

Business tax round up (Lecture B1266 – 25.18 minutes)

Basis period reform for unincorporated trading businesses

The government is introducing a reform of basis periods for unincorporated trading businesses in draft FB 2022 whereby businesses will be taxed on the profits arising in a tax year for 2023/24 with a transitional year in 2022/23. This is different to the current year basis in force at the moment which uses the general rule that a basis period for a tax year is the 12 months ending with the accounting date in that tax year together with additional rules for the opening and closing years of a business and when there is a change in accounting period end. The operation of the current rules in the early years of a business can create overlapping basis periods which result in profits being charged twice and the creation of overlap relief which is usually given on the cessation of the business. The proposed reform aims to make the basis of assessment for trading profits simpler and aligned with other sources of income but also links in with the government's plans for Making Tax Digital which becomes mandatory for self-employed businesses from April 2023.

The changes include:

- from 2023/24 the profits of the tax year will be the profits arising in that tax year with accounting period profits being apportioned by the number of days or another reasonable basis;
- the basis period for the transitional year of 2022/23 will be the current year basis period profits plus the transitional period profits which arise in the period from the day after the current year basis period to 5 April 2023;
- in the transitional year of 2022/23 all overlap relief brought forward must be used and in subsequent years no further overlap relief can be created;
- any additional profits arising for the business under the new rules will be spread over five tax years starting in 2022/23 with an option to elect to accelerate the tax charge;
- trading and property businesses can treat an accounting date between 31 March and 4 April inclusive as being equivalent to ending at the end of the tax year and so would not have to make small apportionments of profits;
- the same basis period reform would apply for businesses which currently use the cash basis to calculate their profits;
- the proposals apply to the self-employed, partnerships, trusts and estates with trading income but the proposals will not affect companies apart from some non-resident companies;
- The government has published a consultation on the proposals which closes on 31 August 2021, alongside a policy paper, draft legislation and explanatory notes. The draft legislation is in clause 1 and 2 of and Schedule 1 to the draft FB 2022.

5th SEISS grant – Eligibility and turnover test

The online service for self-employed individuals and members of a partnership claiming the 5th SEISS grant opened in late July 2021 and claims must be made by 30 September 2021.

The grant is subject to income tax and National Insurance and must be reported on the taxpayer's 2021/22 Self Assessment tax return. The grant also counts towards the taxpayer's annual allowance for pension contribution purposes.

Eligibility criteria

To be eligible for the 5th grant, taxpayers must have:

- traded in 2019/20 and 2020/21;
- submitted their 2019/20 tax return by 2 March 2021;
- trading profits of no more than £50,000 and at least equal to their non-trading income for either:
 - 2019/20; or
 - the average of 2016/17, 2017/18, 2018/19 and 2019/20.

Taxpayers must also declare that they intend to continue trading in 2021/22 and that they reasonably believe there will be a significant reduction in their trading profits due to COVID-19 between 1 May 2021 and 30 September 2021.

As with earlier grants, agents cannot make the claims on behalf of their clients.

Level of the grant

Taxpayers will fall into one of two levels of grant based on how much the taxpayer's turnover has reduced:

1. A turnover reduction of 30% or more - the grant will be 80% of three months' average trading profits, capped at £7,500
2. A turnover reduction of less than 30% - the grant will be based on 30% of three months' average trading profits, capped at £2,850.

HMRC will not ask for any turnover figures if a taxpayer started trading in 2019/20 and did not trade in 2016/17 to 2018/19. These taxpayers will receive a grant based on 80% of trading profits.

Turnover test

Details of how the 30% turnover test works were published on 6 July.

Unlike the earlier grants, it appears that the test is far from straight forward, with taxpayers needing to calculate and then compare two turnover figures:

1. 2020/21 Pandemic year turnover – a 12-month period starting between 1 and 6 April 2020;
2. Reference year turnover - Turnover for 2019/2020 (or 2018/2019 – see below).

HMRC has advised taxpayers to have both figures ready prior to making their claim.

Let's consider each of these in turn.

2020/21 Pandemic year turnover

For this turnover figure, the 12-month period must start on any date from 1 April 2020 to 6 April 2020 so those with a:

- 31 March accounting year end will use the turnover for the 12-months from 1 April 2020 to 31 March 2021;
- 5th April accounting year end will use the turnover for the 12-month period from 6 April 2020;
- Others will need to apportion two year's results.

The guidance states that for businesses that started or ceased during the year, the turnover reported will be for less than 12 months. Presumably this applies for traders who have more than one business, otherwise this would appear to be at odds with the eligibility criteria stated earlier:

Taxpayers must have submitted their 2019/20 tax return by 2 March 2021 so they must already have been trading at the start of 2020/21;

Taxpayers must declare that they intend to continue trading in 2021/22 so ceasing in 2020/21 is not an option.

Taxpayers should include the turnover for all businesses but exclude all other income including COVID-19 support payments, such as previous SEISS grants, Eat Out to Help Out payments and local authority or devolved administration grants.

Reference year turnover

For most, the second turnover figure required will be the total turnover from all businesses as reported in their 2019/20 tax return.

However, where this was not considered to be a 'normal year', taxpayers can use the turnover reported in their 2018/19 return indicating why 2019/20 was not a normal year. HMRC give examples where the taxpayer:

- was on carers' leave, long term sick leave or had a new child;
- carried out reservist duties;
- lost a large contract;
- is eligible for the 5th grant but did not submit a 2019/20 return.

Where a taxpayer has an accounting period that is longer or shorter than 12 months, this must be adjusted to a 12-month figure (see examples below).

Partners in a partnership must provide turnover figures for the whole partnership. However, where they have other businesses, they must use their share of the partnership turnover.

Determining which grant is available

Having calculated the two turnover figures, the two must be compared.

Where the 2020/21 pandemic year turnover is less than the reference period turnover, the 5th SEISS grant is available at either the higher or lower level detailed above.

HMRC' guidance provides some useful examples, some of which are reproduced below.

Higher grant available

A taxpayer has calculated their turnover figures as:

- £20,000 for 2019/20 (Reference year)
- £10,000 for April 2020/21 (Pandemic year)

Turnover reduced by 50% (> 30%) and so the higher grant worth 80% of 3 months' average trading profits is available.

Lower grant available

A taxpayer has calculated their turnover figures as:

- £20,000 for 2019/ 20 (Reference year)
- £16,000 for April 2020/21 (Pandemic year)

Turnover is reduced by only 20% and so only the lower grant worth 30% of 3 months' average trading profits is available.

2019/2020 not a normal year

Taxpayer experienced a long period of sickness in 2019/20 and so chooses to base their reference year on turnover for 2018/19.

<u>Year</u>	<u>Turnover</u>
2018 to 2019	£36,000
2019 to 2020	£12,000
2020 to 2021	£9,000

This means that £9,000 is compared with £36,000 and the higher grant would be available.

Taxpayer with more than one business

A taxpayer has two businesses with the following turnover:

<u>Year</u>	<u>Business A</u>	<u>Business B</u>	<u>Total turnover</u>
2019/20	£30,000	£20,000	£50,000
2020/21	£20,000	£5,000	£25,000

The turnover is combined and the two years are then compared, showing that turnover had reduced by 50% and so the higher grant is available.

Accounting period longer than 12 months

Where a taxpayer has a long accounting period in their return, this must be reduced to 12 months.

For example, a 15-month accounting period with turnover of £45,000 in their 2019/20 tax return is divided by 15 (£3,000) and multiplied by 12 to arrive at the reference period turnover of £36,000.

However, if this method does not produce a fair result an alternative reasonable method may be used.

Accounting period shorter than 12 months

Where a taxpayer has a short accounting period recorded in their 2019/20 return, this must be adjusted to 12 months.

For example, say they had:

- an 8-month period and declared turnover of £16,000 on 2019/20; and
- a 12-month accounting period in 2018/19 and declared a turnover of £24,000.

The 12-month reference period is calculated by adding 4-months of the turnover from their 2018 /19 tax return (£8,000) to the 8-months of turnover from their 2019/20 tax return. (£16,000) to give £24,000 as the reference period turnover.

<https://www.gov.uk/guidance/work-out-your-turnover-so-you-can-claim-the-fifth-seiss-grant>

HMRC amending SA returns for SEISS

HMRC has published new guidance on reporting SEISS grants received.

Payments from the first, second or third SEISS grants should be included on the taxpayer's 2020/21 return in the Self-Employment Income Support Scheme grant box as follows:

- 70.1 on the Self Employment (full) page (SA103F);
- 27.1 on the Self Employment (short) page (SA103S);
- 9.1 of the partnership page (SA104);

- 3.10A of the SA200 tax return.

From 19 June 2021, where SEISS grants information does not match HMRC's records, HMRC has been automatically correcting 2020/21 Self Assessment returns and issuing a revised SA302 calculation showing the correction. Taxpayers must check this revised calculation and consider whether their return needs amending further.

Where a taxpayer or their agent submitted an amendment prior to 19 June, HMRC will make the correction to the original return rather than the amended one. Changes made by the taxpayer before 19 June 2020 will not be included in any revised tax calculation. Such taxpayer amendments require no further action as the update will be processed separately.

Correct box but wrong amount

Amendments have been made where SEISS payments were reported in the correct box but the amount reported did not agree with HMRC records.

Incorrect box but correct amount

Where amounts were not recorded in the correct 'approved' box, HMRC has now included the payments in that box. To avoid being taxed on the same income twice, it is important that taxpayers now remove the grant from where they have reported it.

Failure to report SEISS payments

Where a taxpayer has failed to report their SEISS payment(s) at all, HMRC will have amended the tax return and sent the taxpayer a revised tax calculation.

Taxpayers not submitting the relevant Self-Employment or partnership page

Where these pages were not included, HMRC will assume that these taxpayers were not eligible to claim the SEISS grant and will take steps to recover them.

However, taxpayers who were eligible for SEISS but forgot to submit the correct page, should update their return to include the correct page, with the grants received in the correct box.

Amendment by HMRC for a grant that was not received

Where HMRC make an amendment to a taxpayer's return to include a SEISS payment that was never received by the taxpayer, this may suggest that a grant was claimed fraudulently using the taxpayer's personal details. In this case, they should contact HMRC on 0800 024 1222.

Taxpayers who disagree with HMRC's changes

Taxpayers must contact HMRC within 30 days from the date of the SA302 letter advising them of the correction.

<https://www.gov.uk/guidance/check-if-you-need-to-change-your-self-assessment-return-for-seiss>

Nature of expenditure

Summary – The costs of renovating a run-down farmhouse and cottage were capital in nature and not incurred wholly and exclusively for the purposes of the trade.

The Elliot Balnakeil partnership had existed for over 100 years in Scotland, farming sheep and cattle to be sold on to other farmers. The partners spoke of the financial challenges in farming in such a remote location.

Among the partnership's assets was the Balnakeil House, a 'category A' listed building. Until 1992 the house provided accommodation for the general manager. On his death, instead of appointing a new general manager, one of the partners took over the management of the farm, making regular visits from the Borders. The House became increasingly uninhabitable.

A second property, Beach Bothy, was a small one-bedroom outbuilding, historically used as a shepherd's cottage, last used in the 1970s and uninhabitable due to disrepair.

The house, as a listed building, required the partnership to maintain it. An Urgent Works Notice was served requiring the house to be repaired. The partners decided to renovate both the house and bothy to an extent beyond that required by the notice to provide holiday lets and so diversify the partnership business. While the project was being considered, the farming partnership was dissolved. A new partnership 'Andrew & Elizabeth Elliot (Balnakeil)' was formed in January 2012 and it was this partnership that marketed the properties as furnished holiday lets and received the letting income in January 2013.

The deduction for renovation costs in the partnership return for 2011/12 was disallowed by HMRC as being capital in nature. The disallowed amounts were:

- £206,000 for repairs to Balnakeil House;
- £23,000 for repairs to the bothy;
- £36,000 of related legal and professional fees.

Both parties agreed that there were two issues to determine:

- Issue 1 - whether the disputed expenditure was capital or revenue in nature;
- Issue 2 - whether the disputed expenditure was incurred wholly and exclusively for the purposes of the partnership trade.

Decision

The First Tier Tribunal found that all of the renovation costs were capital in nature, and not revenue. Although the repairs were necessary, the level of work undertaken had converted the pretty much uninhabitable house and bothy into luxury holiday lets, so changing their overall character.

Although a decision on the second issue was then not required, the Tribunal stated that, even if found to be revenue in nature, the partnership was not previously running a holiday letting trade and so the expenses would not have been wholly and exclusively incurred for the trade

The renovation expenditure incurred to convert redundant, uninhabitable properties into luxury letting accommodation was not the taxpayer's trade, but rather the new partnership's trade. It was not incurred 'wholly and exclusively' for the purposes of the farming partnership's trade.

The appeal was dismissed.

Revenue and Customs Brief 9 (2021)

The Brief sets out HMRC's position for the supply of day care services supplied by private bodies following the Court of Appeal's judgment in the joint appeals of LIFE Services Ltd and The Learning Centre (Romford) Ltd [2020] STC 898 (and the Supreme Court's decision to refuse leave to appeal).

The provision of welfare services by private bodies that are not charities is only exempt from VAT if the body concerned is a state-regulated, private welfare institution or agency (VATA 1994 Sch 9 Group 7 item 9). Note (8) to Group 7 defines 'state-regulated', as 'approved, licensed, registered or exempted from registration by any Minister or other authority pursuant to a provision of a public general Act'.

This Brief confirms that the VAT exemption does not apply to private welfare institutions or agencies which supply day care services in England and Wales and are not state-regulated. Providers in Scotland and Northern Ireland are not affected by the judgment because, under devolved provisions, they are required to be state-regulated.

<https://www.gov.uk/government/publications/revenue-and-customs-brief-9-2021-vat-liability-of-daycare-services-supplied-by-private-bodies-in-england-and-wales>

Revenue and Customs Brief 10 (2021)

This Brief announces a further extension to the overseas refund scheme that applies to overseas businesses not established in the EU and not VAT registered in the UK.

Applications for refunds under the scheme for the year to 30 June 2020 should have been submitted with a certificate of status no later than 31 December 2020.

Due to COVID-19 and businesses having difficulties getting the required certificate of status from their official issuing authorities, this deadline had been extended to 30 June 2021. This Brief announces a further six-month extension to 31 December 2021.

HMRC will continue to review the situation and, where businesses are still experiencing difficulties, will consider if further easements are possible.

<https://www.gov.uk/government/publications/revenue-and-customs-brief-10-2021-repayment-of-vat-to-overseas-businesses-not-established-in-the-eu-and-not-vat-registered-in-the-uk>

Production costs not directly linked to catering

Summary – The Court of Appeal has confirmed the Upper Tribunal's decision that as production costs were not directly and immediately linked with catering supplies, input VAT on the production costs could not be recovered.

The Royal Opera House is a charity that stages ballet and opera performances and as part of the "fully integrated visitor experience" provides extensive catering facilities, quite different to a West End theatre, "where there might be a cramped bar or just ice creams available".

It was agreed that ticket sales for admission to performances is an exempt VAT supply of 'cultural services', while the catering supplies were standard rated.

The Royal Opera House claimed there was a direct and immediate link between the production costs and both admission and catering supplies and on that basis claimed £532,069, the proportion of the input VAT paid between 1 June 2011 and 31 August 2012 relating to the catering activity.

HMRC considered the only direct and immediate link of the production costs was with the sale of tickets so that it was not possible to recover the input tax.

The First Tier Tribunal had ruled in favour of the Royal Opera House, finding that there was an economic link between the production expenditure and the catering supplies. The performances brought in the customers with the customers then purchasing food and drink.

The Upper Tribunal had disagreed finding that the production costs were directly and immediately linked to the performances for which tickets were sold. However, there was only an indirect economic link between the production costs and the catering supplies, as the production costs were not used to make the catering supplies and were not part of the costs of making those supplies.

The Royal Opera House appealed to the Court of Appeal.

Decision

The Court of Appeal concurred with the Upper Tribunal, finding that there was no direct and immediate link between production costs and catering supplies.

Although not necessary, the Court of Appeal briefly considered HMRC's alternative argument that the performances could be viewed as promotional activities generating the catering supplies, creating a direct and immediate link but in a chain of transactions. As the performances were chargeable services, these severed the chain between the costs and the catering supplies.

The Court of Appeal noted that had the performances been provided free of charge, there would be no economic activity in the performance. It might be arguable that this established a direct and immediate link with the catering supplies, resulting in the costs becoming recoverable. *Sveda* (Case C-126/14) [2016] STC 447). However, the judge did not expand on this since the supply of tickets was exempt.

Royal Opera House Covent Garden Foundation v HMRC [2021] EWCA Civ 910