

Business tax round up

(Lecture B1216 – 26.12 minutes)

Dentists' deliberate inaccuracies

Summary – Two dentists' accrued contributions to an offshore remuneration trust were disallowed. HMRC's penalties for the dentists' deliberate claims, despite knowing that they were under no obligation to make the payments, were correct.

Dr Hallen and Dr Persson were dentists who were directors of Nationwide Healthcare Providers Limited, a company that provided premises, dental equipment and other supplies needed to run a dental practice. The two dentists were self-employed and paid monthly for the work that they did through this company.

The dentists claimed that they had made tax deductible contributions to an offshore remuneration trust, so reducing their taxable income to below their personal allowance. The contributions were accrued in their accounts but the amounts were never paid to the trust.

HMRC concluded the expenses were not allowable and issued discovery assessments for each of the four tax years concerned. HMRC also imposed penalties at 50.75% of the tax due for deliberate inaccuracies totalling over £100,000 between them.

Neither dentist appealed the assessments but both disputed the penalties arguing that they had taken reasonable care when filing their tax returns.

Decision

The First Tier Tribunal concluded that both dentists knew that the expenses had not been paid and that they were under no obligation to do so. The First Tier Tribunal stated that when the dentists reviewed and authorised their tax returns that had been prepared by their agent, they could not have overlooked or missed the claims, as they were large.

The Tribunal concluded the dentists' behaviour in claiming the deductions was not careless, but rather it was deliberate. The penalties were confirmed and the appeal dismissed.

Marie Christina Hallen and Anette Majvi Persson v HMRC (TC07775)

Cash sales deliberately unrecorded

Summary - Cash sales of two car tyre companies were deliberately unrecorded as it was unreasonable to expect that the company accountants adjusted the sales figures.

Hamid Ali came to the UK in 1999 as refugee from Afghanistan. He founded two tyre shops: ADS Tyre Limited in 2011 and Top Notch Tyres Limited in 2013. Initially he was director of both companies but from April 2014 and November 2016, his wife became sole director but he was "the controlling mind of the companies at all relevant times".

Customers paid by both card and cash. The bookkeeping systems were poor and while the card machine effectively kept a record of card sales, there was no reliable and consistent system for recording cash sales. Cash received from sales was not usually banked but rather it was used to fund purchases from suppliers. Sometimes there were handwritten notes on supplier invoices indicating that the supplier had been paid by cash but such notes were not consistent and were often difficult to understand. As a result, cash sales went largely unrecorded.

Hamid Ali admitted that the companies did not raise invoices for any cash sales. He claimed that the accountants knew about the handwritten notes on supplier invoices and therefore they should have adjusted the companies' accounts accordingly. He claimed that, had he not been under so much personal pressure due to his father's illness and death as well as the serious medical problems relating to his children, especially his daughter, he may have identified the under-declaration of sales. As it was, he claimed that he had no idea that the sales were being under-declared.

HMRC raised VAT assessments and corporation tax discovery assessments for the periods and years concerned from 2012 to 2017. Penalties were charged on the basis that the errors concerned were deliberate, but not concealed, and that the disclosure by the companies was prompted. HMRC reduced the penalties charged from the maximum 70% to 59.5% (the reduction calculated as 30% of the maximum 35% possible reduction). The 30% consisted of 10% for the limited help given to HMRC in quantifying the potential lost tax and 20% for giving HMRC some but not all information and documents that were requested. HMRC gave no reduction in the penalties by reason of special circumstances.

Both parties agreed that the companies' VAT and corporation tax returns contained under-declared sales. The issues to decide related to the penalties charged. Mr Ali argued that the tax return inaccuracies were not deliberate and were not attributable to Mr Ali. He disputed the penalty percentage (59.5%) arguing that this did not reflect the quality of the companies' disclosure and further, he believed that the penalties should also be reduced to reflect special circumstances.

Decision

The Tribunal found that, from the start when the shops opened, Hamid Ali knew that cash sales were largely unrecorded, and that adjustments to the companies' sales records would need to be made, if cash sales were to be accurately reflected in tax returns. The Tribunal did not accept that the hand-written notes on some of the purchase invoices gave the accountants the means to make the appropriate adjustments, as these notes were inconsistent, sporadic and difficult to follow. The companies' accountants were not in a position to do this. The Tribunal found that, on the balance of probabilities, Mr Ali did not genuinely believe that the accountants would adjust the sales figures. The inaccuracies in the companies' tax returns were therefore deliberate on the part of the companies of which Mr Ali a director, shadow director or manager of the companies at the relevant times.

The Tribunal found that HMRC's reduction of the penalty percentage by 30% of the maximum amount did reflect the quality of the companies' disclosure to HMRC, which they classed as moderate to poor. However, the Tribunal considered whether special circumstances applied due to the impact of the time spent away from his business due to his father's ill health and his daughter's medical issues. They found that the cash sales issue had existed from day one of the businesses opening, so prior to these events and so could not have been a cause for failing to disclose the issue to HMRC.

However, once the enquiry had started, his daughter's medical conditions could have affected his ability to assist HMRC and he might have been able to ensure better quality disclosure of the tax return inaccuracies. Consequently, the Tribunal gave full reductions for helping and giving information; this resulted in a final percentage of 45.5%.

Hamid Ali, Top Notch Tyres Limited and ADS Tyre Limited v HMRC (TC07719)

Potential misallocation of payments

One of the ways that the government has helped taxpayers during the COVID-19 pandemic is by allowing them to defer their second payment on account that would have been due for payment on 31 July 2020. Most taxpayers will settle their final 2019/20 bill by 31 January 2021 and their tax account will be brought up to date.

However, some taxpayers will need to take care. Without any instructions from the taxpayer, HMRC will allocate payments in the following order:

1. outstanding amounts of tax currently due
2. outstanding penalties
3. outstanding interest charges

Under normal circumstances, this order of set off would work in the taxpayer's favour as outstanding tax liabilities attract interest and penalties, whilst outstanding penalties only attract interest. However, as HMRC has waived any interest on the 31 July 2020 payment on account, this means that allocation of a payment against the outstanding payment on account rather than against a penalty notice, will result in interest charges being levied against the other charge.

Allocating payment

Taxpayers who have been issued a penalty notice after 31 July 2020, relating to an earlier tax year, should ensure that the payment of the penalty is allocated against the penalty notice rather than the overdue 31 July 2020 payment on account.

In theory taxpayers can notify HMRC of this at the time of making payment. Unfortunately, most payment methods do not allow for an instruction to be easily given to HMRC. Where this is the case, the taxpayer can request that the payment be reallocated at any point up to when HMRC communicates the allocation of the payment to the taxpayer. A request should be made as soon as possible after the payment has been allocated on HMRC's system.

Where the taxpayer calls HMRC and experiences any difficulties with the reallocation request, they may need to insist on a 'referral request' being made. Making this request means that the taxpayer's case is referred to someone within HMRC with the authority to override the automated systems and manually effect the reallocation.

It can take up to three weeks for the reallocation to be effected, but any interest charges accruing in the meantime should be automatically cancelled.

<https://www.gov.uk/hmrc-internal-manuals/debt-management-and-banking/dmbm210105>

Local lockdown grants

In September the government announced that businesses in England required to close due to local lockdowns may be entitled to taxable lockdown payments from their local authority.

The amount that will be paid will depend on the business premises' rateable value, annual rent or mortgage payment.

1. if a business occupies a premises with a rateable value less than £51,000 or occupies a property or part of a property subject to an annual rent or mortgage payment of less than £51,000, it will receive £1,000;
2. if a business occupies a premises with a rateable value of exactly £51,000 or above or occupies a property or part of a property subject to an annual rent or mortgage payment of exactly £51,000 or above, it will receive £1,500.

However, the payments will not be available to any businesses still closed at a national level.

Local authorities will be responsible for distributing the grants. They will receive an additional 5% top up fund to provide discretionary grants to help other businesses affected by closures that may not be on the business rates list. Payments to such businesses can be any amount up to £1,500, but may be less than £1,000 in some cases.

<https://www.gov.uk/government/news/ministers-announce-new-grants-for-businesses-affected-by-local-lockdowns>

Profits of a jewellery and bullion trader

Summary – The 'presumption of continuity' approach was correctly applied to 2010 but the case was remitted back to the First Tier Tribunal to recalculate the profit adjustment required in 2010 and 2011, to take account of the 'anticipated profit margin' approach that the company considered to be relevant.

Stirling Jewellers (Dudley) Limited carried on a trade as a jeweller and bullion dealer. Prior to 2007, the company had a turnover of around £3 million and focused on selling jewellery to the public and to other shops. However, between 2007 and 2012, the price of gold rose substantially and the company's business was transformed. The turnover increased from about £5 million in 2009 to about £50 million in 2010. By 2011, the company had a turnover of over £140 million and its business consisted almost entirely of purchasing scrap gold for smelting.

The company accepted that its record-keeping processes did not cope well with the increase in the scale of its business. The company had no electronic invoicing system until a computer system was introduced in February 2010. Until this date, the company's books depended on manual carbon-copy purchase invoice books and manual calculations made using a calculator by a bookkeeper. A new computer system was introduced in 2010 but it did not improve matters.

As the First Tier Tribunal stated:

“The ... computer system was frankly amateurish it was not really a 'system' as such. It was simply a surrogate typewriter, and not a very good one at that. It did not seem to represent any significant step forward in improving the quality or reliability of the Appellant's record-keeping.”

HMRC argued that the company had not provided sufficient evidence when buying gold. For example, for its accounting period ending in 2011, there was a difference of just over £9 million between the amount that the company claimed to have spent buying gold and the amount that HMRC considered could be justified using the company's business records. For a period of 23 days there were either no invoices or insufficient invoices to justify the company's claim. HMRC applied a 'presumption of continuity' to support adjustments to cost of sales in other accounting periods between 2007 and 2014.

The First Tier Tribunal recalculated the company's business profits using a daily average of purchases to determine the cost of sales for the missing days, but only accepted the 'presumption of continuity' for 2010. The First Tier Tribunal concluded that the company's record-keeping procedures improved markedly from 2012, when the company engaged the services of a qualified accountant and improvements were made to the accounting systems. Thus they denied the 'presumption of continuity' for periods after 2011.

HMRC and Stirling Jewellers (Dudley) Limited appealed to the Upper Tribunal:

Decision

Stirling Jewellers (Dudley) Limited disputed the amount added-back by the First Tier Tribunal, arguing that the 'daily average' approach resulted in an excessive add-back. The Tribunal had ignored the “anticipated profit margin” approach that the company considered to be relevant. This approach involved using the predictable profit margins that were supported by the company's records from sales with Englehard, where records were both complete and reliable. The Tribunal's method ignored the relatively predictable link between gross receipts from Englehard (at most 99.75% of the gold fix) and amounts the company paid to buy gold (at least 97.5% of the gold fix). The Upper Tribunal agreed and the company's appeal was allowed. The Upper Tribunal remitted the case back to the First Tier Tribunal to reconsider the extent of the company's taxable profits for 2010 and 2011, taking into account these margins.

The Upper Tribunal dismissed HMRC's appeal to apply the 'presumption of continuity' to years before 2010. Despite there being problems with the company's record keeping in these earlier years, the under-declaration of tax only became an issue once the business expanded dramatically from 2010 onwards. The sudden increase in turnover and reliance on hand-written IOUs, when cash was short to pay for gold bought, led to expenses being overstated, but not before.

Stirling Jewellers (Dudley) Limited v HMRC [2020] UKUT 0245 (TCC)

Bathroom contractors

Summary - Output tax was due on the payments made by customers to third party self-employed contractors but assessments for the first three periods were out of time.

Marshalls Bathroom Studio Ltd designs, manufactures, supplies and installs bathrooms. In addition to its in-house team of fitters, plumbers and tilers, the company also uses the services of a number of self-employed contractors to assist installing bathrooms. These third party contractors are not VAT registered.

Once a design has been finalised and a deposit paid, the company provides the customer with a quote and order setting out the cost of the bathroom fittings and labour costs but makes no reference to third party contractors. Marshalls Bathroom Studio Ltd decides which fitters to use.

Once the bathroom is completed, the company issues an invoice quoting VAT inclusive figures for the job but no split of the net and VAT amounts. The invoice also shows how the customer should make payment. Where a contractor has installed the bathroom, this is indicated on the invoice and the customer is required to pay the contractor directly.

Marshalls accounted for output tax on the payments it received but excluded any of the payments made directly to the contractors.

HMRC raised VAT assessments totalling £22,615 covering the VAT periods from February 2012 to November 2015. HMRC argued that the company should have accounted for output tax on the invoices that were settled directly with their contractors as the whole contract was supplied by Marshalls Bathroom Studio Ltd to the customer and the contractors worked for the company.

Marshalls Bathroom Studio Ltd appealed.

Decision

The First Tier Tribunal agreed with HMRC. The customers dealt only with the company and not the contractors. Having completed the design work, the company chose the fitters and any issues about the job would be raised directly with Marshalls Bathroom Studio Ltd, not the contractor.

Both contractually and commercially, Marshalls Bathroom Studio Ltd supplied fully installed bathrooms, with the contractors undertaking their work for the company. Marshalls Bathroom Studio Ltd should have accounted for VAT on all of the invoices raised

HMRC issued their assessments on 1 November 2016 and so the first three assessments were issued out of time as they were made more than four years after the end of the VAT accounting period concerned. The assessments for the remaining VAT periods were valid and so output tax totalling £17,646 was payable by Marshalls Bathroom Studio Ltd.

Marshalls Bathroom Studio Ltd v HMRC (TC07753)

Termination and compensation payments

Previously, early termination fees and compensation payments have been treated as outside the scope of VAT. This has now changed retrospectively.

In order to bring the VAT treatment into line with CJEU case law developments (Meo (C-295/17 and Vodafone Portugal (C-43/19)), HMRC has issued Revenue and Customs Brief 12 (2020): Early termination fees and compensation payments. This states that HMRC now treat such fees and payments as subject to VAT at the standard rate, as the

monies are consideration for supplies. Such fees and payments are made as a result of events envisaged under a contract, are part of the agreement and so are considered to be consideration for what is provided under that contract.

HMRC's VAT manual has been updated to reflect this and VATSC05920 states that:

"HMRC's policy is to treat payments arising out of early contract termination as consideration for a taxable supply. Businesses must account for VAT on these fees. This applies in cases where the original contract allows for such a termination, as well as when a separate agreement is reached."

The R&C Brief confirms that businesses are required to correct the 'error'. This confirms that retrospective corrections are expected. However, any taxable person that has had a specific ruling from HMRC saying that such fees are outside the scope of VAT need only account for VAT on such fees received after the issue of this Revenue and Customs Brief.

<https://www.gov.uk/government/publications/revenue-and-customs-brief-12-2020-vat-early-termination-fees-and-compensation-payments>

EU VAT Package

The EU e-commerce VAT package was due to come in to play on 1 January 2021 but due to Covid-19 its implementation has been postponed until 1 July 2021. The new package aims to simplify VAT reporting across the EU, with sellers using a single VAT return in their own country to report all of their EU sales, relieving them of the need to have multiple VAT registrations in other member states where they trade.

Introduction of the One-Stop-Shop EU VAT return

Currently, once a country's distance selling threshold has been exceeded, businesses must register for VAT in that country and file foreign VAT returns in these countries. From 1 July 2021, the thresholds are effectively being withdrawn. Cross-border sellers will have to charge the VAT rate of the customer's country of residence from their first sale and remit it to the foreign tax authorities.

From 1 July 2021, there will be a new single EU VAT return, the 'One Stop Shop' (OSS) return that will build on the success of the MOSS return. The new OSS scheme will be extended beyond digital services, telecoms and broadcasting services to include services and event organisers. By opting to file a new OSS online return together with their domestic VAT return, B2C sellers will no longer need to register in multiple EU countries. Instead, they will submit details of all of their EU supplies to their domestic VAT authority, who will be responsible for forwarding both supply details and payments to the relevant EU VAT authorities.

Non-EU sellers may apply to use the OSS regime, and will need to nominate a single EU state to register and file in. This means that when the UK leaves the EU at the end of the year, UK B2C businesses selling to EU countries will be able to take advantage of this scheme from 1 July 2021.

Ending of the low-value import VAT exemption and implementation of the new IOSS return

From July 2021:

- Low value consignment stock relief will be abolished. Intended to relieve the burden on customs of checking large volumes of low value items, the exemption encouraged fraud with sellers under declaring the values of their goods;
- EU and non-EU sellers must charge VAT at the point-of-sale for consignments up to €150 which can be processed through the new 'Import One Stop Shop' (IOSS). In order to declare the VAT on any affected imports below €150, non-EU sellers must register for IOSS in one EU state.

Making marketplaces the deemed seller and collector of VAT

Under the new rules, online marketplaces will become the 'deemed seller'. For imports up to €150, the marketplace must charge the customer VAT at point-of-sale. Sellers will benefit from reduced VAT obligations, and may be able to deregister in some EU states.

If a marketplace opts out of the scheme, the VAT obligation becomes the responsibility of the seller's delivery company

<https://www.avalara.com/vatlive/en/vat-news/eu-2021-e-commerce-vat-package.html>

Temporary reduced VAT rate queries

Following the Chancellor's announcement in July that certain supplies of hospitality, holiday accommodation and admission to attractions would be subject to a temporary 5% reduced rate of VAT until 12 January 2021 (now 31 March 2021), the ATT raised a number of questions with HMRC. On 14th September 2020, the ATT published the responses received from HMRC.

Non - alcoholic drinks

HMRC has confirmed that alcohol served with a mixer is a single supply of an alcoholic drink and so is chargeable to standard rate VAT. Low alcoholic drinks, like a shandy, qualify for the reduced rate if there is no excise duty charged on them as they would be they would be considered a soft drink.

Promotional offers

Where a business makes a promotional offer, the economic and commercial reality of that deal must be considered. Supplying a burger with a free pint of beer represents two supplies: the supply of a burger and the supply of a pint of beer. The consideration received will need to be apportioned to ensure that the correct amount of VAT is accounted for on the supply of each item.

On the premises

The temporary reduced VAT rate applies only to supplies of food and non-alcoholic drinks for consumption on the premises on which they are supplied. HMRC has confirmed that this means the food retailer's own premises or any area set aside for the consumption of food by the food retailer's customers whether or not the area may also be used by the customers of other food retailers. Where catering is not provided on the catering supplier's own premises the standard rate of VAT still applies.

HMRC has confirmed that, although off premises caterers cannot take advantage of the temporary reduced VAT rate, they can take advantage of the new flat-rate percentage of 4.5%, as this applies to "Catering services including restaurants and takeaways". When HMRC introduced the new temporary rates, they were based on an estimate of the reduction of VAT declared across the sectors. They have stated that they recognise that this will work in some businesses favour. This could not be changed whilst still maintaining the simplification benefits the scheme provides.

Wedding packages

HMRC clarified that a supply of a package of wedding services (for example, use of rooms for a ceremony, a wedding breakfast and evening party), is a single standard-rated supply. Who supplies the catering is not relevant. However, until 12 January 2021 (now 31 March 2021), where a business provides catering on its own premises and are not providing this as part of a wedding package, it may benefit from the temporary reduced rate.

Holiday accommodation deposits

HMRC has confirmed that where a deposit was taken before the reduction in the VAT rate, the business may choose to apply the rate applicable at the basic tax point to the deposit as well as the balancing payment. Currently, there are no plans for anti-forestalling legislation to be implemented when the rate reverts back to 20%.

Admission to parks/ attractions

An admission charge to enter an amusement park/fair ground or similar facility is eligible for the reduced rate but what about additional amounts paid for certain rides once inside? HMRC has stated that to be considered eligible for the reduced rate, the ride must be similar to that of an amusement park or fairground in its own right. The individual features of the rides in question and the charging structure in place will need to be assessed before a final ruling can be given on this issue.

Where a ticket [season or otherwise] is for a bundle of supplies, some of which are eligible for the reduced rate and some that are not, then the consideration will need to be apportioned. The temporary reduced rate will apply to season tickets purchased and paid for from 15 July 2020 to 12 January 2021 (now 31 March 2021).

<https://www.att.org.uk/technical/news/hmrc-response-att-queries-temporary-reduced-rate-vat>