

Deductible expenses (Lecture B1176 – 23.24 minutes)

Summary – The taxpayer was denied professional fees against his employment income and self-employment expenses were held not to be genuine.

Alastair Jordan had extensive experience at a senior level in the provision of logistical services and equipment and had developed skills in property portfolio management.

Rapid Platforms Ltd was owned by Alastair Jordan's parents though he held a minority shareholding and was employed by the company for many years. His parents decided to sell the company and advised Alastair Jordan that he would be made redundant and so he should find alternative work. He commenced self-employment while still employed with the company

Alastair Jordan realised that it would be beneficial to incorporate his business and so A & C Jordan Ltd (ACJ Ltd) was incorporated on 19 February 2014.

He signed a contract of employment with Rapid Platforms Ltd for his director duties and a second contract for consulting services for which he received £5,000.00 in the year in question. Against this income for 2013/14, he claimed £120,000 of expenses creating a loss of £115,000. HMRC denied the expenses on the basis that the business was not run on a commercial basis with a view to making a profit.

As he had little in the way of provision for his retirement he sought the services of a professional to explain the options available to him. This advice cost him £25,000 and was reported as employment expenses in 2013/14. HMRC denied the employment expenses arguing that they were not deductible under s336 ITEPA 2003 as the expenses were not incurred wholly, exclusively and necessarily in the performance of his employment duties.

Alastair Jordan appealed.

Decision

Starting with the employment expenses, the Tribunal concluded that as the invoice related to advice of a personal nature, these were not incurred wholly, exclusively and necessarily in the performance of the duties of the employment.

The £120,000 related to 1,200 hours of work invoiced at £100 per hour. These services were performed between 19 February 2014 and 31 March 2014 during which time there were only 984 hours (41 days x 24 hours). The burden was on Mr Jordan to prove on the balance of probabilities that the work referred to in the invoice could genuinely have been carried out. The Tribunal stated that Alastair Jordan had failed to adequately explain what the "Value Adding Services" totalling £120,000 related to.

In the alternative, the Tribunal was satisfied that there was no commercial activity supporting the arrangement. A net loss over the period 19 February 2014 to 5 April 2014 with no further income reported in subsequent years does not amount to a commercial trade as required by s66 ITA 2007.

The appeal was dismissed.

HMRC indicated they were going to issue a penalty notice for inaccuracies of just over £11,000. However, in error HMRC failed to raise a penalty assessment and accordingly no penalty was payable by Mr Jordan.

Alastair Jordan v HMRC (TC07501)

R&D tax credit– lack of accounting records

Summary – R&D tax credit claim was denied due to a lack of supporting evidence and failure to pay remuneration.

In November 2015, Tekolutions-Inc Ltd filed a tax return for the period 28 February to 21 October 2015, showing expenses of £246,500 and trading losses of £224,300. The expenses included £75,000 of salaries and wages, £62,000 of subcontractor payments, £30,000 of accountancy and audit fees, £24,000 of consultancy costs, £5,000 for entertaining and £12,000 of travel and subsistence.

A second tax return, for the period 28 February 2014 to 30 January 2015 contained similar figures, and gave expenses of £182,825, with trading losses of £174,025.

There was no tax return filed for 31 January 2015 to 27 February 2015.

Tekolutions made a claim for R&D tax relief in the tax returns to be made in the form of an R&D credit.

HMRC requested further details on the expenses and invoices to support the costs. The company responded and noted that they could not provide details as some suppliers had gone out of business. They also noted that in relation to the wages, salaries and subcontractor payments there were no records as they had not yet been paid. The director of the company advised that the cash book recording payments to other suppliers had been thrown away. There was further lengthy correspondence between HMRC and the company director but no further evidence supporting the claim for R&D credit was provided. And so the matter was finally referred to the Tribunal.

Decision

The First Tier Tribunal dismissed the claim for R&D tax credit due to the lack of supporting evidence. In addition, none of the remuneration amounts had been paid and therefore were not allowable as qualifying R&D costs.

Tekolutions-Inc Limited v HMRC [2019] UKFTT 0683

Corporation tax instalments for very large companies

HMRC has published new guidance, with examples, on the new corporation tax instalment payment dates for companies with taxable profits exceeding £20m. The new regime applies to accounting periods beginning on or after 1 April 2019.

Assuming a 12-month accounting period, instalment payments will be due:

- 2 months and 13 days after the beginning of the accounting period
- 3 months after the first instalment
- 3 months after the second instalment, and
- 3 months after the third instalment

A very large company

A very large company is one whose profits for the accounting period in question are at an annual rate of more than £20 million. The threshold is reduced proportionately if the accounting period is less than 12 months and where the company has one or more related 51% group companies.

Exceptions

A company does not have to pay by instalments for an accounting period even though the profits exceed the threshold of £20 million if the amount of its total liability for the accounting period is less than £10,000 (pro-rated if accounting period less than 12 months).

There is no first year period of grace for a very large company as there is for large company instalment payments.

Example 1

A company with a December year end in 20X1 will have to pay on:

14 March 20X1

14 June 20X1

14 September 20X1

14 December 20X1

A March 20X2 year end will pay on:

14 June 20X1

14 September 20X1

14 December 20X1

14 March 20X2

Accounting periods less than 12 months

If the accounting period is shorter than 12 months, the rules apply to ensure that the final instalment payment falls within the accounting period.

Subject to exceptions detailed below, the last instalment date will depend on which day of the month the end of the accounting period falls - if the accounting period ends on:

- the last day of the month, the last instalment will be due 14 days after the end of the preceding month
- a day for which there is a corresponding date in the preceding month, the last instalment falls 14 days after that date in the preceding month
- a day for which there is no corresponding day in the previous month, the last instalment is due 14 days after the last day of the previous month

Exceptions

If the last instalment date falls before the beginning of the accounting period, a single payment is due on the last day of the accounting period.

The first instalment date is 2 months and 13 days after the start of the accounting period. There is an exception to this is if this date falls on or after the date of the final instalment. If this occurs, the total liability is paid on the final instalment date.

The second instalment date is 3 months after the first, unless this falls on or after the final instalment date in which case the total liability is paid on the first and final instalment dates.

The third instalment date is 3 months after the second, unless this falls on or after the final instalment date in which case the total liability is paid on the first, second and final instalment dates.

Example 2

Instalment payment dates for an accounting period from 1 January 2020 to 30 March 2020. The accounting period ends on a date for which there is no corresponding day in the previous month.

There is no first instalment. This would have been 14 March 2020, that is 2 months and 13 days after the beginning of the accounting period. As this ends on the date of the final instalment, the whole liability is payable on the last instalment date of 14 March 2020.

Example 3

Instalment payment dates for an accounting period 1 January 2020 to 30 May 2020. The accounting period ends on a day for which there is a corresponding date in the previous month.

There is no second instalment as this would have been 3 months after the first instalment (14 June 2020). As this is after the final instalment date, the liability is payable over 2 instalments on 14 March 2020 and 14 May 2020.

Instalment payments for short accounting periods

If there is only one payment date, the whole of the CT liability for the period is due on that date.

If there is more than one instalment date, the amount due on the first instalment date is the lesser of the CT liability and the amount given by the formula:

$$3 \times (\text{CT liability} / \text{wm} + \text{wmd})$$

Where:

- 'wm' is the number of whole months falling within the accounting period
- 'wmd' is the decimal (calculated to two places rounded arithmetically where necessary) of the fraction $R/30$, where 'R' is the number of days in an accounting period outside the whole months represented by 'wm'

The amounts due on the second and third instalment dates are the lesser of the CT liability – B and the amounts given by the formula, B is the amount of the liability due to be paid on previous instalment dates.

The amount payable on the final instalment date is the CT liability – B.

Example 4

Working out instalment payments for a company with an accounting period 1 January 2028 to 31 July 2028 and Corporation Tax to pay of £3,100,000.

The formula becomes:

$$3 \times (£3,100,000 \div 7) = £1,328,571$$

The smaller of company's total liability and company's total liability ÷ months in the accounting period x 3 is £1,328,571.

First payment: £1,328,571

Second payment: £1,328,571

Third payment: £442,858

Guidance: Pay Corporation Tax if you're a very large company

Contributed by Joanne Houghton

UK property of non-UK resident companies

HMRC's has issued guidance for the changes that are coming in this April.

From 6 April 2020, Non-UK resident companies including those who invest in UK property through collective investment vehicles will pay Corporation Tax instead of Income Tax on profits from UK property.

HMRC are automatically registering taxpayers for Corporation Tax who should be sent a Company Unique Taxpayer Reference (UTR). HMRC are advising that anyone who does not receive their UTR by 30 June 2020 or if they already have a Company UTR. Taxpayers must register with HMRC Online Services to file their Company Tax Return online. If using an agent or adviser, taxpayers will need to submit a new authorisation form to

Only taxpayers with a permanent UK establishment will need to register with Companies House.

Pre-6 April 2020 Income Tax losses

If the UK property business is reporting a cumulative loss that is chargeable to Income Tax, this will be carried forward for Corporation Tax and set off against future profits from the same UK property business or any Non-trade loan relationship profits relating to that UK property business.

Capital allowances

Any Capital Allowances pools as at 5 April 2020 will transfer to Corporation Tax without giving rise to a balancing allowance or a balancing charge. Capital allowances will need to be apportioned between Income Tax and Corporation Tax. (An example is given below)

Loan relationship rules

Remember, interest and other finance costs will now fall under the loan relationship rules, normally as a non-trading loan relationship deficit for the period.

Profits and losses from derivative contracts used as part of the UK property business are treated in a similar way to loan relationships. The credit and debit amounts of a derivative contract that have been entered into for the purposes of the UK property business are included in the calculation of the non-trading loan relationship profit or deficit for the period.

Corporate Interest Restriction will apply unless you are dealing with standalone companies or groups that have net deductible interest and other financing costs of less than £2 million per annum

Loan losses referable to a period before 6 April 2020

Taxpayers cannot claim relief for losses under a loan relationship where the loss is referable to a period where the company was not liable to pay Corporation Tax. This usually happens where a Non-UK resident company migrates to be a UK resident company.

Paying tax

A one-off transitional rule will apply so that the instalments for very large companies will not start until the second and next Corporation Tax accounting periods.

Where a company's only source of UK income after 6 April 2020 is expected to be income from the UK property business, no Income Tax payments on account for 2020/2021 and future tax years will be needed

Credit held on your company's Income Tax account

If a credit balance remains in the company's Income Tax account after all Income Tax liabilities for 2019/2020 and earlier years have been settled and the company's only source of UK income from 6 April 2020 is income from UK property, any credit balances will be repaid to the company. Taxpayers will need to tick the box on the 2019/2020 Non-resident Company Income Tax Return to claim a repayment of tax and provide the company's UK bank details to enable the repayment to be made securely.

www.gov.uk/guidance/paying-corporation-tax-if-youre-a-non-resident-company-landlord

HMRC example – Apportionment of writing down allowances

A company prepares accounts to 31 December each year. In the year to 31 December 2019 it made a UK property business profit of £150,000 and for the year to 31 December 2020, the company made a UK property business profit of £250,000. At 6 April 2019, the main Capital Allowances pool balance was £30,000.

On 6 April 2020, the company moves to the Corporation Tax regime and its first Corporation Tax accounting period runs from 6 April 2020 to 31 December 2020.

The company's taxable profit before capital allowances for 2019/20 are:

	£
270/365 x £150,000 (profits of 12 month period ended 31 December 2019)	110,959
96/366 x £250,000 (profits of 12 month period ended 31 December 2020)	<u>65,574</u>
Total	<u>176,533</u>

The Capital Allowances for 2019/20 will be:

	£
6 April 2019 to 5 April 2020	
Main Capital Allowances pool balance at 6 April 2019	30,000
Capital allowances available (£30,000 x 18%)	<u>(5,400)</u>
Capital Allowances pool balance at 5 April 2020 (£30,000 – £5,400)	<u>24,600</u>

The taxable profits liable to income tax for 2019/20 will be:

	£
6 April 2019 to 5 April 2020	
Profit	176,533
Less: Capital Allowances	(5,400)
Taxable Profit	171,133

Moving to the corporation tax regime from 6 April 2010, the company's taxable profit before capital allowances for the accounting period from 6 April 2020 to 31 December 2020 is:

	£
270/366 x £250,000 (profits for the 12 month period ended 31 December)	<u>184,426</u>

The Capital Allowances calculation will be as follows:

6 April 2020 to 31 December 2020

Main Capital Allowances pool balance at 6 April 2020	24,600
Capital allowances available (24,600 x 18% x 270 days/366 days)	<u>(3,267)</u>
Written down value at 31 December 2020 (24,600 – 3,267)	<u>21,333</u>

The taxable profits liable to corporation tax for the period 6 April 2020 to 31 December 2020 are:

6 April 2020 to 31 December 2020	£
Profit	184,426
Less: Capital Allowances	(3,267)
Taxable Profit	181,159

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_t_data/file/857821/Appportionment_of_written_down_allowances_example_3.docx.pdf

Digital newspapers

Summary – Digital editions of The Times and The Sun are newspapers that qualify for zero rating.

News Corp UK & Ireland Limited is the representative member of a VAT group that publishes, principally, The Times, The Sunday Times, The Sun and The Sun on Sunday.

The main issue in this appeal was whether digital versions of newspapers published by News Corp UK & Ireland Limited were 'newspapers' under Item 2, Group 3 Schedule 8 VATA 1994 and were therefore zero rated for VAT purposes.

This appeal concerned a number of digital versions including an e-reader edition, a tablet edition, a website edition and a smartphone edition. Additional content is available with each of the editions including a number of news and sports videos and links to podcasts.

It was common ground that it is an essential characteristic of a newspaper that it is produced in periodic editions rather than being rolling news such as is available on websites such as the BBC or competitors such as The Guardian, which are updated

continually throughout the day. The First Tier Tribunal concluded that the content of the digital editions was “fundamentally the same or very similar” to the printed editions.

It was also common ground that the digital editions constituted a supply of services.

The First Tier Tribunal found in favour of HMRC concluding that, although the content of the digital and printed editions was 'fundamentally the same or very similar', the digital editions provided services rather than goods and the legislation relating to zero rating was confined solely to goods.

News Corp UK & Ireland Limited appealed to the Upper Tribunal.

Decision

The Upper Tribunal concluded that, properly interpreted, there was nothing in Group 3 to indicate that it applied only to goods. What mattered was the digital versions met the description of “newspaper” but also did the “always speaking” doctrine apply.

The Upper Tribunal agreed with the First Tier Tribunal that the digital versions “were essentiallythe same as or very similar to the newsprint editions”. They went on to state that the purpose of the legislation was to ‘promote literacy, the dissemination of knowledge and democratic accountability by having informed public debate’. The digital versions satisfied this requirement. When drafted back in 1972, digital newspapers did not exist but such products now carry out the same or very similar functions as a printed version. The introduction of a digital newspaper was exactly the type of technological development, not contemplated when the legislation was passed, which the ‘always speaking’ doctrine was intended to address.

The Tribunal concluded that the digital editions not only fulfilled the legislative purpose of zero-rating but also had the essential characteristics of a “newspaper”. They were therefore “newspapers” and so were zero-rated.

The appeal was allowed.

News Corp UK & Ireland Limited v HMRC [2019] UKUT 0404 (TCC)

Church bar

Summary – A member of the congregation who ran the church’s social bar, was in business on her own account and liable to register for VAT.

Marites Salabit and her mother were members of the congregation at their local church. The parish priest and her mother told her that somebody needed to operate the bar of the church social club. She agreed to do this to help the church and its wider congregation.

The then parish priest said that the arrangement needed to be put on a formal basis and gave Marites Salabit a document titled “management contract” to sign. She signed this on 28 February 2013 agreeing that she would pay rent of £625 a week to the church and that she would be responsible for paying suppliers, staff as well as the TV licence and Sky TV. She understood that she was responsible for repairs/maintenance to the bar and that she would be liable if anything went wrong. The premises licence was transferred to her in October 2013;

The bar was open 7 days a week from midday to 10pm serving drinks and light meals. Marites Salabit would open up on most days. On weekdays, she would then go to work as a housekeeper and paid parishioners would serve behind the bar. Marites Salabit would then return to the bar to “close up”. Throughout the day, she would monitor the bar by way of a camera. At weekends, she would serve behind the bar.

Marites Salabit did not receive any wage from the church for operating the bar. She understood that if the bar made a profit that was hers to keep. Bar takings were paid directly into her personal bank account.

HMRC argued that Marites Salabit was operating the social club bar as a business in her own right, and should have been registered for VAT between 1 April 2014 and 31 December 2015. HMRC issued assessments to collect VAT of nearly £11,000.

Marites Salabit appealed, maintaining that she was simply a manager of the social club bar and, accordingly, was not liable to register for VAT and so had no liability to VAT. It was the church who should have been VAT registered.

Decision

The First Tier Tribunal found that, although her motivation for running the social club bar was to help the church and its congregation, the contract and the agreed arrangements showed that she was in business on her own account and so liable to register.

The appeal was dismissed.

Marites Salabit v HMRC (TC7450)

Chips as vouchers

Summary – Chips bought by customers were face value vouchers to be treated as credit vouchers; dancer redemption charges were a taxable supply while employee charges were not.

The appellants in this appeal were separate companies within the same group, each with their own VAT registration. Each company operates as licensed “lap dancing” or “table dancing” clubs in various cities around the country.

This appeal is concerned with the correct VAT treatment for transactions involving what are known as “Chips”.

In summary, this is how the system operates:

- Customers buy chips, from the clubs’ Chip sellers, with a face value of between £10 and £100 each. The price paid for the Chips is face value plus a 20% premium.
- The customers then use the Chips to pay self-employed dancers for performing dances in VIP booths. The suggested rate charged is £500-600 per hour, the standard industry rate.
- Once the price is agreed, the dancer must notify the club of the length of time they wish to use a booth but is not required to notify the club of the amount she

has negotiated as a fee. The dancer pays the club a flat rate fee for use of the booth.

- Dancers redeem the Chips for cash from the clubs. Most of the companies redeem Chips at face value. However, the London club charges the dancers 20% of the nominal value of the Chips. Club employees, such as bar workers and Chip sellers, who are given Chips by way of tips are charged a fee of 40% on redemption. (Clubs outside London are smaller and dancers are local. In London the club is much busier and dancers are more transient. It would not be practical to keep a check on dances being performed in London. This is also how the clubs' competitors operate both in and outside London).

There were two issues to decide in this case. In order to illustrate the issues and the arguments the tribunal helpfully referred to a £100 Chip issued to a customer. This would have cost the customer £120 on their credit or debit card, and would have been redeemed in the London club by dancers for £80 or employees for £60.

1. The VAT treatment on the supply of Chips to customers by the clubs. HMRC argued that they were taxable on the full amount paid by the customer. The companies argued that the Chip payments were exempt as security for money (Item 1 Group 5 Schedule 9 VATA 1994) or, were credit or face value vouchers (Schedule 10A VATA 1994) and so only the consideration of £20 over and above face value was taxable.
2. The VAT treatment on redemption of Chips by dancers and employees in the London club. HMRC sought to treat the 20% or 40% fee charged to dancers and employees on redemption as consideration for a taxable supply of services. The London company argued that there was no taxable supply.

Decision

The First Tier Tribunal concluded that Chips were security to receive services from dancers in the club, and not for the payment of money. Buying a Chip did not secure payment of money as the Chips were non-refundable by the clubs. On purchase, the Chip simply gave the customer rights to obtain entertainment from dancers. The buying of Chips by the customer was not an exempt supply.

It was accepted by both parties, up to 10 May 2012, that Chips were face value vouchers for the (10A VATA 1994) and also credit vouchers under paragraph 3 Schedule 10A. Para 3 treats only the excess above face value as a taxable supply. Hence it would only be the £20 in excess of the £100 face value of a Chip purchased by a customer using a card that was taxable.

From 10 May 2012, para 7A came into force for vouchers issued from that date. From that date, para 3 should be disapplied for "single purpose vouchers" and the whole £120 should be chargeable to VAT. The Tribunal stated that Chips were face value vouchers because they represented a right to receive entertainment from dancers taxable at a single rate of VAT. The fact that a Chip may also be used to tip a dancer or employee because it has a value in the hands of a dancer or employee did not affect that analysis.

The Tribunal concluded that Chips were face value vouchers, treated as credit vouchers:

- Up to 10 May 2012, output tax was due on the excess over face value paid by customers (£20);
- From 10 May 2012, Chips became single purpose vouchers and so output tax was due on the full £120 paid.

The Tribunal concluded that:

- The 20% redemption fee charged to dancers was consideration for a taxable supply of services. The 20% charged was how the company charged fees to dancers in return for providing facilities and services to enable dancers to earn money. It was only because it was impractical in the London club to charge dancers a fee per dance that a redemption fee is charged to dancers.
- The 40% redemption fee charged to employees was not consideration for a supply of services. Employees obtain access to the club as employees. The club did not provide facilities to employees enabling them to earn tips. The Chips were tips received in the course of their employment and as such were employment income. The charge, although high, was for the encashment services and inextricably bound up with the employment relationship. The deduction was not consideration for a supply of services by the employer to the employee. The appeal was allowed in relation to the employees.

Romima Limited, Platinum Lace Trading Limited, Bright Crew Limited, Rocco Mana Limited, The Aviary (Leicester) Limited v HMRC (TC07494)

Advice for paying directors' bonuses (Lecture B1176 – 23.24 minutes)

Summary - Input tax on remuneration tax planning fees was deductible as it was directly linked to the purposes of a business.

In March 2012, Taylor Pearson (Construction) Ltd rewarded its directors with bonuses of £50,000 each. Appreciating that this might not be the most tax efficient way to reward staff, the company engaged a tax adviser to advise on a more tax efficient approach.

The scheme suggested included an issue of shares to the directors and that share issue is the subject of a separate appeal.

HMRC denied a claim for input VAT on the advisory fees arguing that the services were not for the purposes of the company's business. HMRC claimed that the fees were for the exempt purpose of issuing share capital. In addition, they argued that the services had no direct and immediate link to Taylor Pearson's taxable supplies.

Decision

The First Tier Tribunal rejected HMRC's argument that the advice was used for the purposes of issuing share capital. The Tribunal concluded that the company's objective in using the scheme was to avoid the payment of Class1A NICs, and to reward and incentivise its directors in a tax-free manner. The services provided were thus tax advice in relation to the provision of employment rewards.

The Tribunal also rejected HMRC's argument that there was no immediate link with the purposes of the business. The Tribunal stated that the reward and incentivisation of employees is one of the more obvious overheads of a business that is treated as a cost component of the company's overall economic activities. The Tribunal highlighted that in the Doran Bros case the Tribunal held that the advice received was analogous to payroll services, which would be an overhead of the business. This case was very similar. HMRC has not appealed this case and not surprisingly this Tribunal came to the same conclusion. The incentivisation of employees, even though in this case they were directors and shareholders of the company, had a direct and immediate link to the purposes of the business.

The appeal was allowed

Taylor Pearson (Construction) Ltd v HMRC (TC07464)