

## **Business tax update (Lecture B1416 – 19.02 minutes)**

### **The Post Office Horizon scandal**

You may well have watched the recent ITV drama 'Mr Bates vs The Post Office'. This was a four-part drama looking at the Post Office scandal where, between 1999 and 2015, hundreds of sub-postmasters and mistresses were accused of false accounting, theft and fraud, when in fact it was Fujitsu's Horizon software issues incorrectly showing money missing from their accounts.

#### *Prime Minister's announcement*

On 10<sup>th</sup> January 2024, Rishi Sunak announced that a new law would be introduced clearing the names of hundreds of postmasters and mistresses who were wrongly convicted because of faulty IT software; we wait to see how quickly this is achieved.

#### *Free advice available*

Unfortunately, the tax treatment of the compensation sums agreed to date are not straightforward, with some amounts taxable, while others are exempt. To further complicate matters, some such sums have yet to be paid.

AccountingWeb has reported that "a team of philanthropic accountants is offering free advice and support to affected sub-postmasters to help them get their tax affairs in order." Initiated by Rebecca Benneyworth, the team are offering free tax advice to sub-postmasters and mistresses who have received compensation from the Post Office.

A website has been set up at <https://subpostmasterstax.org.uk/tax-on-your-compensation>, that includes a contact form for concerned individuals to complete and so link up with advisers. This form can also be used by volunteers who wish to join the team and offer their help for free. The link to this site is repeated at the end of this article.

Further, there is a useful general advice page "Tax on your compensation" that summarises how compensation payments are taxed under the two existing compensation schemes. This can be found at <https://subpostmasterstax.org.uk/tax-on-your-compensation>.

#### *Group Litigation Order compensation scheme*

This scheme applied to the group of postmasters, who did not have a Horizon-related conviction, and pursued their case (Alan Bates and Others v Post Office Ltd) through the courts under a Group Litigation Order.

Payments under this scheme related to loss of earnings and interest where the loss of earnings was calculated based on net pay. As a result, the loss of earnings element was not taxable and any interest paid was exempt from tax under an exemption introduced by HMRC.

#### *Horizon Shortfall Scheme compensation scheme*

This scheme was put in place by Post Office Ltd to compensate postmasters who, while not subject to criminal conviction, made good their apparent losses caused by the Horizon system from their own pockets.

In June 2023, the Government announced that postmasters in this scheme would receive:

- top-up payments to ensure that the amount of compensation they received was not unduly reduced by tax;
- £300 to pay for independent advice on filing their tax return.

However, not all top-up payments and tax advice grants have yet been made by the Post Office.

#### *HMRC guidance*

On 8<sup>th</sup> January 2024, HMRC published its guidance to help individuals complete their 2022/23 tax returns. The link to this guidance is given below.

Compensation payments under the Horizon Shortfall Scheme relating to 2022/23 needed to be reported, and any related tax due paid, by 31 January 2024.

Where individuals have not been able to file their return by the due date, or where they have not paid the tax due to not receiving their top up payment, HMRC has confirmed it will cancel any related interest and penalties.

Further, HMRC has set up a dedicated specialist support team that can be contacted on 0300 322 9625, Monday to Friday between 8am and 6pm.

*<https://www.gov.uk/government/publications/get-help-with-self-assessment-filing-if-youre-a-sub-postmaster>*

*<https://subpostmasterstax.org.uk/tax-on-your-compensation>*

Incorrect tax treatment by the Post Office

Payments made are deductible for tax if incurred “wholly and exclusively” for the purpose of trade.

Tax Policy Associates has stated:

“The Post Office has claimed a £934m tax deduction for its compensation payments to the victims of the Post Office scandal.”

It seems unlikely that the Post Office compensation payments made to sub-postmasters and mistresses is likely to satisfy this rule.

Tax policy Associates continue:

“The consequence is that the Post Office has underpaid its corporation tax by over £100m over the last five years and may no longer be solvent.”

Further, they state:

“We understand that HMRC are actively pursuing this point – and it’s just one of five major Horizon scandal matters where the Post Office has, we believe, materially underpaid its tax. The Post Office failed to declare these issues in its accounts until this year, when it included an obscure reference which failed to adequately disclose the point.”



The other tax liabilities referred to by Tax policy Associates are:

1. **Tax on the “shortfalls” recovered from postmasters for supposed stolen funds, which it now seems** were “a windfall for the Post Office”;
2. **Adjustments needed where the Post Office has claimed non-deductible costs** “including the costs of falsely prosecuting postmasters ..... carried on outside the course of the trade”;
3. **Adjustments for costs claimed, including legal fees, for fighting the postmasters’ claims”;**
4. **Funding received by the Post Office from the Government which may be taxable** as “if the shareholder just gives money to a company, to supplement its trading receipts and enable it to carry on in business, then that will be a taxable trading receipt.”

<https://www.taxpolicy.org.uk/2024/01/12/934m/>

### **Equity release and estate planning**

*Summary – Input VAT on advertising was directly attributable to the equity release services and the Partial Exemption Special Methods proposed by the group were rejected.*

KRS Finance Ltd is the representative member of a VAT group and brought four related appeals on behalf of that group.

The group offered advice and related services to individuals aged 55 in two main areas:

1. Equity Release Mortgages which are treated as exempt financial services; and
2. Estate Planning which is standard rated.

As a partially exempt trader, KRS Finance Ltd used the Standard Method to recover residual input tax at a rate of approximately 10%.

Believing that this did not give rise to a “fair and reasonable” recovery rate the group instructed KPMG LLP to carry out a review of its business to see if a Partial Exemption Special Method would produce a better result.

1. Following this review, in 2018 KPMG LLP submitted a proposal to adopt a “Transactional Count Method” which was rejected by HMRC.
2. In December 2019 KRS Finance Ltd proposed an alternative approach referred to as the “Income Adjusted Method”. This too was rejected by the HMRC.
3. Between November 2018 and April 2021 KRS Finance Ltd submitted four Error Correction Notices seeking to amend earlier returns based upon use of these methods, which not surprisingly HMRC also rejected.
4. In March 2022 HMRC carried out a review of the group’s marketing expenditure, concluding that input VAT on advertising was all directly attributable to the equity release services, rather than general overheads of the group to ‘promote the business as a whole’, meaning that input tax recovery had been overstated.

The group appealed all four areas.

## *Decision*

The Tribunal agreed with HMRC's view on the marketing expenditure, observing that the wording used in the advertisements made reference to Equity Release. They made comments such as “staying in your home for longer and not having to downsize”. Typically, initial enquiries would relate to Equity Release, which may or may not lead to Estate Planning work at a later stage. The Tribunal found that the advertising focused on Equity Release, with no 'direct and immediate link' with the Estate Planning services that were offered.

The Tribunal agreed with HMRC that KRS Finance Ltd had failed to show that the “Transactional Count Method” proposed by KPMG LLP was fair or reasonable and was guaranteed to produce a more precise result than by applying the standard method already in operation.

Further, the First Tier Tribunal agreed that the changes made in the “Income Adjusted Method” did not solve the defects identified with KPMG’s method. This method continued to use a transaction-based approach “grouping together a diverse range of transactions” without any objective evidence that the transactions in each sector used “broadly the same inputs”.

Having rejected the two special methods, the Error Correction claims were bound to fail. In fact, the First tier Trier Tribunal stated that there was scope for the group to suggest amendments to the special methods and it should be left for HMRC to consider these. If agreed, this would solve the correction notice issue. However, if agreement could not be reached, the matter should then revert to the First Tier Tribunal.

The group’s appeal was dismissed.

*KRS Finance Ltd v HMRC (TC08956)*

## **Refer a friend scheme**

*Summary – Referral credits received by existing customers represented non-monetary consideration, with VAT due on the gross amount, including the credit received.*

Bulb Energy Limited, a member of the Simple Energy VAT group, supplied energy to UK business and retail customers.

Under its “refer a friend” scheme, whenever a new customer joined Bulb Energy Limited, the company would provide them with an electronic referral link which the customer could give to potential new clients. If, having used the link, the new person switched to use Bulb Energy as their supplier, both the referrer and the new customer received a credit against their energy charges.

The issue in this case was whether the referral fee received by the existing customer was:

- the provision of a service to Bulb Energy Limited, with the credit constituting non-monetary consideration for the supply of energy and so subject to VAT, as contended by HMRC.
- a discount that reduced the value of the energy supplied by Bulb Energy Limited to the existing customer. The credits were simply a reduction in the price payable rather than consideration for delivering a service. If correct, VAT was only due on the net amount actually paid by the customer.

In July 2021, HMRC issued an assessment charging output VAT on the gross value of energy supplied so including the monetary referral fees paid.

The group appealed.

### *Decision*

The referring customer only received their energy credit as a result of the additional actions taken, by passing on the electronic link.

Consequently, the First Tier Tribunal found that there was a direct link between the customers passing on their electronic link and the referral credits received from Bulb Energy Limited.

The referral credits represented non-monetary consideration, with VAT due on the gross amount, including the value of the non-monetary consideration.

The First Tier Tribunal noted that the treatment of the fee received by the new account holders was different. While referring customers received a financial reward, new account holders earned a discount as all they did was open their account with Bulb Energy Limited.

*Simple Energy Limited v HMRC (TC08995)*

### **Online sale of contact lenses**

*Summary – The supplies made by the taxpayer were standard rated supplies and not exempt medical care.*

Vision Dispensing Limited supplied services connected to the online sale of contact lenses.

This appeal looked at whether those supplies should be treated as:

- standard rated, as contended by HMRC; or
- exempt medical care (Item 1(b) Group 7 Sch. 9 VATA 1994).

Vision Dispensing Limited worked together with a Dutch company, Vision Direct BV, that was part of the same group. When a customer ordered contact lenses online, they entered into two contracts:

1. A contract with the Dutch company that sold the contact lenses;
2. A contract with Vision Dispensing Limited that:
  - selected and dispatched the lenses from a UK warehouse on behalf of the Dutch company;
  - dealt with online customer enquiries.

Of the monies received from the customers, 82% of the consideration was for the supply by the Dutch company of prescription contact lenses or other products and 18% was for the UK company's services.

HMRC argued that the supplies were standard rated as the company was not providing professional medical advice or therapeutic care via its online customer facility.

## *Decision*

The First Tier Tribunal highlighted two questions to answer:

1. Did the company's services constitute medical care?
2. Were the company's services wholly performed or directly supervised by appropriate persons?

The First Tier Tribunal stated that medical care involves "the diagnosis, treatment and.....cure of diseases or health disorders".

The Tribunal disagreed with HMRC, finding that the content of the group's website could amount to the provision of "medical care". Indeed, the website content was comprehensive and sought to deal with every conceivable question about contact lenses. However, the information on the website was provided by the Dutch company. Even if Vision Dispensing Limited had provided the website information, the website information was accessible for free by anyone who chose to visit that site. The Tribunal concluded that it was "wholly unrealistic to regard the payment customers make for "dispensing services" as having any link at all ... to the website". The website content was not part of any supply made by the company and so should be ignored when characterising the supplies that it did make.

When considering the supplies made, 92% of customers did not seek clinical advice through the company's helpline. Of those that did, very few customers asked for their prescriptions to be verified and the Tribunal confirmed that even if they did ask, it would not be possible to do this for many of those who did. The Tribunal concluded that the company provided a customer support facility, with limited clinical advice, and selected, packed and posted goods, all of which were standard rated.

Although not needed, the First Tier Tribunal did consider whether the services were wholly performed or directly supervised by appropriate persons, concluding they were not. There was no evidence to show that the small number of opticians that were employed, delivered the level of supervision required.

*Vision Dispensing Limited v HMRC (TC09002)*