

## **Business tax update (Lecture B1406 – 13.25 minutes)**

### **No cash accounting under FRS 105**

*Summary – A company, trading as a property development company reporting under FRS 105, was required to adopt the accruals basis of accounting.*

Hart St Maltings Ltd was a property development company that prepared accounts to 28 February each year under FRS 105.

The company acquired a building and redeveloped it into two properties, referred to as 'House 3' and 'House 4'.

In its year to 28 February 2018, the company:

- sold House 4 and included the income from its sale in the accounts;
- deducted the costs of developing both Houses 3 and 4 to that date but at that point, House 3 remained unsold.

In February 2022, HMRC raised a discovery assessment stating that the costs relating to House 3 were not deductible as the accruals rather than cash basis of accounting applied.

The company appealed and HMRC applied to have the appeal struck out.

#### *Decision*

The First Tier Tribunal noted that it was clear that during the accounting period ended 28 February 2018, when House 4 was sold, the company was a trading company, and the sale of that property was a trading transaction.

The First Tier Tribunal confirmed that s.46 CTA 2009 requires a company's trading profits to be calculated in accordance with Generally Accepted Accounting Practice. With the company adopting FRS 105, it was required to use the accruals basis of accounting. This meant that the costs relating to House 3 could not be deducted in the year ended 28 February 2018 as the property was unsold.

With no real prospect of success, the company's appeal was struck out.

*Hart St Maltings Ltd v HMRC TC08961*

### **Expenditure on environmental and technical studies**

*Summary – Expenditure on environmental and technical studies carried out prior to the installation of wind turbines was not eligible for capital allowances.*

The companies in this case formed part of the Danish Orsted A/S group, generating and selling electricity from UK offshore windfarms.

To decide the best positioning for wind turbines, the companies incurred around £48 million carrying out various studies relating to wind, ocean and seabed conditions.

These costs, together with the wind turbines themselves, were claimed as expenditure eligible for capital allowance purposes.

HMRC accepted that the costs incurred to build and install the wind turbines qualified but rejected the claim for the cost of the various studies.

The First Tier Tribunal found that the studies were 'necessary' for the installation of the turbines and allowed the claim.

HMRC appealed to the Upper Tribunal.

### *Decision*

The Upper Tribunal found that the study expenditure put the companies in a position to be able to provide plant, by advising on how to make and install the plant. This was not the same as being money spent 'on the provision of plant' or its installation. Although the expenditure may be 'necessary' to allow the manufacture and installation to go ahead, it did not have the effect of providing the plant. Consequently, the expenditure did not qualify for allowances.

The companies had also argued that if the expenditure did not qualify as plant for capital allowance purposes, it should be eligible for a revenue deduction. As non-qualifying capital expenditure, it was not revenue in nature and so no such deduction was available.

*Gunfleet Sands Ltd and other companies v HMRC [2023] UKUT 00260 (TCC)*

## **Share for share anti-avoidance**

*Summary – A share deal that was renegotiated so that cash consideration was replaced with preference shares did not mean that the deal fell foul of the anti-avoidance rule contained in s.137(1) TCGA 1992.*

Euromoney had agreed to transfer its shares in Capital Data Limited to Diamond Topco Limited in exchange for ordinary shares (US\$59 million) and cash (US\$21 million).

Realising that this would result in a large chargeable gain, the agreement was restructured so that the cash was replaced with preference shares. No gain would be chargeable as s.135 TCGA 1992 applied and by waiting 12 months before the preference shares were redeemed, the Substantial Shareholding Exemption applied.

However, HMRC argued that to decide whether s.137(1) applied, one should look at the elements of the "scheme or arrangements" separately, rather than as a whole. The preference shares had been introduced into the scheme to avoid paying tax on the cash element of the consideration. This element of the scheme formed part of a scheme or arrangements of which the main purpose, or one of the main purposes, was the avoidance of liability to tax. HMRC amended the company's return, denying relief under s.135 TCGA 1992,

Both the First Tier and Upper Tribunal's found in the company's favour.

HMRC appealed to the Court of Appeal.

## *Decision*

The Court of Appeal stated that s.137(1) TCGA 1992 “envisages that there may be tax avoidance so long as that is not the sole or a main purpose of the scheme or arrangements”.

The Court of Appeal stated that the statutory test contained within s.137(1) TCGA 1992 required two questions to be answered:

1. Was the exchange of shares effected for bona fide commercial reasons?
2. Did the entire exchange of shares form part of a scheme or arrangements of which the main purpose, or one of the main purposes, was tax avoidance?

The Court of Appeal found that the First Tier Tribunal had identified the entire exchange and the entire scheme that Euromoney had entered into and then addressed both of these questions finding that:

1. It was common ground that the entire exchange of shares was effected for bona fide commercial reasons;
2. Tax avoidance was not the main purpose, or one of the main purposes, of entering into that entire exchange of shares.

The First Tier Tribunal had decided that avoiding corporation tax on gains was one of the purposes of the arrangements as a whole because there was no commercial purpose for receiving consideration in the form of preference shares rather than cash. However, because the preference share arrangements were not significant in the context of the arrangements as a whole, the Tribunal decided that this was a purpose, but not one of the main purposes, of the arrangements.

The reasons given by the First Tier Tribunal for this decision had not been challenged in this appeal and so HMRC’s case was dismissed.

*Delinian Limited (formerly Euromoney Institutional Investor PLC) v HMRC [2023] EWCA Civ 1281*

## **Blissful biscuits**

*Summary – A baked snack that was partly covered with chocolate was found to be standard-rated for VAT.*

United Biscuits (UK) Ltd manufactured McVitie’s ‘Blissfuls’ which consisted of a:

- biscuit cup with a flat bottom base;
- layer of chocolate hazelnut and a layer of chocolate;
- McVitie’s logo made of biscuit on top that did not cover the entire top, so leaving some of the underlayer exposed.

The company zero rated this product as food (Sch 8 Group 1 VATA 1994).

HMRC argued that the product should be standard rated as it fell within excepted item 2 being ‘biscuits wholly or partly covered with chocolate or some product similar in taste and appearance’.

The company appealed, claiming that the product's lid served more than a decorative function; it ensured that the product kept its shape and provided a crunch texture before the consumer tasted the chocolate filling. To be a covering the chocolate must be the first part of the biscuit to be bitten into. As the chocolate was not the first part, it was simply a filling, and the exception did not apply.

#### *Decision*

The First Tier Tribunal found that to be standard rated, the legislation requires the product to be wholly or partly covered with chocolate. Further, the term 'partly' should be interpreted in such a way that it could apply to any part of the biscuit, so long as it was covered to some extent with chocolate.

This meant that the question to be answered was: "What covered the remaining area of the product that was not covered by the biscuit logo lid?"

The Tribunal found that the ordinary man in the street would say that the biscuit was covered by the logo biscuit lid and 'in part' by a layer of chocolate. Being partly covered in chocolate, it fell within the exception to zero-rating and standard rated VAT applied.

*United Biscuits (UK) Ltd v HMRC (TC08941)*

### **Loan administration services**

*Summary - The administration services provided by the taxpayer did not transfer funds or change the legal and financial position in anyway, meaning the supplies did not qualify as exempt financial services.*

Shawbrook Bank Limited provided mortgages and loans, with Target Group Ltd administering these loans by providing instructions through BACS, calculating fees, interest and principal repayments due and making the relevant entries in loan accounts. Target Group Ltd did not make loans.

Target Group Ltd argued that they were providing exempt financial services falling within article 135(1)(d) of the Principal VAT Directive, contained within Sch 9 Group 5 items 1, 2, 2A and 8 VATA 1994. The exemption covers transactions including negotiation of deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluded debt collection.

HMRC disagreed arguing that the exemption did not apply because case law made it clear that the exemption only applies to the execution of an order for transfer or payment. Simply processing the payment did not qualify.

The Court of Appeal, as well as the Upper Tribunal, had upheld HMRC's case and the company appealed to the Supreme Court.

#### *Decision*

The Supreme Court stated giving instructions which automatically resulted in payment from the borrower's bank accounts to Shawbrook's bank accounts was not enough to fall within the exemption. Interpreting the legislation narrowly, to be exempt, the services provided must transfer funds and change the legal and financial situation of the parties involved.

The Supreme Court found that entries made by Target Group Ltd in the ledgers were simply the process of recording the effect of payments made by customers to Shawbrook Bank Limited. This process did not legally change anything for either party.

The services did not fall within the financial services exemption.

The appeal was dismissed.

*Target Group Ltd v HMRC [2023] UKSC 35*

### **VAT group joining date**

*Summary – There was no statutory right to retrospectively amend the date that the taxpayer’s parent company joined its VAT group meaning it was unable to recover the VAT accounted for under the reverse charge.*

Dollar Financial UK Ltd was the representative member of the Dollar Financial UK VAT Group which included other members from the same corporate group.

On 27 June 2013, Dollar Financial Group Inc (DFGI), the company’s US parent, applied for its UK branch to be added to the DFUK VAT Group with immediate effect.

On 12 August 2013, HMRC issued a letter approving its inclusion with effect from 27 June 2013.

Later, on 29 September 2016, Dollar Financial UK Ltd wrote to HMRC requesting an amendment to the date on which the parent company had joined the group, amending the date back to July 2012. The company argued that the parent had failed to identify it had a UK fixed establishment prior to June 2013, which had been created by the secondment of its employees to the UK. This fixed establishment gave rise to both a UK registration requirement and an entitlement to join the UK VAT group from July 2012.

The company argued that because the supplies made were provided solely by the employees located in the UK fixed establishment and not bought in, there was no requirement for Dollar Financial UK Ltd to account for over £2 million of VAT under the reverse charge.

In March 2018, HMRC wrote to refuse the requested retrospective amendment back to 2012 and so also declined the VAT repayment arguing that HMRC only permitted backdating of group registration to exceed 30 days in exceptional circumstances.

Having failed at the First Tier, the company appealed to the Upper Tribunal.

### *Decision*

The Upper Tribunal reminded us that VAT grouping is not mandatory, but that eligible companies established in the UK can apply to register as a group if they satisfy the conditions set out in s.43B VATA 1994.

The Upper Tribunal rejected the claim that S.43B “imposes no bar on present group members applying to be a member at an earlier time in the group’s existence, or, alternatively, that s43B(2)(a) can be read so that DFGI was ‘another body corporate’ because it was not a member of the group between 1 July 2012 and 27 June 2013.”

The Upper Tribunal stated that under s.43B, any application to HMRC to join a VAT group must be for ‘another’ body corporate as a member of the group cannot apply again to be treated as a member of the group if they are already a member.

As Dollar Financial Group Inc was already part of the VAT group on 29 September 2016 it could not apply retrospectively to change it, unless HMRC agreed there were exceptional circumstances.

The Upper Tribunal stated that:

“If Parliament had intended to permit a body corporate to amend the date from which it is to be treated as a member of the group, it could very easily have done so.”

Consequently, the retrospective application was not a valid application. However, it was open to Dollar Financial UK Ltd to invite a decision from HMRC to consider whether exceptional circumstances applied. Where HMRC declined to do so, it remained possible to apply for judicial review.

*Dollar Financial UK Ltd v HMRC [2023] UKUT 256 (TCC)*