

Business tax update (Lecture B1351 – 22.48 minutes)

MTD for Income Tax delayed

On 19 December 2022 the government announced that the start date for MTD for income tax will be delayed from April 2024, with the new start date set as April 2026. The announcement confirms that from April 2026, businesses, self-employed individuals, and landlords will be required to report under MTD for income tax if their income exceeds £50,000, a welcome increase from the previous £10,000.

From April 2027, those with income of over £30,000 will then be required to join the scheme. The government has stated that it will now review the needs of smaller businesses, particularly those under the £30,000 threshold. The announcement stated that this review 'will look in detail at whether and how the MTD for ITSA service can be shaped to meet the needs of smaller businesses and the best way for them to fulfil their Income Tax obligations.' The government confirmed that it remains committed to introducing MTD for income tax for partnerships but at a later date.

Further, the new penalty system, that brings the late submission and late payment penalties for Income Tax Self-Assessment into line with those for VAT, will come into effect when taxpayers become mandated to join MTD. The government will introduce the new penalty system for Income Tax Self-Assessment taxpayers outside the scope of MTD after its introduction for MTD taxpayers.

<https://questions-statements.parliament.uk/written-statements/detail/2022-12-19/hcws465>

CT returns not matching computations

HMRC has found discrepancies between information contained within CT returns and the amounts appearing in tax computations.

HMRC has stated that when the Corporation Tax loss reform rules were introduced on 1 April 2017, the treatment of brought-forward losses changed. In some instances, they have found that one or more boxes on the CT600 form have included brought-forward amounts, which is not in line with these rules.

The boxes which could be affected are:

- 805 and/or 810 UK property business losses – s.102 CTA 2010;
- 830 and/or 835 non-trading losses on intangible fixed assets – s.104 CTA 2010;
- 850 and/or 855 management expenses – s.103 CTA 2010.

HMRC have written to the companies and their agents to make them aware of the issue and that they will rely on the tax computations as the correct position. No action is required from companies, unless they disagree with HMRC's approach, in which case they have 60 days from the date of the letter to contact HMRC.

<https://www.tax.org.uk/hmrc-letter-differences-in-the-loss-position-of-company-tax-returns>

List C capital allowances

Summary – The Upper Tribunal had erred in law in setting aside the First Tier Tribunal’s decision that expenditure incurred on the construction of nuclear deconversion facility did not qualify for capital allowances. It also found that a drafting error had wrongly narrowed the scope of list C of s.23 CAA, and that, on a proper construction of the provision, expenditure incurred 'on the provision of' list C assets should qualify for capital allowances.

Urenco spent £1billion constructing a 'tails management facility' for the processing of depleted uranium tails. The treatment for capital allowances of most of the expenditure was agreed but £192m was disputed by HMRC.

Decision

The Court of Appeal accepted the First Tier Tribunal’s finding that some of the expenditure was not on plant (but on the premises or 'setting') and that, in any case, all the expenditure was on 'buildings' or 'items incorporated in or connected with buildings' and therefore not eligible for capital allowances by virtue of s.21 CAA 2001. Accordingly, it accepted HMRC's appeal against the Upper Tribunal’s decision to set aside the First Tier Tribunal’s decision.

The Court of Appeal also accepted a cross-appeal by Urenco in relation to the proper statutory construction of list C of s.23 CA 2001. List C contains 33 types of assets which are exceptions to the general rule that expenditure on buildings does not qualify for capital allowances.

Items 1 to 22 of list C simply list the assets; items 23 to 33, on the other hand, expressly refer to expenditure 'on the provision of' such assets. The latter is a wider formulation as it permits capital allowances to be claimed not just for expenditure 'on' the actual item itself but also for the ancillary costs of ensuring it can be safely used on site (for example, transport and installation costs).

Urenco argued that parliament cannot have intended to create this discrepancy within list C and that the wider formulation should apply to all the assets in list C. Accordingly, its expenditure 'on the provision of machinery and processing equipment' (items 1 and 4 of list C) should qualify for capital allowances and not just its expenditure 'on' those items. The Court of Appeal agreed. It considered it 'implausible' that parliament should have intended to draw a distinction between expenditure 'on' items 1 to 22 of list C and expenditure on their 'provision', with only the former qualifying for capital allowances.

Instead, it concluded that this distinction arose from an inadvertent drafting error that could be traced back to the tax law rewrite project. To remedy this error, the Court of Appeal held that expenditure 'on' list C assets should be read as meaning 'expenditure on the provision of' such assets. It remitted the case to the First tier Tribunal to decide the remaining issues based on this interpretation.

Urenco Chemplants Ltd and others v HMRC [2022] EWCA Civ 1587

Adapted from the case summary in Tax Journal (9 December 2022)

Management expenses were capital

Summary - Expenditure on services relating to the proposed sale of a subsidiary qualified as management expenses but were disallowed as they were capital in nature.

Centrica Overseas Holdings Ltd was an investment holding company which had a Dutch subsidiary, Oxxio.

In 2009 the group decided to sell Oxxio and its subsidiaries, achieving a part sale in 2011 by means of a partial demerger. Between 2009 and 2011 the group incurred fees of £3.8 million which were paid to three firms for services relating to this transaction. The expenditure was recharged to Centrica Overseas Holdings Ltd, which claimed £2.5 million as management expenses deductible from its profits.

HMRC refused the claim on the basis that the expenses did not belong to Centrica Overseas Holdings Ltd 's investment business; rather they related to a decision already taken by a different company.

The First Tier Tribunal had found for HMRC, although it ruled that the expenses were management expenditure and not capital. The Upper Tribunal allowed the company's appeal. HMRC appealed to the Court of Appeal.

Decision

On HMRC's assertion that the expenses were not management expenses, the Court of Appeal held that the issue was not a 'pure question of law'. It followed that the role of an appellate court or tribunal was a limited one. The judge said the First Tier Tribunal had correctly directed itself as to the legal principles and applied them to the facts.

It was entitled to reach the conclusion that the disputed expenses were management expenses. HMRC's appeal on this ground was dismissed.

However, the second ground – whether the expense was of a revenue or capital nature – was a matter of law, therefore the court was free to arrive at its own decision. The judge said it was clear that s.1219(3) CTA 2009 was intended to exclude capital expenditure and should be interpreted in accordance with the case law on trading expenses.

The crucial feature was the commercial decision to dispose of the Oxxio business. The purpose of the expenditure was to decide how to carry that out. The previous tribunals had made errors of law by 'confusing the test for whether something is an expense of management with the distinct legal question of whether it is capital expenditure'.

The disputed expenditure was within the exception in s.1219(3)(a) CTA 2009.

HMRC's appeal on the capital expenditure issue was allowed.

HMRC v Centrica Overseas Holdings Ltd [2022] EWCA Civ 1520

Adapted from the case summary in Taxation (1 December 2022)

Associated company lease

Summary – A partnership could recover input VAT on property leases entered into by an associated company as the economic and commercial reality was that the partnership received the supply.

The appellant was a firm of solicitors. The partnership had been registered for VAT since 1 October 2011. As a result of a previous merger, the partnership had three offices and for a number of years had been looking for alternative premises in order to consolidate their operations.

Having found suitable premises, lease negotiations were carried out by, and on behalf of, the partnership and it was the partnership that signed the heads of terms. However, the Law of Property Act 1925 only allows a partnership to enter into a lease in the name of up to four partners. Consequently, the lease was agreed with Ashtons Legal Limited, a dormant shell company, acting as the partnership's nominee.

The landlord understood that the partnership would be the sole occupants of the premises and would pay the rent. However, under the lease, the rental invoices were addressed to the limited company but sent directly to the partnership for payment. The invoices were processed, paid and input VAT recovered on the partnership's VAT return.

HMRC denied the input VAT claim arguing that the supply was made to Ashtons Legal Limited, with a second supply of equal value made by that company to the partnership. As the company had not opted to tax, this supply was exempt from VAT.

The partnership appealed, arguing that commercially there was one lease between the landlord and the partnership. The company's involvement was only needed because of the Law of Property Act restrictions.

Decision

The First Tier Tribunal considered it necessary to look at the economic and commercial reality of the deal.

The First Tier Tribunal found that the partnership used the premises and was liable pay the rent as it fell due. All parties knew that Ashtons Legal Limited was simply a dormant company, a 'mere cypher' inserted into the leases to deal with property law issue.

The judge concluded that *Airtours Holiday Transport Ltd v CRC* [2016] STC 1509 supported the partnership's view that the 'commercial and economic reality' was that the partnership had received the supply of rent and could therefore claim input tax.

The appeal was allowed.

Neil Warren, VAT consultant, commented:

'The legislation confirms that input tax can only be claimed by a business or person that receives a supply of goods and services. Although the lease was between the landlord and the company, the commercial reality was that the partnership was receiving the benefits of the lease and dealt directly with the landlord. HMRC's guidance in its *VAT Input Tax Manual* VIT13440 deals with the situation when a lease is recorded in the name of an individual director rather than a partnership or company – allowing input tax to be claimed by the partnership or company if certain conditions are met – perhaps the time is now right to extend this guidance to include other parties and not just individuals.'

Ashtons Legal (A Partnership) v HMRC (TC08641)

Transfer of a going concern or stock?

Summary – Stock was transferred as part of a transfer as a going concern and so the input tax claim in relation to the stock was disallowed.

On 6 October 2015, Apollinaire Ltd was incorporated as a men's outfitters, and registered for VAT from that date. The company's sole director and shareholder was Benny Hashmi.

Benny Hashmi had a history of setting up companies, where he acted as director. The companies failed to submit returns and/or had unpaid tax debts and were then dissolved.

One such company was Snow Whyte Limited. The company traded under the name Benny Hamish but referred to as Snow. This was incorporated in November 2010 and was supposedly owned by a Mr Singh. A VAT deregistration form was submitted to HMRC stating that Snow ceased to trade on 30 September 2015 and the company was dissolved on 2 August 2016.

HMRC's Real Time Information for PAYE showed that until 30 September 2015, Snow had 6 full-time employees including Benny Hashmi and they all commenced employment with Apollinaire Ltd on 1 October 2015, with Apollinaire Ltd also trading under the name of Benny Hamish and operating from the same premises as Snow had done. Apollinaire Ltd submitted its first VAT return covering the period 6 October 2015 to 31 January 2016, seeking a repayment of £98,191.21, due mainly to input tax claimed on stock allegedly bought from Snow.

HMRC believed there had been a transfer of a going concern from Snow to Apollinaire Ltd. The input tax claim was denied. The return was adjusted for input tax claimed on stock purchases as well as output tax errors connected with retail scheme calculations.

Initially, the company's accountants confirmed there had been a transfer of a going concern but later, with new accountants appointed, the company argued that only stock had been bought and not the business as a whole meaning that the input tax was recoverable.

Further, with Benny Hashmi's history, HMRC issued a personal liability notice as they believed the errors on the return were deliberate and there was a risk that the company would become insolvent.

Apollinaire Ltd appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal found Benny Hashmi's evidence lacked credibility and questioned whether Mr Singh ever existed.

The First Tier Tribunal found that there was a transfer of a business as a going concern between Snow and Apollinaire Ltd, with Benny Hashmi as director, or shadow director, controlling both companies. The trade before and after Snow ceased trading was unchanged, with the same trading name, employees and premises.

No input tax was recoverable on the stock transferred and the appeal was dismissed.

As stated by Neil Warren, independent VAT consultant:

The director's previous history with dissolved companies highlights why it is so important that the legislation gives HMRC the power to issue a personal liability notice against a director or shareholder where deliberate errors have been made by a company that underpays VAT.'

Apollinaire Ltd and Zakir Hussain Hashmi V HMRC (TC08648)

Subway standard-rated sales calculation

Summary – In arriving at their best judgement assessment, HMRC had done everything expected and the taxpayer had failed to provide any evidence to displace the figures arrived at.

Neoterick UK Limited operated a Subway in Suffolk, having commenced trading back in 2014.

Having reviewed the company's VAT returns, HMRC were concerned that the reported standard-rated sales of between 55% and 78% of total sales were low when compared to the 87% average for other Subway franchises across the country. Consequently, in August 2017 HMRC carried out two test purchases, with the till receipts showing the items as zero-rated, when some of the items bought were in fact hot food that should have been standard rated.

Following two further investigations in October, HMRC established that the percentage of standard-rated sales on these days were recorded as 88.97% and 93.3%. HMRC wrote indicating that a VAT assessment would be issued for the under-reporting of standard rated supplies. The letter invited the company to provide evidence if it thought that the assessment was incorrect. Having received no reply, a best judgment assessment was raised in November 2017 for £45,000 for the VAT periods 01/14 - 07/17.

Neoterick UK Limited appealed, arguing that the percentage of standard rated turnover was too high and could not be relied on as HMRC had only undertaken a relatively small sampling exercise. Apart from the two "one-off" purchases in August, they had only attended for part of one day and a whole of another and then extrapolated those results over a four-year period. The company argued that the assessment had not been issued on a 'best judgment' basis.

Decision

The First Tier Tribunal considered past tribunal cases on the principle of best judgment and stated that officers had a duty to use only the material available to them and then to calculate the tax underpaid with an honest and bona fide approach.

HMRC had done everything expected of it, having used evidence from four separate occasions combined with their experience of other Subway franchises.

Further, Neoterick UK Limited had not provided any alternative calculations or evidence to support their claim that the percentage used by HMRC was too high.

The company's appeal was dismissed.

Neoterick UK Limited v HMRC(TC08652)