

Business tax update (Lecture B1346 – 12.44 minutes)

Dividend not accessible by creditors

Summary – A large dividend paid at a time when the company was solvent was lawfully made and not accessible to the company's creditors following a subsequent insolvency.

In 2009, the directors of AWA distributed €135 million as a dividend to its only shareholder, Sequana SA, extinguishing most of a larger debt owed. At the time, looking at both the company's balance sheet and on a cashflow basis, the company was solvent. However, there were long-term pollution-related contingent liabilities meaning that there was a risk of insolvency in the long term, but the risk was not imminent nor probable,

Roll forward nearly 10 years, and AWA went into insolvent administration. BTI 2014 LLC, as the assignee of AWA's claims, sought to recover the amount of the May dividend from AWA's directors. It argued that, when paying the dividend, the directors had failed in their 'creditor duty' as there was a real risk of, insolvency. This duty is also known as the "rule in West Mercia" after the leading case of West Mercia Safetywear v Dodd.

Both the High Court and the Court of Appeal rejected the creditor duty claim. The Court of Appeal had stated that:

"the creditor duty did not arise until a company was either actually insolvent, on the brink of insolvency or probably headed for insolvency."

At the time of the dividend payment, AWA was not insolvent or on the brink of insolvency and so the appeal failed. BTI 2014 LLC appealed to the Supreme Court.

Decision

The judges confirmed that, under Companies Act 2006 there is a duty for directors to act in good faith to promote the success of the company for the benefit of its members.

The Supreme Court found that, in certain circumstances, this duty was modified by the common law rule that the company's interests are taken to include the interests of the company's creditors.

Creditors have an economic interest in the company and that interest increases where the company is insolvent or nearing insolvency. Where this is the case, directors should manage the company's affairs in a way which takes creditors' interests into account.

The key issue in this case was whether the creditor duty was engaged at the time the dividend was paid. The Supreme Court found that it was not.

The judges confirmed that the creditor duty was only engaged when the directors knew, or ought to have known, that the company was insolvent or bordering on insolvency, or that an insolvent liquidation or administration was probable. When the 2009 dividend was paid, AWA was not actually or imminently insolvent, nor was insolvency even probable.

The Supreme Court unanimously dismissed the appeal.

Unavailable information

Summary – The taxpayer, a charity, should be issued with the closure notice requested, with HMRC deciding the outcome based on the data already in its possession.

Newpier Charity Limited submitted its corporation tax return claiming charity tax relief on payments made by the charity to its creditors. HMRC raised an enquiry to check the claim and asked the taxpayer for more information.

The charity provided some information, but said it was unable to obtain anything further. It said that because the transactions had taken place more than 20 years ago, it was 'unreasonable' to expect the information relevant to them to be available. Further, it was not in HMRC's power to assess for such periods so the documents could not be reasonably required before the enquiry was closed.

However, HMRC continued to seek information and said that the enquiry could not be closed without it. The charity applied to the First Tier Tribunal for a direction that HMRC close the enquiry. HMRC said that it still had concerns about whether the income had been used for charitable purposes and without further information would be unable to reach a conclusion.

Decision

The First Tier Tribunal accepted that some of HMRC's concerns as to the legitimacy of the claim were reasonable and might justify the continuation of the enquiry.

However, the judge said the taxpayer's assertion that the information requested was 'not available due to the effluxion of time' or because it had never existed had been 'definitively stated in two witness statements which contain a statement of truth', which made it subject to the Perjury Act 1911.

As a result, the First Tier Tribunal directed HMRC to make an 'informed judgment' based on the information it held and then to close the enquiry.

The charity would be entitled to appeal against the closure notice if it wished and the tribunal would then decide – on the evidence already held – whether relief was due.

The charity's application for a closure notice was allowed.

Newpier Charity Limited v HMRC (TC08622)

Adapted from the case summary in Taxation (3 November 2022)

Delayed input tax claim denied

Summary – Although the late claim for input tax recovery was within time, there was a lack of evidence to support the amount of the claim made.

Between 1974 and 1997, NHS Lothian Health Board operated a number of scientific labs which undertook both business and non-business activities. NHS Lothian Health Board did not reclaim the input VAT paid in respect of those years until after the enactment of s.121 FA 2008. This provided that input tax recovery claims for accounting periods ending before 1 May 1997 could be made without time limit, provided the claim was made before 1 April 2009.

NHS Lothian Health Board submitted their claim in-time, but the issue was with the amount of the input tax reclaimed. The Board had insufficient records to show exactly how much input VAT had been paid for the work done in the labs, or to support the split of that work between business and non-business activity over the claim period. As a result, the Board calculated and applied a baseline percentage of 14.7%, adjusted for each year, to the total amount of VAT incurred for each year. The percentage used was their estimate of activity that was business activity in 2006/2007.

NHS Lothian Health Board's claim for repayment of the overpaid tax was rejected by HMRC, who argued that the Board had not established that the method of valuing the claim was reasonable. In particular, they challenged using the 14.7%.

Both the First Tier and Upper Tribunal had dismissed the appeal, but the Inner House of the Court of Session had allowed the appeal. HMRC appealed to the Supreme Court.

Decision

The Supreme Court found that it was not enough to merely show that input tax had been suffered for the period; it was also necessary to be able to quantify the amount accurately through invoices or by using an alternative credible method.

The First Tier Tribunal had not found that the proportions of NHS Lothian Health Board's business and non-business activities were pretty much the same across the claim period. The First Tier Tribunal had found there was insufficient evidence to establish what the proportion was and whether, and if so, how it varied through the claim period.

Further, the EU principle of effectiveness prohibits national laws which make claims based on directly effective EU law "virtually impossible or excessively difficult" to enforce. The Supreme Court held that the EU principle of effectiveness was not infringed. This principle did not require the ordinary rules on evidence and the burden and standard of proof to be changed, just because the taxpayer could not comply with these rules. The rules in this case were no different to other historic claims.

The Supreme Court held that the First Tier Tribunal's decision, as upheld by the Upper Tribunal, was correct. HMRC's appeal was allowed.

HMRC v NHS Lothian Health Board [2022] UKSC 28

Hospital car parking fees

Summary – An NHS Trust was acting as a taxable person when providing car parking facilities and that not charging VAT would lead to a significant distortion of competition.

Northumbria NHS Foundation Trust provides goods and services for the purpose of the health service in England and is required to ensure that its sites and services are accessible at reasonable cost. This obligation includes the provision of parking for patients and visitors at a reasonable price.

Operating in a largely rural area, with public transport often limited or non-existent, around 80% of visitors to the Trust's main hospital sites travel by car.

The Trust provided free parking to certain hospital users and at certain local health centres; reduced rate parking for staff but at other sites a fee was charged to deter people from using the car parks for non-hospital related reasons.

Some sites made a loss on the provision of parking, but the Trust made a small surplus at three of its four major sites, which it used to improve the provision of healthcare at the Trust.

HMRC considered that the charges should be subject to VAT because the taxpayer was a taxable person.

The trust argued that the fees should be treated as non-business as it was not a taxable person in relation to the supply and was operating as a public authority under a special legal regime. It also argued that this would not be a distortion of competition, even though commercial operators are required to charge VAT on car parking.

The First Tier Tribunal had found against the Trust, so it appealed to the Upper Tribunal.

Decision

There was no dispute that the Trust was a public authority for the purposes of s.41A VATA 1994. The issue was whether when providing car parking facilities, it met the two conditions for treatment as a non-taxable person:

1. The car parking facilities must have been supplied in the course of the activities in which the Trust was engaged as a public authority;
2. The supply must not lead to a significant distortion of competition.

The Upper Tribunal stated that for the provision of car parking facilities to be subject to a special legal regime it was necessary to show that the pursuit of that activity involved or was closely linked to the exercise of rights and powers of the public authority. The Upper Tribunal found that the Trust was not subject to such a special legal regime.

The Upper Tribunal found that the First Tier Tribunal was entitled to conclude that competition existed between the trust's car parks and other private operators. This would result in a distortion if the trust was able to provide cheaper parking or obtain higher profits by not charging VAT on their parking. The potential difference 'could not be described as negligible'.

Northumbria NHS Foundation Trust v HMRC [2022] UKUT 00267

Power to delay a VAT refund

Summary - HMRC had raised its VAT assessment in time and had the power to refuse a repayment while it was checking the validity of the claim.

DCM (Optical Holdings) Limited, trading as Optical Express, supplied:

- taxable frames and lenses for glasses;
- exempt supplies of eye tests and dispensing services.

On 20 October 2005, HMRC raised an assessment for VAT but the company argued that the assessment was out of time as HMRC was time barred under s.73 VATA 1994 that required HMRC to raise their assessment by one year after evidence of facts came to HMRC's knowledge.

DCM (Optical Holdings) Limited argued that HMRC knew that “something was wrong” by January 2004 and so should have raised their assessment within 12 months of that time. October 2005 was too late.

Secondly, the company argued that HMRC did not have an implied power to refuse an input tax claim made on its VAT return.

Decision

The Supreme Court unanimously held that the October 2005 assessment was not time-barred as HMRC had only obtained the last items of evidence during a visit on 1 September 2005. Before this time, HMRC did not have evidence of facts sufficient to justify that assessment.

On the second point, the Supreme Court found that it is implicit in s. 25(3) VATA 1994 that the obligation on HMRC to pay a VAT credit arises only once it has checked that the VAT credit is due. The Supreme Court stated:

“The obligation to pay does not depend solely on the say-so of the taxable person”.

The Court went on to say:

“This implied power is consistent with the purpose of ensuring that the taxable person pays the right amount of VAT or receives the right amount of VAT credit”.

DCM (Optical Holdings) Ltd v HMRC [2022] UKSC 26