

Business tax round up (Lecture B1171 – 23.36 minutes)

Suppressed takings

Summary – The company had deliberately suppressed cash takings to reduce the amount of Corporation Tax and VAT payable arguing that a card to cash sales ratio was typically 90:10.

Exotic Spice (Sprotborough) Limited was formed in 2008 and registered for VAT on 1 July 2009. It operates an Indian restaurant and takeaway business near Doncaster that is run by Mr Ala Uddin who is a director of the company. It is open 7 days a week.

On 1 March 2013, HMRC opened an enquiry into the company's corporation tax return for the accounting period ending 30 June 2011. In April 2014 the enquiry was extended to cover the company's VAT returns as well. By the time of the trial, the enquiries had been extended to a number of periods.

A key part of the enquiry involved a covert visit on Saturday 10 May 2014. On this date, two groups of two HMRC officers dined at the restaurant. At the end of the evening the officers observed the cashing up procedure. In evidence, HMRC stated that takings on 10 May 2014 showed one of the lowest card : cash sales ratios identified during their enquiry. The presence of the HMRC officers meant that there was no opportunity for Mr Uddin to suppress the takings. HMRC calculated that the ratio of card payments to cash payments on this date was 55:45. From their analysis of the company's records the declared card to cash ratio was consistently around 90:10

This ratio discrepancy indicated a substantial suppression of restaurant takings resulting in understated corporation tax and VAT liabilities. HMRC sought to recover £138,000 of corporation tax covering the accounting periods 30 June 2011 to 2014, and £73,000 of VAT for the returns from March 2012 to March 2015 as well as penalties totalling £150,000.

Decision

Having reviewed all of the evidence, the First Tier Tribunal agreed with HMRC.

The company had deliberately suppressed its takings in order to reduce the amount of VAT and corporation tax for which it would be liable to and they agreed that the extent of that suppression should be calculated by reference to HMRC's card:cash ratio of 55:45.

Exotic Spice (Sprotborough) Limited v HMRC (TC07436)

Enterprise Zone Allowance

Summary – Two limited liability partnerships had been carrying on a business with a view to profit and could claim enterprise zone allowances on part of their investments, some of which was due on the basis of legitimate expectation.

On 4 / 5 April 2011, two limited liability partnerships acquired, among other assets, an assignment of rights under a construction contract known as the “Golden Contract”. The LLPs paid consideration of £153 million and £110 million respectively.

The “Golden Contract” related to construction works to be undertaken at the Cobalt Business Park that was within an enterprise zone. The amounts paid were considered to be advance payments for construction works to be undertaken. Two large data centres were subsequently constructed, but no tenants were ever found.

The LLPs claimed Enterprise Zone Allowance on the price that they paid but this was denied by HMRC.

The LLPs considered that, in denying the allowances that had been claimed, HMRC were acting contrary to their published practice which gave them a legitimate expectation that Enterprise Zone Allowances would be available and they therefore also instituted judicial review proceedings.

Decision

The Upper Tribunal found that the LLPs were carrying on business with a view to a profit as partnerships under s863 ITTOIA 2005 and so liable to income tax on the profits shared between its members. If s863 ITTOIA 2005 had not applied, it was common ground that the LLPs would have been corporate bodies subject to corporation tax. The distinction was important because the expenditure had been incurred on 4 and 5 April 2011 and the Enterprise Zone Allowance regime had been repealed from 1 April for corporation tax purposes and from 6 April for income tax purposes. Being liable to income tax meant that Enterprise Zone Allowance was potentially available. On the basis of examples and modelling prepared at the time of the transactions, the Upper Tribunal found that the LLPs had believed that making a profit was reasonably achievable.

So in theory, the expenditure qualified for Enterprise Zone Allowances. However, the sums paid were not paid wholly for the relevant interest in the sites and so some expenditure, including the arrangement fee and rental support agreement fees, did not qualify for relief.

However, HMRC had explained its position on Enterprise Zone Allowances in correspondence with an industry committee, which the Upper Tribunal concluded HMRC knew would be relied on by investors. The LLPs had understood that HMRC would not deny Enterprise Zone Allowances on the purchase price that was paid for rental support agreements. The Upper Tribunal held that the LLPs had a legitimate expectation that such expenditure would qualify and found no good reason to allow HMRC to resile from its guidance.

Cobalt Data Centre 2 LLP and Cobalt Data Centre 3 LLP v HMRC [2019] UKUT 0342 (TCC)

Losses carried forward on transfer of trade

In the *Spring Capital* case, the FTT found that losses could not be carried forward between the predecessor trade and the successor trade under ICTA 1988, s 343.

The FTT had released its decision in relation to Spring Capital's (SC) appeal in February 2015 but had adjourned the appeal in relation to one issue. This issue was whether SC was entitled to utilise carried forward losses, which arose on the transfer of trade from Spring Salmon & Seafood (SSS), a company under common ownership with SC.

SC claimed to be entitled to carry forward losses of SSS under what was then (ICTA 1988, ss 343 and 344) (now chapter 1 of Part 22 of CTA 2010). These rules apply where a company transfers a trade to another company under the same ownership, and effectively permit the successor company to step into the shoes of the predecessor company with respect to trading losses and capital allowances.

The losses that can be transferred are restricted if the predecessor company is left with liabilities that exceed its assets. The liabilities and assets that are left in the predecessor company after the transfer are referred to as relevant assets and relevant liabilities. Under ICTA 1988, s 343, when determining whether this restriction applies, the predecessor company's assets and liabilities are compared immediately before it ceased to carry on the trade.

The FTT accepted that the gradual closing down of a trade could be a 'process' rather than an overnight event, but it noted that the legislation required the identification of a point in time immediately before the cessation of the trade. This had to be the end of the process; when the trade actually ceased rather than when it started to wind down. The trade of SSS had therefore ceased on 11 November 2004, as this was the date of the last invoice issued by SSS to its customers. Consequently, the cash comprising the £1m interim dividend paid on 1 November 2004 could not be counted as a 'relevant asset' of the appellant; the dividend had been paid by SSS before its trade had ceased. In addition, the disputed sum of £2.8m, which was originally shown in the appellant's July 2002 loan account, had not been substantiated by evidence. It was therefore not a 'relevant asset' of the appellant.

The FTT concluded that the 'relevant liabilities' of the appellant exceeded its relevant assets by £1,579,574 and thus exceeded the losses that could potentially be carried forward (£424,544), so that no losses of the predecessor company (SSS) could be carried forward, under s 343, to the successor company (the appellant).

The tribunal observed that ss 343(4) and 344(5) and (6) had been introduced expressly as restrictions on the relief contained in s 343. Their purpose was to prevent insolvent companies from being transferred with their tax losses (in circumstances where there was no major change in the nature or conduct of the underlying trade). The FTT concluded: 'Accordingly, this appeal – which has lasted more than five years – is finally dismissed.'

It should be noted that the wording in the equivalent current provisions at CTA 2010, s945 is different to the wording in ICTA 1988, s 344 as now the reference to the date when relevant assets and liabilities are reviewed is the date immediately before the transfer of trade rather than immediately before the cessation of trade as was the case under s 344.

Spring Capital Ltd v HMRC (TC07471)

Adapted by Joanne Houghton from Tax Journal, 4 December 2019

Matchmaking services

Summary – In a split decision, the provision of matchmaking services went beyond the provision of consultancy services so that article 59(c) Principal VAT Directive did not apply.

Gray & Farrar International LLP ran a well-established, exclusive matchmaking business providing its services to clients in many jurisdictions.

Each client had a face to face meeting making it more difficult for a person to present themselves differently so enabling a better match. After the interview Gray & Farrar International LLP would prepare a brief describing the client and the characteristics of the person that they were seeking. The brief was sent to the client for approval. Gray & Farrar International LLP also conducted some vetting of clients from publically available data.

After the brief had been agreed, Gray & Farrar International LLP identified possible matches for clients. The matching suggestions were not done by a computer program or by any sort of algorithm; they were individually selected.

Regularly, after suggestions had been made, clients were telephoned by the liaison team to gain feedback as to whether the date was successful, gather information that might give rise to amendments to their brief, or to arrange further introductions. During the telephone calls, advice or coaching could be given to the client.

The LLP argued that its services fell within the description in Article 59(c) Principal VAT Directive as being:

“the services of consultants, engineers, consultancy firms, lawyers, accountants and other similar services, as well as data processing and the provision of information”,

As a result, they believed that when it supplied its services to non-taxable persons who reside outside the EU, its supply should to be treated as made outside the EU and is thus outside the scope of VAT.

HMRC disagreed arguing that the services supplied were not services "principally and habitually" provided by a consultant.

Decision

The First Tier Tribunal agreed that the supply was a single composite service and to decide whether that service fell within Article 59 (c) they needed to look at the principal components of that supply and ask whether they all fell within that provision.

The Tribunal agreed that the clients sought a person for a long-term relationship and that Gray & Farrar International LLP supplied information about carefully selected individuals but the service went further.

Judge Wilkins concluded that the material elements of the supply consisted of the provision of information and expert advice, and that the supply fell within Article 59(c).

Judge Hellier, with his casting vote, accepted that an individual could be an expert at matchmaking. However, he stated that the support provided by the liaison team was support in the developing of a relationship and provided a form of ready-made confidante with whom the client could discuss a relationship. This was support in addition to the use of the information and expert advice received and, as it was not shown to be sufficiently inconsequential, it could not be ignored. He concluded that the services provided went beyond the provision of consulting expert advice covered by article 59(c).

The appeal was dismissed.

Gray & Farrar International LLP v HMRC (TC07457)

School holiday camps

Summary – The holiday camps provided a single composite supply where the predominant element was childcare, as opposed to the provision of activities, and were therefore exempt supplies under item 9 of Group 7 Schedule 9 VATA 1994.

RSR Sports Limited traded under the name of Get Active Sports and among other things they provided school holiday camps.

The company was registered with OFSTED as a private welfare institution or agency and was recognised by both parties as a “state-regulated private welfare institution or agency” for the purposes of construing and applying item 9 of Group 7 of Schedule 9 VATA 1994.

Both parties agreed that the Holiday Camp Services amounted to a single composite supply of services and not multiple supplies of services because the goods and services supplied in the course of providing the Holiday Camp Services were so closely linked that they formed objectively, from an economic point of view, a single supply which it would be artificial to separate into its constituent elements for the purposes of applying VAT law.

In order to decide the correct VAT treatment, the predominant element of the service had to be determined from the point of view of the typical consumer and having regard to the qualitative and not merely quantitative importance of the elements.

RSR Sports Limited considered that these supplies constituted supplies of “welfare services” within the meaning of item 9 of Group 7 of Schedule 9 to the VATA 1994 and so were exempt. By contrast, HMRC considered that these supplies did not fall within these provisions and were properly treated as standard-rated taxable supplies for VAT purposes. So the issue to be decided was whether the predominant element of the supply was the provision of childcare or the provision of activities.

Decision

The First Tier Tribunal confirmed that the Holiday Camp Services provided included both an activities element and a childcare element. In order to make the Holiday Camp Services attractive to potential consumers the company was keen to emphasise to those potential consumers the activities element of the relevant services.

Staff supervised the activities at the holiday camps but there was no coaching or teaching of the relevant skills and the staff were not required to have any coaching or teaching qualifications or experience. In addition, there was no external standard to which the activities were being provided. The only qualifications that needed to be held were the appropriate DBS checks required by OFSTED, a child safeguarding certificate from the NSPCC and a first aid certificate. Parents looking for childcare could choose a either a passive or active provider. The former would have children sitting in front of a television or allowing the relevant children to entertain themselves. An active provider, such as RSR Sports Limited, would offer a more active approach to childcare in the form of supervised activities. In the First Tier Tribunal's opinion, a more active provider should not be disqualified from falling within the VAT exemption. They added that with the present focus on obesity in children, a childcare provider adopting an active approach is "surely doing more for the welfare of the children in its care than the passive childcare provider" and should be "more deserving of the exemption."

The appeal was allowed.

RSR Sports Limited v HMRC (TC07453)

Hay making business

Summary – haymaking and the sale of buildings did not constitute operating as a business during the relevant period and so input tax recovery was denied

Babylon Farm Ltd had been registered for VAT since 1991 and had previously carried out more extensive farming activities whilst under the ownership of Mr McLaughlin and his wife.

Mr and Mrs McLaughlin owned land and other buildings on a farm, while Babylon Farm Ltd owned and had control over some outbuildings on the farm that were occupied by Mr and Mrs McLaughlin. The company produced hay and maintained the outbuildings.

Babylon Farm Ltd claimed £19,765 of input tax, the majority of which related to the construction of a new barn. No output tax was reported in this period and HMRC denied the claim, arguing that the scale of the business was not of a kind that could be argued to be a business venture

Babylon Farm Ltd claimed that its farming activity had been carried on uninterrupted since 1989 and that the haymaking was the remains of its original farm business. The company claimed that its activities had always been run on sound business principles and its activities as a whole were not negligible. During the relevant period, the company's only income, apart from an exempt property sale, was just over £400 per annum for selling hay to Mr McLaughlin for his livery business.

Decision

The First Tier Tribunal stated that the mere fact that Babylon Farm Ltd was registered for VAT did not constitute an acceptance by HMRC that a person was operating as a business. Whether or not company was carrying on business and making taxable supplies needed to be determined on the facts.

The Tribunal looked at the six factors from the case *CCE v Lord Fisher* to determine whether an activity constitutes a business, and considered was:

1. the activity a serious undertaking earnestly pursued?
2. there a certain measure of substance?
3. an occupation or function actively pursued with reasonable or recognisable continuity?
4. the activity conducted in a regular manner and using sound and recognised business principles?
5. the activity predominantly concerned with the making of taxable supplies for consideration?
6. the supply of a kind that, subject to differences of detail, commonly made by those who seek to profit from it?

The Tribunal concluded that Babylon Farm Ltd was hay making seriously, but with Mr McLaughlin doing the work, using the company's equipment and machinery. The customers of Mr McLaughlin's livery business were the end-users for the hay.

However, they concluded that it was a very modest activity carried out on a casual, non-commercial basis. The company's activities did not give rise to any staff or other costs. Mr McLaughlin fixed the price that he paid for the hay and decided what costs were borne by Babylon Farm Ltd. Mr McLaughlin appeared to carry out some or all of the activity himself without charge. The profitability of the company's hay making activities was entirely dependent on Mr McLaughlin's subjective judgement as to where costs and revenue should be allocated between his various activities. The Tribunal concluded that the company's activity was not predominantly concerned with making a profit as the business generated less than £500 per year, with no invoices raised until HMRC questioned the input VAT recovery

The First Tier Tribunal found that haymaking and the sale of buildings had not been conducted on a basis that followed sound and recognised business principles or on a basis that was predominantly concerned with the making of taxable supplies for consideration. As a consequence the company was not operating as a business during the relevant period.

The appeal was dismissed.

Babylon Farm Ltd v HMRC (TC07356)

Supply to profit making parent

Summary - Applying the Halifax doctrine, the supply by a non-profit making company was redefined as a supply by its profit-making parent and so made taxable supplies.

Snow Factor Limited operated a large leisure and adventure complex promoted as a family entertainment destination described as an "indoor snow sport resort" with two slopes and an ice wall. It includes a licensed café/bar.

Snow Factor Limited's Managing Director set up Snow Factor Training Limited, a company limited by guarantee, with no shareholders or staff, to provide training and tuition in relation to snow sports.

Having set up the new company, Snow Factor Limited's transferred its snow training and education business as a transfer as a going concern for £1. The company never registered for VAT as it was argued that it provided exempt supplies as it qualified as an "eligible body" for the purposes of Note 1 Group 6 Schedule 9 VATA 1994.

An agreement between the two companies provided that 100% of Snow Factor Training Limited's income would be paid to Snow Factor Limited, plus the costs incurred.

HMRC argue that the use of two companies whereby the tuition services were supplied by SFTL and all of the other supplies were made by SFL, amounted to an abusive tax avoidance arrangement liable to redefinition under the Halifax doctrine.

Decision

The First Tier Tribunal observed that very little changed following the creation of Snow Factor Training Limited. Customers were attracted to the Snow Resort by Snow Factor Limited's marketing. There was no mention that a separate company, Snow Factor Training Limited, provided the tuition services.

The Tribunal concluded that the set up between the companies was 'wholly artificial' and abusive and that any non tax savings were merely incidental compared to the VAT savings that applied. Indeed little evidence was put forward to support these non-tax benefits. The Tribunal concluded that the tuition supplies should be treated as if supplied by Snow Factor Limited. In any event, Snow Factor Training Limited did not qualify as an eligible body as the main aim of setting up the company was to enrich Snow Factor Limited.

They concluded that the commercial and economic reality was that at all material times Snow Factor Training Limited was part of a single integrated commercial organisation trading under the brand "Snow Factor". Nothing at all was at arm's length and it was not an eligible body.

The appeal was dismissed

Snow Factor Limited and Snow Factor Training Limited v HMRC (TC07439)

Loan administration services

Summary - Loan administration services were not exempt financial services under Article 135(1)(d) PVD but should be treated as taxable supplies of debt collection.

Target Group Limited provided outsourced loan administration services to banks and building societies including Shawbrook Bank Limited, a provider of a range of mortgages and loans.

On 21 May 2015, Target Group Limited wrote to HMRC requesting a non- statutory clearance of the proposed VAT treatment of supplies it made to Shawbrook Bank Limited, following changes to their supply agreement. Target Group Limited believed its supplies were composite supplies of payment processing and so were exempt.

As an undisclosed agent of Shawbrook Bank Limited, it established loan accounts, liaised with borrowers, dealt with their payments, and so on.

In July 2015, HMRC notified Target Group Limited of their decision that the supplies to Shawbrook Bank Limited were composite supplies of the management of loan accounts and were therefore taxable.

Target Group Limited appealed to the First Tier Tribunal where they lost their appeal with the Tribunal finding that the loan administration services supplied were standard rated as debt collection stating:

“the essence of what is being acquired, and the main objective [of Target’s supplies], is the collection of debts as they fall due ...” and the predominant nature of the services supplied by Target to Shawbrook is debt collection.”

Target Group Limited appealed to the Upper Tribunal.

Decision

The Upper Tribunal upheld the First Tier Tribunal’s decision.

Article 135(1)(d) PVD that requires Member States to exempt “transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluding debt collection...”

Although the transactions were transfers concerning payments, Target Group Limited’s role was to recover the interest and principal from borrowers. However, the actual payments were processed between the borrower’s bank and Shawbrook Bank Limited. Target’s supply was limited to passing on information to enable the transfer or debt collection. As debt collection is specifically excluded from exemption, their supply was taxable at the standard rate.

Target Group Limited v HMRC [2019] UKUT 0340 (TCC)

B2B supply chain operators - ‘4 quick fixes’

With effect from 1 January 2020, EU member states have agreed four changes to the Business To Business VAT rules on intra-community supplies’. These changes aim to simplify EU VAT compliance and will be in use provisionally until 1 July 2022, when a new definitive VAT system is planned.

Call-off stock

Call off stock refers to the situation where a supplier moves stock to a known customer’s warehouse in another EU country but the supply only takes place when the customer removes or ‘calls off’ the goods from storage.

Under current EU rules, the supplier must:

- register for VAT in the country of destination, reporting the stock movement in both their domestic return and foreign return as a self-supply;
- record a domestic sale when the customer removes the goods and also report it on their foreign VAT return.

Some countries (including the UK) operate their own 'call off stock relief' and so do not require the supplier to register for VAT in the foreign country. Here, the customer accounts for VAT on the acquisition under normal rules.

Under the new rules, provided that the relevant conditions are met, VAT registration in the storage country will not be required. The supplier must record the stock movement in their EC Sales Listing and both parties must maintain a register of the goods.

If the goods are not 'called off' within 12 months of dispatch, the stock should be returned, or the transaction be recorded as an intra-community supply.

Cross border chain transactions

Cross border chain transactions are supply chains involving at least 3 parties, making it hard to identify when the zero-rated cross border supply step occurs. Under the new rules, where there are more than three parties involved, it will be important to identify the intermediary who is responsible for the transport of the goods.

From 1 January 2020, new rules will apply when the parties are located in three different EU countries, with the goods moving between the supplier and customer's countries only.

1. Intermediary provides a VAT number from another EU state:

- supplier zero-rates the sale - cross-border supply to the intermediary;
- intermediary
 - transports the goods from supplier's to the customer's country;
 - reports a domestic supply with the customer in their country.

Triangulation would be available to the intermediary in this instance.

2. Intermediary presents a non-resident VAT number in supplier's country where the goods are dispatched:

- supplier charges VAT to the intermediary as a domestic transaction in their country;
- intermediary
 - transports the goods to the customer's country
 - reports a zero-rated cross-border supply to the customer.

Proof of cross-border transportation

B2B goods sold cross border within the EU are exempt from VAT provided that the supplier holds evidence that the goods left their country.

From 1 January 2020, the evidence required will depend on who is responsible for the movement of goods.

- supplier responsible: they must keep 2 pieces of evidence that the goods were transported;
- customer responsible: supplier must obtain written evidence of the transport from the customer, supported by two pieces of evidence as detailed above.

Customer VAT number

Despite what many believe, currently for zero rating to apply to Cross Border EU supplies, a customer does not have to provide a valid VAT number issued by another Member State. This was only a formal rather than substantive requirement.

However, from 1 January 2020 customers must provide a valid VAT number for zero rating to apply and these must appear on suppliers' invoices as well as their EC Sales list. Without this information, the supply will be subject to VAT in the EU state of dispatch. The new rules do not require the supplier to validate the customer's VAT number, although it would seem sensible to do so in order to avoid becoming involved in any VAT evasion.

Avalara – 2020 Guide: EU VAT Four Quick Fixes