

Business tax update (Lecture B1401 – 21.33 minutes)

Compensation payments were disallowed

Summary – Looking at the compensation payments as a whole, they were made in lieu of penalties, making them non-deductible for corporation tax.

The companies in this case were energy providers regulated by the energy regulator, Ofgem.

They entered into settlement agreements with Ofgem in settlement of a number of regulatory investigations into matters such as mis-selling, complaints handling and costs transparency.

The First Tier Tribunal concluded that:

- payments to make good the loss the customer had suffered totalling some £554,000 were allowable as they were paid directly to consumers as compensation, paid wholly and exclusively for the purposes of the trade.
- the remaining £28 million redress payments, although wholly and exclusively incurred for the purposes of the trade, were effectively penalties and therefore not tax deductible.

The case moved to the Upper Tribunal.

Decision

The Upper Tribunal considered the First Tier Tribunal had been wrong to distinguish between punitive payments and compensatory ones.

On the redress payments, the First Tier Tribunal had held to be non-deductible, the Upper Tribunal agreed that it was entitled to find that the agreements were entered into under the threat of penalties and therefore the payments were made in lieu of the penalties. They were therefore penal in nature and not deductible.

Turning to HMRC's appeal, the Upper Tribunal agreed that the First-Tier Tribunal had made an error of law in concluding that £554,000 was tax deductible. The facts indicated the £554,000 payment was clearly part of a package of payments, negotiated as part of an overall deal, put together under the threat of penalty and was so also paid in lieu of a penalty.

The Upper Tribunal remade the First Tier Tribunal decision to the effect that none of the payments were deductible.

Scottish Power Ltd and others v HMRC [2023] UKUT 218 (TCC)

S.455 when withdrawing suppressed funds

Summary - Suppressed turnover resulted in the sole shareholder/director being personally liable for VAT and corporation tax penalties but this did not mean that the resultant s.455 charges had been deliberately unaccounted for.

Prutish Gopaul was the sole shareholder and director of Gopaul Limited, a company trading under the name “Milano Pizza”.

In June 2017, HMRC issued the company with “best judgement” assessments for £74,000 of VAT relating to suppressed turnover. Further, HMRC issued deliberate behaviour penalties on the company and a personal liability notice for the same amount on the basis that the inaccuracies were attributable to the director.

HMRC then opened enquiries into the company’s corporation tax returns, subsequently issuing discovery and amended assessments for the years 2014 through to 2017 relating to corporation tax on undisclosed profits and s.455 charges relating to the undisclosed profits effectively withdrawn from the company by Prutish Gopaul, as loans to him as a participator.

HMRC also issued the company with a £71,000 penalty being 56% of the total extra corporation tax, on the basis that the behaviour had been deliberate as well as a personal liability notice of the same amount.

In February 2018 the Company went into liquidation and was finally struck off on 19 August 2020.

Prutish Gopaul appealed the personal liability notices for both VAT and corporation tax.

Decision

The First Tier Tribunal found that the company had acted deliberately by suppressing its turnover for both VAT and Corporation Tax. With an 80% difference between till data and figures included on the VAT returns, this was not a minor discrepancy caused by the occasional human error. Prutish Gopaul had deliberately failed to manage his company’s tills and business records and was unable to provide information requested by HMRC.

As a result, the penalties and personal liability notices in respect of VAT and corporation tax were upheld but they were reduced for the lack of deliberate behaviour in relation to the s.455 charges. The Tribunal found that HMRC had not proved that the company acted deliberately by not including the s.455 charges on its returns. Taking money from the company did not mean that the company/director knew about the potential s.455 charges that arose as a result of HMRC assuming that the missing income had been withdrawn from the company and effectively debited from the director’s loan account. The Tribunal reduced the penalties and personal liability notice for corporation tax to take this into account.

Prutish Gopaul v HMRC (TC08917)

Allocation of consideration to goodwill

Summary – The value of goodwill should be based on the assets valued at open market value rather than depreciated replacement cost.

Nellsar Limited acquired residential care and nursing homes as going concerns with the relevant purchase agreements stating that an amount of the purchase price for the respective businesses was attributed to goodwill.

Tax legislation used to permit a tax deduction for amortised goodwill to the extent that the expenditure and amortisation are reflected in the company’s UK GAAP-compliant accounts.

Under UK GAAP, the goodwill in each case is the difference between the purchase consideration and the “identifiable assets” valued at their appropriate fair values. With the care home properties being the bulk of the “identifiable assets” acquired, the dispute here concerned the valuation of those properties. These values were subsequently used for both SDLT and corporation tax computations.

The company argued that the value of consideration relating to assets acquired should be calculated valued using depreciated replacement cost, rather than open market fair values.

HMRC disagreed, arguing that there was an open market for similar assets and so fair value should have been used. Consequently, the properties had been undervalued, with goodwill effectively overvalued. HMRC raised assessments accordingly.

The company appealed.

Decision

The First Tier Tribunal found it was possible to value the properties by reference to an adjusted operational entity valuation. This could be done using other operational care homes with appropriate adjustments per RICS guidance, so that the property valuations reflected the properties as stand-alone assets, without residents, staff and the like.

Consequently, the company’s valuation using depreciated replacement cost did not comply with UK GAAP.

The First Tier Tribunal stated that the correct property valuations required input from professional valuers and if they could not be agreed, should be appealed to the Lands Chamber of the Upper Tribunal.

For SDLT purposes, the Tribunal agreed that a ‘just and reasonable’ apportionment valuation should be carried out by reference to the agree market values of each property acquired.

Nellsar Limited v HMRC (TC08908)

Academic work

Summary – Despite a change in contract terms, the taxpayer was still not acting as agent in relation to its writing services outsourced to third parties, meaning it was required to account for output VAT on the full payment received from its student end users.

All Answers Limited returned to the First Tier Tribunal, having previously lost at both the First Tier and Upper Tribunals. You may remember that the internet-based company used third party writers who were teachers, lecturers or PhD students to supply dissertations, essays, and other pieces of coursework for students.

The company failed in its argument that these writers were supplying services direct to the students, meaning that the company was acting as principal and not an agent. This made the company responsible for charging output VAT on the full fee charged, and not simply the proportion retained by the company.

All Answers Limited had updated terms within its contracts with the writers, effective from October 2016 so that copyright for the work produced remained with the writer. Further, it made reference to a contract between the writer and end customer whereby the writer provided the work to the student. The company argued that this changed the legal basis as well as the commercial reality of the arrangement.

HMRC disagreed and raised VAT assessments for some £419,000 for VAT periods from December 2016 onwards.

All Answers Limited appealed to the First Tier Tribunal.

Decision

Agreeing with HMRC, the First Tier Tribunal found that the changes to the contracts did not affect the commercial and economic reality of the arrangements.

There was no contract at all between the writer and end customer and this could not be implied to exist as a result of clauses inserted within the contract between the company and its writers.

In reality, the academic writers provided completed written answers to the company to enable the company to supply these on to their student customers. All Answers Limited was making direct supplies as a principal rather than an acting as agent.

The appeal was dismissed.

All Answers Limited v HMRC (TC08920)

Intention to make taxable supplies

Summary – The taxpayer company provided sufficient evidence of an intention to make taxable supplies and in fact provided evidence that it did make supplies.

Heartland House Limited undertook construction contracts using subcontractors to carry out the work.

In October 2018, the company registered for VAT, with that registration backdated to 9 June 2016.

HMRC investigated three repayment claims relating to the periods 09/19, 06/20 and 09/20.

Heartland House Limited accepted that HMRC's assessments for 06/20 and 09/20 were correct, as the VAT had been claimed in error in respect of purchases relating to exempt supplies. Consequently, the dispute in this appeal was the 09/19 £28,000 assessment which related to the input tax reclaimed in respect of a number of projects.

HMRC stated that Heartland House Limited had failed to prove that its input tax claims related to actual or intended taxable supplies, meaning that input tax recovery was blocked.

HMRC commented on the company's lack of credit control, customer due diligence checks and failure to register for the construction industry scheme.

Heartland House Limited appealed providing details of four projects where construction services had been received from subcontractors, and these costs recharged on to the final customer.

Decision

The First Tier Tribunal found in favour of the company and were 'puzzled'. Why would the company have incurred construction-related costs and entered into construction contracts if it did not intend to make taxable supplies?

Provided relevant evidence is supplied, the state of the company's accounting and administrative processes should not prevent it reclaiming input tax suffered. In this case, although poorly managed, the company had produced sufficient evidence to link its construction project sales to the costs it had incurred.

The appeal was allowed.

Heartlands House Limited v HMRC (TC08927)

Repatriation of dead bodies

Summary – The repatriation of dead bodies was a transport service rather than services supplied in connection with the disposal of human remains. This made the supplies zero-rated rather than exempt for VAT.

UK Funerals On-line Limited repatriated deceased persons' bodies, predominantly from the UK to other countries around the world.

With only 3 or 4 businesses in the UK offering this service, its customers usually found them through either an online search or through word of mouth.

Typically, the next of kin would contact and appoint UK Funerals On-line Limited to repatriate the body and then the company would:

- arrange for an "out of England" form to be granted from the coroner, giving the company permission to transport the body, but with no burial or cremation rights;
- prepare the body and place it in the required zinc-lined coffin or casket ready for transport (not suitable for cremation or burial);
- sort out the required paperwork and arrange the flight through a shipping agent;
- provide the airline with the name and contact details of the person who will take responsibility for the body on arrival in the other country;

Once the body cleared the x-ray at the airport, the company ceased to have any further involvement.

UK Funerals On-line Limited believed they were supplying specialist transportation services that were zero-rated under Item 5(b) Group 8 Sch. 8 VATA 1994.

However, HMRC argued that the supplies fell within Item 2 Group 8 Sch. 9 VATA 1994) which covers:

"The making of arrangements for or in connection with the disposal of the remains of the dead"

HMRC argued that the company was undertaking services usually provided in a funeral supply, including a coffin, embalming and the use of a chapel of rest.

HMRC also made reference to VAT Notice 701/32 which states:

“7.2 Repatriation packages supplied by undertakers

If you are an undertaker or business that specialises in repatriation and you supply a repatriation package consisting of goods and services that are normally provided by undertakers, your supply will be exempt from VAT to the extent that it consists of the supply of:

- goods and services covered by paragraphs 3.1 and 3.2 (for example, coffin, embalming, use of chapel of rest);
- services of obtaining documents and permits necessary to repatriate the deceased;
- transportation of the deceased to burial ground, crematorium or to another undertaker”.

Decision

In interpreting Item 2 Group 8 Sch. 9 VAT 1994, the Tribunal referred to *Network Insurance Brokers v HMRC* [1998] STC 742 where Judge Moses J focused on the “result” of the exemption.

The First Tier Tribunal accepted there were other parties involved in the arrangements, in this case, including the Consignee at the airline destination and funeral directors in the end country.

However, the result was that each time the company was engaged, there was a deceased person and the reason for engaging the company was ultimately to lead to the disposal of the remains of that person. Consequently, the First Tier Tribunal concluded that the repatriation services were made in connection with arrangements for the disposal of the remains of the dead and so fell within Item 2 Group 8 Sch. 9 to VATA 1994.

However, this was a complex supply consisting of:

- an exempt supply - disposing of the remains of the dead;
- a zero-rated supply - transporting the body.

Both parties agreed that if the services fell within the definition of both a zero-rated and exempt service, under s.30(1) VATA 1994 the zero-rating provision would prevail.

Citing *Gray & Farrar International LLP v HMRC* EWCA 121, the Tribunal found that the predominant element of the supplies being made was that of transport. In the Tribunal’s view, the typical customer was looking primarily for a business that could arrange the transport of their deceased relative.

Having reached that conclusion, under s.30(1) VATA 1994, the supplies were zero-rated and the appeal was allowed.