

Business tax update (Lecture B1296 – 22.03 minutes)

Legal fees allowed

Summary – Legal fees incurred by a partnership to defend a partner against a criminal charge were deductible as they were incurred wholly and exclusively for the purpose of the partnership's trade.

T R Rogers and Sons is a scrap metal business run by Simon Rogers and his parents.

Operation Symphony was conducted by Thames Valley Police whereby undercover officers sold property which the police implied was stolen property. As a result of this operation criminal charges were brought against two partners, both of whom were subsequently cleared of charges. In the Simon Roger's case, this went all the way to the Court of Appeal. The legal costs of £543,091 incurred to defend the charges were deducted in the partnership accounts for the tax year ending 5 April 2014 and a further £61,240 were deducted in the year after.

Following an enquiry, HMRC issued a Closure Letter on 18 August 2019 disallowing the expenses on the basis that they were not wholly and exclusively incurred for the purpose of the trade as they had a duality of purpose. They agreed that there was a benefit to the trade but the defence also prevented a prison sentence and defended the individuals' personal reputations.

Unsuccessful at a review, the appellants appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal concluded that that the legal fees were incurred wholly and exclusively for the purposes of the trade. If found guilty, this would have had a major impact on the partnership's ability to continue trading. It was clear from the evidence provided that the lease would have been terminated, the Scrap Metal Dealer's licence was unlikely to be granted and insurance would not have been obtainable.

The Tribunal stated that they doubted that 'defence of liberty' was ever a concern. They found it extremely unlikely that Simon Rogers ever thought that there was a chance that he would go to prison. He had been told by his lawyers that he had a strong case, and the purported crime related to one purchase.

The Tribunal concluded that the damage to the Rogers' personal reputation occurred mainly when the police operation featured in the local news. Any positive impact on the reputation following the success at the Court of Appeal was effectively a by-product of the case and not a reason for the costs being incurred. The Tribunal stated that personal reputation was not relevant when deciding whether to incur the legal fees. It was the professional reputation that could be restored.

The appeal was allowed.

TR, SP and SR Rogers v HMRC(TC 08342A/V)

Tax relief on pension contributions denied

Summary - Pension contributions made on behalf of key employees were not deductible as, through the tax scheme, they were not incurred wholly and exclusively for the purposes of the trade.

Through a promoter, the companies set up unfunded unapproved retirement benefit schemes to provide pensions to their directors and key employees. The scheme was registered under DOTAS.

The pensions were calculated by reference to the estimated profits for the relevant year. In each case, the aggregate amount of the pensions was set at 80% or 100% of the estimated profits before tax. Both companies deducted provisions in their accounts, in respect of their liability to make pension payments to employees in the future. A D Bly Groundworks and Civil Engineering Limited had provisions totalling £5 million and CHR Travel Limited a much smaller figure of around half a million pounds.

HMRC disallowed the provisions, arguing that they were incurred “for the purpose of a tax avoidance scheme and not wholly and exclusively for the purposes of paying pension income to the employees”.

The companies appealed with the schemes provided by the same promoter, the appeals were joined.

Decision

The First Tier Tribunal stated that there had been two purposes in mind when the companies had decided to establish the unfunded unapproved retirement benefit schemes:

1. To provide future pensions for key individuals in a way that did not involve any immediate reduction in working capital;
2. To create a tax deduction which reduced the amount of tax payable by the company.

The issue was whether the companies were doing so wholly and exclusively for the purposes of their businesses or whether there was a non-business purpose.

The First Tier Tribunal concluded that it was “inherently unlikely that two separate companies with very different businesses would independently decide to do the same thing for the same reasons and in exactly the same way.” The Tribunal was not satisfied that both companies separately came to the conclusion that they needed to discuss the remuneration packages of key members of the business to incentivise and motivate them while maintaining working capital. Neither produced any documentary evidence, such as minutes from board meetings, to support their claims. Further, there was no evidence to show that the companies had sought advice on the competitiveness of their remuneration packages.

The Tribunal concluded that the provision of pensions was “at best” only an incidental aim.

The primary purpose was to reduce the companies’ liabilities to pay tax without incurring any actual expenditure. This was supported by the facts that:

- the promoter’s engagement letters stated that the scheme could be viewed as aggressive tax planning, indicating that tax panning was a fundamental consideration.
- The size of the pension liability “was determined as a percentage of the profits before tax regardless of the level of those profits and without discussion of or reference to any future pensions benefit to the directors.”

Consequently, the “wholly and exclusively” test was failed and the appeal dismissed.

Learning to swim is not education

Summary – A partnership running a swimming school was not providing education similar to that provided by a university or school. Its supplies were standard rated.

Dubrovin & Tröger GbR – Aquatics, a German partnership, runs a swimming school for children, with courses of different levels relating the basics and techniques of swimming. The partnership treated their supplies as exempt for VAT purposes.

Following a tax inspection relating to the years 2007 to 2011, the German tax authorities disagreed, stating that the partnership was not providing education similar to that provided by a university or school. The supplies were standard rated and issued assessments on that basis.

Dubrovin & Tröger was successful in their appeal to the Finanzgericht (The German Finance Court) who held that the teaching of basic swimming techniques constituted school education. Furthermore, a civil-law partnership may rely on Article 132(1)(j) of Directive 2006/112 in the same way as individual traders.

The German Tax Office appealed to the Federal Finance court arguing that the services were not exempt, on the ground that Dubrovin & Tröger did not have the status of a teacher giving private tuition, within the meaning of Article 132(1)(j) of Directive 2006/112.

The Federal Finance court referred the matter to the CJEU.

Decision

The CJEU found that the VAT exemption did not apply as 'school or university education' does not cover swimming tuition.

The Court acknowledged that swimming tuition was of undoubted importance but stated that it:

“constitutes specialised tuition provided occasionally, which does not amount, in itself, to the transfer of knowledge and skills covering a wide and diversified set of subjects or to their furthering and development which is characteristic of school or university education.”

HMRC currently allows a sole trader or partnership to treat education in subjects normally taught in universities and schools as exempt from VAT and swimming is commonly taught in primary schools in the UK. Although no longer bound by CJEU decisions, it will be interesting to see whether HMRC policy will be influenced by this decision.

Finanzamt München III v Dubrovin & Tröger (Case C-373/19)

Student consultancy services

Summary – Career coaching and other support services supplied by a company were standard rated as the company was unable to provide adequate evidence that the recipient was permanently resident outside of the UK.

The company supplied career coaching and support services to Chinese students. Arguing that it was supplying consultancy services to persons usually resident outside the UK, the company did not account for VAT as the place of supply of consultancy services is where the recipient belongs

The First Tier Tribunal agreed that the services were consultancy services rather than educational services, supplied where the non-taxable recipients of those supplies had their permanent address, or usually resided.

But that was not the end of the matter. Prior to July 2016, the company supplied its services direct to the students who were studying in the UK but from July 2016, the company contracted with their parents, who were usually resident in China.

It was common ground that parents had their usual residence in China and so from July 2016 onwards, the company's supplies were outside the scope of VAT.

The issue in this appeal to the Upper Tribunal concerned the VAT treatment for the supplies that took place before July 2016 when the company supplied the student's directly, even though in most cases it was the parents that funded the fees payable.

Mandarin Consulting Limited did not obtain information as to the students' "permanent addresses" in China but they did obtain information on where they were living while studying in the UK. The First Tier Tribunal concluded that the company did not take the steps required under Article 23 of the Council Implementing Regulation 282/2011/EU to establish the usual residence of its customers before the time it made supplies to them.

The company appealed to the Upper Tribunal.

Decision

The Upper Tribunal found that the First Tier Tribunal had erred in law and set aside their decision. The company was entitled to seek to establish that its customers had their usual residence outside the EU based on information gathered at, before, or after the time of supply, provided that this showed that this was the case at the time of the supply.

However, this did not change the final decision. Although not limited to evidence that it gathered at, or before, the time of supply, the company still failed to demonstrate, based on the evidence before the First Tier Tribunal, that the place of supply of the services provided to all students was outside of the EU. While its students would often have been usually resident in the same jurisdiction as their parent in China, this was not the same as all students being so resident. This was due to the multi-factorial nature of the test of residence. Consequently, these supplies were not outside the scope of VAT.

Mandarin Consulting Limited v HMRC [2021] UKUT 0292 (TCC)

Roof or roof insulation

Summary - Insulated roof panels forming part of the roof were roofing and not insulation that could be separately attached to a roof.

Greenspace Limited supplied and installed insulated roof panels to residential customers, fitted onto customers' pre-existing conservatory roofs. It was common ground that these panels had insulating properties.

Having taken measurements, a third-party company manufactured the insulating panels, which Greenspace Limited then installed by removing the existing glass or polycarbonate panels and slotting in the new panels to the existing roof structure.

HMRC argued the new panels were roofing materials subject to the standard rate of VAT. By contrast, Greenspace Limited argued that they were subject to the reduced 5% VAT rate as a supply of energy saving insulation materials (Sch.7A Group 2 Note 1(a) VATA 1994). Energy saving materials are defined as insulation for walls, floors, ceilings, rooves or lofts or for water tanks, pipes or other plumbing fittings.

The First Tier Tribunal found as a matter of fact that the new panels were not self-supporting and could be used only if the customer already had an existing conservatory roof structure. It was important that, after the removal of the existing panels, the new panel installation disturbed as little as possible of a customer's pre-existing roof structure in order to prevent leaks. The Tribunal dismissed the appeal, finding that the company supplied new standard rated rooves.

The company appealed to the Upper Tribunal.

Decision

Whether a supply was the insulation of a roof or the supply of the roof itself, was not a question of fact and degree. The Upper Tribunal concluded that the First Tier Tribunal was entitled to question whether the overall supply of panels involved the company supplying a roof or insulation for a roof.

The Tribunal was not restricted to consider the panels in isolation from "the back of the van". Once fitted, the panels covered the entire conservatory roof. The Tribunal concluded that the panels formed a roof, and so the reduced rate could not be available. Had the panels been installed on top of the existing glass or polycarbonate panelled roof, it might have been supplying insulation for rooves, rather than a roof itself but this was not the case.

The appeal was dismissed

Greenspace Limited v HMRC [2021] UKUT 290 (TCC)

Reclaiming VAT on rent

Summary – With no evidence provided to support his claim, recovery of input tax suffered on rental payments was denied.

Mpala Mufwankolo ran a pub from rented premises in London. The landlord had opted to tax the property and raised invoices accordingly.

Between 2015 and 2017, Mpala Mufwankolo sought to reclaim VAT of £1,300 and one for £4,923 in 11 quarterly returns.

HMRC denied the claim stating that there was no taxable supply from the landlord to Mpala Mufwankolo as the lease was in his wife's name. Further, there were no VAT invoices to support the claims or indeed evidence that he had actually paid the rent.

Decision

Despite being requested by HMRC, there was no evidence to support the repayments claimed.

Far from supporting the taxpayer's case, the documents provided actually contradicted his claims:

- There was no property lease produced in either his sole name or jointly with his wife;
- There was no partnership business between Mpala Mufwankolo and his wife registered for VAT, nor any partnership agreement between them produced;
- There were no VAT rental invoices produced that were addressed to Mpala Mufwankolo but rather, the rent demands produced were addressed to his wife;
- There were no bank statements provided showing payment of any rent.

The appeal was dismissed.

As Neil Warren, independent VAT consultant, stated:

'There was probably a commercial reason why the lease was agreed between the landlord and the taxpayer's wife but this would not have been a problem if she had registered for VAT herself and opted to tax the property. She would then have claimed input tax on the invoices from the landlord and charged output tax to her husband, who could then have claimed input tax on his own returns. There would have been no VAT leakage with this arrangement.'

Mr Mpala Mufwankolo v HMRC (TC08308)

Matchmaking services

Summary – Matchmaking services were 'services of consultants' and 'the provision of information' and so outside the scope of UK VAT when supplied to non-EU customers.

Gray & Farrar International LLP provided an exclusive matchmaking service to clients in many countries, with fees ranging from £15,000 to £140,000. The services provided included an initial interview and vetting process, the creation of the client's requirement brief, the matching process and then a follow up phone call to the client, seeking feedback following each introduction. All but the last stage of the services were carried out by Claire Sweetingham, the managing partner.

The partnership argued that no VAT should be charged on fees to non- EU customers because their services qualified as consultancy services or similar services including data processing and the provision of information under Art 59(c) of the Principal VAT Directive enacted as Sch.4A para 16(d) VATA 1994 within the UK.

HMRC disagreed and so the partnership appealed to the First Tier Tribunal.

The First Tier Tribunal found that the supply made by Gray & Farrar International LLP was a single composite supply of services and so the question as to whether that supply of services fell within Article 59(c) should be determined by reference to the principal components of the supply. The First Tribunal stated that 'if material elements of the supply went beyond the provision of expert advice, the supply was not services of a consultant.'

The Tribunal concluded that the services provided as the post-introduction liaison calls were important and material and were what distinguished Gray & Farrar International LLP's approach from other matchmaking businesses. This part of the service was not merely incidental to other parts of the supply. It could not be regarded as assisting the provision of information about a potential partner or the expert advice provided by Claire Sweetingham. This part of the service "went beyond" the provision of information and expert advice and so could not fall within Article 59(c). The appeal was dismissed.

Gray & Farrar International LLP appealed to the Upper Tribunal arguing that the First Tier Tribunal had erred in law by failing to properly characterise the partnership's supplies, and more specifically by not giving effect to the 'predominant element' test (Cases Levob and Mesto).

Decision

The Upper Tribunal agreed that the activities listed under Art 59(c) of the Principal VAT Directive were not confined to services provided by members of 'the liberal professions', as claimed by HMRC.

However, the Upper Tribunal confirmed that the First Tier Tribunal had erred in law by finding that the addition of 'post-introduction liaison' services changed the supply so that it "went beyond" what was covered by the Article. The First Tier Tribunal should have considered the potential application of 'the predominant element test'. It was possible to fall within Art 59(c), despite a material element of the supply going beyond what was covered in the legislation.

Applying this test, the Upper Tribunal found that a typical customer received expert advice and information relating to potential matches and that the post-introduction liaison services were not enough to change the character of the supply. The most important element supplied was the introduction to a possible match in the form of expert advice about the potential partner and the provision of related information.

The Tribunal remade the decision concluding that the matchmaking services supplied to non-EU clients fell within the scope of the special rule and were outside the scope of UK VAT.

Gray & Farrar International LLP v HMRC [2021] UKUT 0293 (TCC)