

## **Business tax round up**

**(Lecture B1096 – 15.15 minutes)**

### **Class 2 U Turn**

The Government had announced plans to abolish Class 2 National Insurance Contributions in April 2018; this date was then delayed until April 2019. However, on 6 September 2018 the Government announced that the abolition has been scrapped altogether.

For 2018/19 Class 2 NICs are paid by self-employed people with profits of £6,205 or more a year. The abolition would have saved millions of workers about £150 a year (£2.95 per week).

However, the Government realised that their proposed tax simplification would have come at a cost to a significant number of low earning self-employed people. In order to access the state pension, self-employed people earning less than £6,205 often pay Class 2 NICs on a voluntary basis. With its abolition, the only option available to these individuals would have been to pay Class 3 contributions, increasing their effective weekly payments from £2.95 to £14.65.

### **Self-employed exotic dancer**

*Summary – Self employed dancer could deduct the cost of her 'costumes' but her travel expenses were disallowed.*

Gemma Daniels was a self-employed exotic dancer who was engaged to perform at Stringfellows nightclub.

The issues in dispute concern the deductibility of travelling expenses incurred by her to and from her home to Stringfellows and the deductibility of certain items including clothing, lingerie and make-up, all of which were claimed as allowable in her tax returns for the years in dispute.

Ms D had an office at home where she carried out various activities related to her work; for instance, contacting customers to encourage them to attend her performances and ordering costumes. She travelled in her car from her home to Stringfellows, leaving home at 6:30 pm and returning at approximately 4:30-5:00 am the following morning. Sometimes she used her car to travel to markets and a fancy dress shop in Camden to buy cosmetics and other items for her performances including jewellery.

Her dresses were long, see-through, skimpy and often decorated with sequins. Her shoes had 6 to 10 inch stiletto heels. They were made so that it was possible to hang upside down from a pole when her performance included pole dancing. Her make-up was heavily applied in a theatrical manner and the lingerie she wore was of a suggestive nature.

#### *Decision*

The First Tier Tribunal disallowed her travelling expenses stating that they were not incurred wholly and exclusively for the purposes of her trade. They were partly incurred

because of where she chose to live and partly in order for her to get from her home to Stringfellows. The duality of purpose caused her claim to fail.

She wore costumes and dresses that could not be worn outside Stringfellows. The Tribunal concluded that this expenditure was similar to a costume used by an actor for use in a performance. HMRC allowed the deduction of such expenditure. The Tribunal allowed her appeal in relation to the penalties incurred for claiming clothing, etc.

*Gemma Daniels v HMRC (TC06640)*

## **Loans written off**

*Summary – The First Tier Tribunal made no error of law in concluding that, to the extent Jamie White had made loans to M White Limited, the expense arising when those loans went bad or were estimated to be bad was of a capital nature and so disallowed.*

Jamie White ran a skip hire business as a sole trader. On 30 October 2012, he wrote to HMRC seeking to correct his self-assessment tax returns for 2008/09, 2009/10 and 2010/11 pursuant to Schedule 1AB TMA 1970. The corrections related to relief for what were described as irrecoverable debts in connection with loans he had made to a company, M White Limited, that was owned by his father.

HMRC rejected the corrections on the basis that the irrecoverable debts were not allowable for income tax relief because they were capital investments and were not wholly and exclusively laid out for the purposes of trade.

The First Tier Tribunal concluded that they could not be satisfied that at any particular date whether there was any debt owed by M White Limited to Jamie White, nor could they identify at any particular date the amount of any debt outstanding or the minimum amount of any debt outstanding. Even if that had been able to identify such an amount, no relief would have been available to Jamie White on estimating those debts as bad because the underlying loans were capital in nature.

Jamie white appealed to the Upper Tribunal.

### *Decision*

In the circumstances of this appeal the Upper Tribunal held that Jamie White carried on no money-lending trade. When he lent money to M White Limited, he did so as an investment in that company. The loans made were capital in nature, so that the loss he made when they went bad was also capital in nature, as in the English Crown Spelter case.

That conclusion was not altered by the fact that Jamie White's reason for making his investment in M White Limited was to ensure that it could continue to provide him with essential business facilities.

*Jamie White v HMRC UT/2017/0087*

## **Supplies of digital services**

In 2015 the VAT rules changed so that businesses making sales of digital services across the EU had to account for VAT in each EU member state that their customers are based

in. There is no VAT threshold for these types of sales and so VAT is due on all sales made to other EU member states.

The VAT MOSS scheme was introduced to simplify the administration of the VAT system for businesses making these types of sales overseas. This is an online service which allows businesses to account for all VAT due on these types of supplies through a single return in their home country, rather than registering in every member state where they have customers.

In an attempt to ease the administrative burden on businesses making sales of digital services, and to allow a group of businesses currently excluded from the MOSS scheme to access it, two changes to the operation of the VAT mini one-stop-shop for supplies of digital services will take effect from 1 January 2019.

1. Introduction of a €10,000 threshold for total supplies to the EU in a year of sales of digital services. This change means businesses will only be subject to the VAT rules of their home country if their relevant sales across the EU in a year (and the preceding year) falls below this threshold. If the businesses total taxable turnover is below the UK VAT registration threshold they will be able to de-register from VAT. Businesses can continue to apply the current rules if they so choose.
2. Allow non-EU businesses, which are registered for VAT for other purposes, to use the MOSS scheme to account for VAT on sales of digital services to EU member states. This group are currently excluded from using MOSS - a business facilitation system.

*[www.gov.uk/government/publications/vat-changes-to-the-supply-of-digital-services-2019](http://www.gov.uk/government/publications/vat-changes-to-the-supply-of-digital-services-2019)*

### **R&C Brief 6/2018**

From 1 November 2018, HMRC will require all property management companies to account for VAT at the standard rate on fees they charge landlords for providing common services to the occupants of residential property. Management companies cannot use ESC 3.18, under which landlords who provide such services directly may treat mandatory service charges paid by the occupants as exempt from VAT.

More detailed guidance is given in VAT Information Sheet 7/2018.

*[www.gov.uk/government/publications/revenue-and-customs-brief-6-2018-vat-exemption-for-all-domestic-service-charges](http://www.gov.uk/government/publications/revenue-and-customs-brief-6-2018-vat-exemption-for-all-domestic-service-charges)*

### **VAT information sheet 7/2018**

This information sheet sets out HMRC's view of the correct application of ESC 3.18, which allows landlords to exempt mandatory service charges paid by both freehold and leasehold occupants of residential property.

The concession does not apply to property management companies providing services on landlords' behalf and HMRC identifies common examples of where companies have incorrectly applied or relied on ESC 3.18.

### *ESC 3.18 - VAT: exemption for all domestic service charges*

Customs and Excise Brief 03/94 introduced this concession in April 1994. Its purpose is to enable the same VAT treatment on mandatory service charges to a freehold occupant as to a leaseholder or tenant living on the same common estate. Such charges are:

- exempt from VAT when made to leaseholders or tenants as they directly link to an exempt supply of an interest in land from the landlord
- standard-rated for VAT when made to freeholders as they constitute a separate supply not linked to a supply of an interest in land

As a landlord of a common area of a shared residential estate, mandatory charges to freeholders of property on that estate can be treated as exempt from VAT. But doing so, may restrict their ability to recover the tax incurred on their costs and overheads.

### *Services covered by the concession*

The services covered are the:

- upkeep of the common areas of the estate, dwellings or blocks of flats where the occupants live and where these charges are mandatory for all the occupants
- provision of a warden, superintendent, caretaker or those performing a similar function connected with the day-to-day running of that estate, dwelling or blocks of flats, for those occupants
- general maintenance of the exterior of a block of flats or individual dwelling - where the residents cannot refuse this

### *Mrs Janine Ingram (2015) UKUT 0495(LC)*

The decision in this case confirmed that if a landlord is contractually obliged to provide services to the occupant of a property, and uses a property management company or similar, to provide these services, the property management company cannot use the concession. This is because the management company is providing a standard-rated supply of services to the landlord, not the occupant, even though they are collecting payment on behalf of the landlord directly from the occupant.

## **Fish and chip takings**

Kyriakos Karoulla ran a VAT registered fish and chip shop during the relevant period (1 December 2011 to 31 October 2014).

The VAT returns which had been submitted by Kyriakos Karoulla included sales figures based solely on the close of day "Z readings" generated by the till. As part of a VAT inspection, HMRC analysed the information they had obtained relating to purchases in the shop paid for by credit or debit card and concluded that Card Purchases made after 8pm each day were not being entered on the till and concluded that takings had been suppressed.

In March 2015 HMRC issued a VAT assessment for £28,323 and in April 35 2015 raised an associated penalty of £26,913.18. HMRC upheld the assessment and penalty on statutory review.

Kyriakos Karoulla appealed against the First Tier Tribunal's decision to uphold a best judgment assessment by HMRC for under-declared VAT from takings from its fish and chip shop. The Upper Tribunal had twice refused his application for permission to appeal the decision but he was finally allowed to do so on credit card transactions reflected in HMRC's best judgment assessment.

The taxpayer wished to offer new evidence consisting of originals of till rolls and records relating to card purchases. These had been removed by HMRC and only returned shortly before the hearing of the taxpayer's application for permission to appeal.

### *Decision*

The Upper Tribunal noted that Kyriakos Karoulla had asked HMRC to return these items before the First-tier Tribunal hearing but HMRC had either ignored or refused such requests on the basis that it was under no obligation to assist the taxpayer with its case.

The judge said:

“That was a totally inappropriate response to a proper request from the taxpayer for the return of documents which he himself had provided to HMRC during the course of its enquiries and which the taxpayer plainly required in order to answer HMRC's case.’ He noted that the First-tier Tribunal's observation that the failure to produce the till rolls was 'unfortunate' was a 'gross understatement’.

The Upper Tribunal said that Kyriakos Karoulla accepted there had been suppression of card purchases but new evidence showed that this was inconsistent, and payments were not omitted from the till every day after 8pm.

The Tribunal set aside the original decision and remitted the appeal to be heard by a new panel of the First Tier Tribunal but said that this would not be necessary if both parties could agree a settlement as to quantum.

Kyriakos Karoulla’s appeal was allowed.

*Kyriakos Karoulla T/A Brockley ’ s Rock v HMRC [2018] UKUT 0255 (TCC)*

## **Preparing for MTD for VAT?**

Under Making Tax Digital (MTD) for VAT businesses must:

- keep their records digitally, and
- file their VAT return through MTD compatible software, and
- be able to receive information from HMRC

Businesses will not be asked to keep digital records, or to update HMRC quarterly, for other taxes until at least 2020. When preparing for MTD for VAT do factor in that other taxes will undoubtedly follow.

### *VAT registered businesses*

VAT Notice 700/22 (July 2018) provides useful guidance but this is likely to be updated by the end of 2018!

MTD will apply to all VAT registered business that have taxable income over £85,000 on 1 April 2019 or which exceed the threshold on any rolling 12-month basis thereafter.

If you breach the £85,000 at 31 March 2019 you must be MTD compliant for the next return period commencing on or after 1 April 2019. For quarterly returns this would be the 30 June, 31 July or 31 August return depending on your VAT stagger.

A client compulsory registering after 1 April 2019 must be MTD compliant for their first VAT return.

If you are VAT registered at 31 March 2019 but below the £85,000 limit you do not need to comply with MTD unless you want to!

If you are voluntarily registered but below £85,000 at 1 April 2019 and subsequently exceed the £85,000 limit in any rolling 12 month period, you must be MTD compliant for the next VAT return commencing after the breach.

#### *Example 1*

Consider a voluntarily VAT registered client with a calendar quarter VAT stagger. They breach the £85,000 limit on 30 November 2019.

The VAT return to 31 March 2020 must be MTD compliant

Once a business is required to keep digital records, this requirement will remain in place whilst you are VAT registered. The MTD requirement only stops when you deregister.

If you voluntarily comply with MTD (i.e. taxable income < £85,000) you can voluntarily come out of MTD if you wish.

Going forward new registrations will have extra considerations:

....getting registered for VAT, and

.....complying with MTD if compulsorily registering

#### *What income do you count?*

Only count the zero rated, 5% and SR income for the £85,000 MTD limit.

Do not count exempt or outside the scope income such as residential rental income (exempt) or B2B international services (outside the scope).

#### *Example 2*

A UK VAT registered consultant has turnover of £200,000 (£70,000 UK plus £130,000 overseas).

The consultant does not have to be MTD compliant as taxable income is only £70,000. The £130,000 is outside the scope (B2B).

### *MTD for landlords*

Only taxable sales are included in the threshold so for property landlords that would be opted commercial rent and furnished holiday letting income. Residential rent is exempt so this income is excluded.

Landlords that have opted to tax their commercial property would have taxable income and this would count towards the £85,000 MTD limit.

A taxpayer must include all their business income in this test.

So if a VAT registered business had taxable trading income of £70,000 and opted commercial rent of £20,000 their taxable income is £90,000 and they must be MTD compliant.

If the rental income was exempt residential rent then they would be outside of the MTD regime as their taxable income is only £70,000.

### *Exemptions*

For those with taxable turnover above VAT registration threshold the current exemptions from digital filing will be extended to MTD where the Commissioners are satisfied:

- Your business is run entirely by practicing members of a religious society whose beliefs are incompatible with the use of electronic communications, or
- It is not reasonably practicable for you to use digital tools to keep your business records or submit your returns, for reasons of age, disability, remoteness of location;
- you are subject to an insolvency procedure.

You will have to contact HMRC to request exemption but they are not yet in a position to give you an answer!

There is a right of appeal where HMRC refuse exemption.

### *Common errors*

HMRC has identified the following common scenarios where people have failed to apply ESC 3.18 correctly:

1. Property management companies treating their supply as being to the occupant, rather than the landlord;
2. Not recharging costs borne on behalf of the landlord back to the landlord;
3. Supply of staff - the recharge of staff or personnel costs by a management company is a taxable supply to the landlord. In some cases, management companies have wrongly relied on ESC 3.18 to recharge staff or personnel costs direct to the occupant as an exempt supply.

[www.gov.uk/guidance/applying-the-correct-vat-liability-on-residential-domestic-service-charges-vat-information-sheet-0718](http://www.gov.uk/guidance/applying-the-correct-vat-liability-on-residential-domestic-service-charges-vat-information-sheet-0718)