Another area of focus is around whether groups can move funds between client money environments without going through this consent process if each entity has the same owners and directors. In these circumstances, the FCA expects that any process should fall back on the client terms of business as the backbone of governance for any potential transfer. Firms should ensure that the terms of business in place with clients clearly communicate the proposed transfer of client money.

How we can help

Contact our experts or your usual point of contact if you would like to discuss any of the issues raised in more detail.



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Will insurance brokers be hit by the Autumn Budget?

With the date for the Autumn Budget now set at 26 November 2025, there is mounting speculation about what tax changes the Chancellor will announce.

We already know that there is pressure on the Chancellor from the Government's fiscal rules. The manifesto pledge not to raise taxes on working people in theory rules out increases to Income Tax, National Insurance or VAT. So what are the Rachel Reeves' options and what would they mean for brokers?

Freeze thresholds for longer

Income tax thresholds are currently frozen until 2027/28. Extending this for a further period of time, perhaps until the end of this parliament, would raise additional tax revenue for the Government while also not breaking their manifesto promise of not increasing tax rates.

These changes would impact employees and business owners alike, bringing more people into tax at higher rates.

Pension tax relief

We already know that residual pension funds will become liable to Inheritance Tax (IHT) from 6 April 2027. However, there are further changes that the Chancellor is thought to be considering:

- Ending higher and additional rate tax relief for pension contributions meaning that individuals will only be entitled to 20% basic rate tax relief.
- Scrapping or further limiting the 25% tax-free lump sum. Currently individuals can withdraw 25% of their pension without paying income tax up to a cap of £268,275.

Changes to pension tax relief would be a blow to employees and might deter people from saving for retirement, something that the Government has already acknowledged as being an issue.

Salary sacrifice arrangements

Linked to pension tax relief changes are salary sacrifice arrangements. Typically, an employee foregoes an amount of their salary in exchange for pension contributions. This has the benefit of Income Tax relief but also saves on National Insurance Contributions for both the employee and the employer (something that has become more attractive with the increase to employer's National Insurance announced at the previous Budget).

Options to change these rules include:

- Capping the amount an individual can sacrifice each year
- Abolishing the National Insurance savings.

Both of these changes would be felt by employees and employers, with the largest impact being felt by those brokers with a significant number of employees making salary sacrifice pension contributions. Further, if salary sacrifice arrangements were to be changed for pension contributions, it seems likely that similar arrangements that apply to benefits such as electric vehicles, childcare vouchers and cycle-to-work schemes may also be impacted.

Capital Gains Tax (CGT)

CGT rates were previously increased in 2024 to 18% and 24%; they could be increased further.

Although aligning CGT rates with Income Tax rates could have a detrimental effect, causing business owners to delay sales, increases in rates have been shown to increase tax revenues in the year before introduction with people wanting to secure a sale at the current rate.

This was something we saw last with a significant increase in sale activity within the market in the run up to the Budget. Whether a further increase this year would have the same effect remains to be seen.

Inheritance Tax

We know that significant changes were made to the IHT rules last year, some of which have still to take effect. Further changes that the Government are thought to be considering are in respect of gifts.

Currently if someone makes a gift and then survives for at least seven years from the date of the gift, the entire amount is exempt from IHT. The amount of relief tapers where a gift is made and the donor survives more than three years but less than seven. The Chancellor could:

- Introduce an overall cap on the value of gifts made within a donor's lifetime.
- Adjust the taper period for gifts, with the 7 year point at which gifts are exempt being extended to 10 years.

Family-owned brokers have already seen a significant change in the way they plan for succession. With Business Property Relief now only applying to the first £1m of qualifying shares passed on, further changes to the gift rules could see more and more people coming within the charge to IHT when taking over the business.

National Insurance on partnerships

Currently partners pay class 4 National Insurance on their profits from the partnership as self-employed. However, because of this their profits are not subject to employer's NIC.

While most brokers do not operate through partnerships, if this were to change such that employer's NIC did apply to partnership profits, this would significantly impact those that do.

Conclusion

As well as the above it is thought that there are further changes being considered, some of which include reforms to property taxes, rental income and indirect taxes.

It remains to be seen what changes are announced on 26 November, however it seems likely that whatever these changes are they will impact the tax position for the insurance broking market.

If you would like to discuss the impact of these changes or any other tax related issues, please contact our expert.



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Input VAT refunds: How HMRC is increasing its revenues from insurance brokers without raising headline tax rates

A broker that is registered for VAT and successfully claiming refunds on input VAT from HMRC might consider that its historic refunds are secure. Unfortunately, this is not the case, as Mark Ellis explains.

Since the change in Government, we have seen a reinvigorated HMRC starting to review VAT returns filed in the past four years by brokers and other insurance sector businesses. Many of these VAT inspections arise out of a pre-credibility check of the most recently filed VAT return form that claimed a refund of VAT – and there are a number of lessons to be learned.

Lesson 1: Resolve HMRC enquiries quickly

Unless and until HMRC's enquiries are satisfactorily resolved, HMRC holds on to the input VAT refund claimed, as well as any further input VAT refunds claimed in the meantime. This is so that any monies that HMRC identifies as owed to it from the past can be set off against the most recent input VAT refund claims. So, from a cashflow perspective, it is in the interests of the broker concerned to resolve HMRC's enquiries as quickly as possible.

Lesson 2: Past treatment does not mean you are safe

If HMRC issues an assessment to claw back previously made input VAT refunds, the cashflow impact on the broker can be significant: the firm will be expected to pay back the refund plus interest (currently 8%) and potentially also a 'careless error' penalty of up to 30% of the amount of VAT clawed back. It's tempting to think that HMRC's previous conduct towards the broker (ie making VAT refunds without challenge) should somehow prevent HMRC from retrospectively applying its current position on previous refunds. However, that would be a mistake.

This is because the VAT Act gives HMRC the power to review, and challenge where necessary, the underlying VAT return workings going back up to four years.

Lesson 3: Input VAT refunds following a pre-credibility check are 'provisional'

Where a broker points towards a previous four-year HMRC VAT inspection or a pre-credibility check of one VAT return that did not result in any VAT assessment raised in respect of the VAT accounting error(s) that HMRC is now identifying on a current basis, the broker may try to argue that HMRC approved its VAT accounting during those previous HMRC interactions. However, when HMRC concludes a pre-credibility check of a single VAT return form, it states the following in its closing email / letter issued to a business:

"It is important that you understand that this check is not a full audit of your VAT declarations. If we consider that a more detailed check of the same periods is appropriate we may carry out a further review at a later date."

So, input VAT refunds received following a 'successful' pre-credibility check of a single VAT return form claiming a VAT refund are, as far as HMRC is concerned, provisional and subject to future HMRC inquiries as part of any future in-depth four-year VAT inspection.

Lesson 4: Unless HMRC made a positive statement in a previous VAT inspection, you could still be caught

Where HMRC has previously carried out a four-year VAT inspection without challenging the broker's VAT accounting at the time, then a broker may feel that it has stronger grounds to rebut any retrospective VAT assessments issued now. However, the courts have confirmed that this is not the case on several occasions, the most recent of which being the case of Realreed Ltd t/a Chelsea Cloisters. Here the taxpayer lost its judicial review High Court case against HMRC's retrospective four-year VAT assessment issued after several previous VAT inspections had passed without incident. The Court ruled that a taxpayer can only defend against retrospective VAT assessment action where HMRC does or says something positively during a previous VAT inspection about the taxpayer's VAT accounting (ie HMRC clearly states in writing that it agrees with the taxpayer's VAT accounting) rather than just not take issue with the taxpayer's VAT accounting by issuing a VAT assessment.

The same taxpayer also lost its argument in the First-tier Tribunal that HMRC should not have levied a 'careless error' penalty, on top of the retrospective four-year assessment for VAT and interest, because HMRC considered that the taxpayer had not taken 'reasonable care' in its VAT accounting. The Tribunal provided the following reasons for its view:

1. The taxpayer did not take considered professional advice from a specialist VAT adviser about (i) its VAT accounting or (ii) whether HMRC's 'positive' conduct following previous VAT inspections (ie no assessments being issued) gave the taxpayer a 'legitimate expectation' that HMRC had effectively approved the taxpayer's VAT accounting.
2. When they arrived at the business, the taxpayer's finance director did not investigate (internally or externally) the taxpayer's VAT accounting - they just accepted that it was correct.
3. HMRC offers a VAT ruling service - the taxpayer did not use this to try to obtain positive written confirmation from HMRC that HMRC agreed with its VAT accounting.

How can a broker protect itself?

In short, obtain VAT advice from a specialist VAT adviser. Even if HMRC disagrees with the VAT accounting adopted, it does not levy 'careless error' penalties on top where a competent adviser has provided an arguable view that the broker's VAT accounting is correct based upon full knowledge of all of the relevant facts. Where there is risk that HMRC may seek to clawback previous VAT refunds (plus interest) then consider one or more of the following actions:

- Earmark funds to cover any potential future VAT assessments
- Where the total potential amount at stake is greater than £0.5m, consider taking out tax exposure insurance
- Where possible, follow the advice given by the specialist VAT adviser and change contractual and commercial arrangements to support the VAT accounting currently being adopted.

For further advice on issues raised in this article, please contact our expert.



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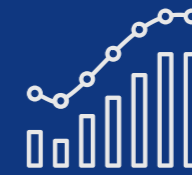
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