

Business tax update (Lecture B1276 – 24.05 minutes)

Chinese food - Suppression of takings

This month we have two cases involving Chinese restaurants/takeaways, both with a similar outcome.

Kong's Restaurant Ltd v HMRC (TC08169)

HMRC made two unannounced visits to Mr Kong's restaurant and take away business. The first was on a Friday evening which was Chinese New Year and the second roughly six months later at the end of June.

HMRC's case depended on the assumption that as the takings on these two Fridays exceeded the average reported Friday takings during the first six months of 2017, that amounted to clear evidence of suppression of takings on the other 24 Fridays, as well as the previous two and a half years.

Kong's Restaurant Ltd appealed stating that the assessments were not valid best judgment assessments as Mr Kong, the owner and director of the business, had not been given the opportunity to justify why HMRC's assessments were inappropriate. It was unreasonable to extrapolate from the two Fridays (Chinese New Year's Eve and a midsummer pay day) that the restaurant had been undeclaring its takings on a consistent basis.

The First Tier Tribunal found HMRC's assumptions to be unreasonable. HMRC had assumed the worst and sought subsequently to justify their approach with limited investigation to support their decision. The Tribunal stated that the arbitrariness of their assumption could be illustrated by simply selecting two other Fridays, for example one week before each of the two Fridays actually chosen. Both these figures were well below the overall average calculated for the period by HMRC.

The First Tier Tribunal concluded that the company did show that HMRC had not exercised best judgment.

Brough East Yorkshire Limited v HMRC (TC08213)

In this case, HMRC made a single inspection visit to the Chinese takeaway on a Friday afternoon. As far as HMRC could see, there was no till, with cash takings being placed under the counter. Having followed up their visit by checking credit card and banking data, HMRC established that Friday's Gross Daily Takings of £1,656.91 were some £600 more than the average for Fridays and so concluded that there was a suppression of cash sales. HMRC raised a best judgement VAT assessment that covered a six-year period, together with a £25,000 penalty and a Personal Liability Notice on the owners.

The company appealed the VAT assessment arguing that there was no reliable evidence of suppression of cash takings and that HMRC's approach was flawed.

The Tribunal found that the owners recorded sales from the order slips taken at the point of sale, passing her figures to their accountants. There was no evidence during HMRC's visit of any irregularities in the way that orders were processed or paid for. Despite being shown that prices had increased, HMRC failed to take these into account, despite both recorded cash and credit card sales increasing after HMRC's visit.

With HMRC disregarding the owners' explanations for the inconsistencies in the figures and one night's Invigilation being unrepresentative of the previous VAT periods concerned, the Tribunal allowed the appeal.

Health and Social Care Levy

Introduction

Going against their manifesto pledge, and in an attempt to address the funding gap facing the NHS and our social care system, the Prime Minister has announced that national insurance contributions (NICs) and dividend tax rates will increase by 1.25 percentage points across the UK from April 2022.

Building Back Better: Our Plan for Health and Social Care

In September, the government published "Building Back Better: Our Plan for Health and Social Care". Here the government:

- explains its plans to clear the current electives backlog, put the NHS on a sustainable footing, and focus on the prevention of chronic conditions;
- pledges to cap adult social care costs at £86,000 over an individual's life. Anyone with assets worth less than £20,000 will not need to pay towards their care, and those with up to £100,000 will be eligible for means-tested support. Further, an integrated care system aims to link the range of health and social care services that patients might receive.

Funding the plans

From 1 April 2022:

- the government will introduce a new 1.25% Health and Social Care Levy on Employee Primary and Employer Secondary Class 1, 1A and 1B as well as Class 4 NICs payable by the self-employed;
- The Class 1 rise will include deemed employees;
- Class 2 and Class 3 NICs will be unaffected.

From 6 April 2023:

- the Levy will be separately identified and collected independently of NICs;
- Class 1 and 4 NICs will return to their lower rate;
- the new Levy will also apply to those individuals working above the State Pension age.

Current secondary class 1 NIC reliefs and allowances will apply to the levy, including:

- the £4,000 employment allowance;
- reliefs for employers of apprentices;
- newly employed veterans; and
- new employees in freeports.

Increase in dividend tax rates

The government has also announced that, after the dividend allowance of £2,000, from 1 April 2022 there will be a 1.25% increase in dividend tax rates so that rates will become:

- 8.75% for basic rate taxpayers;
- 33.75% for higher rate taxpayers; and
- 39.35% for additional rate taxpayers.

Under s455 CTA 2010 the rate of tax that applies to overdrawn directors' loan accounts is directly linked to the dividend higher rate. This will mean that from April 2022 this rate will increase from 32.5% to 33.75%.

Dividends received from ISAs will remain tax-free.

Funds raised

The government estimates these measures raise around £12bn per annum and have stated that these funds will be ringfenced to pay for health and social care.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1015736/Build_Back_Better_-_Our_Plan_for_Health_and_Social_Care.pdf

Deductibility of amounts paid to father

Summary – The was insufficient evidence to support the deduction of payments of £30,000 paid to the taxpayer's father in arriving at his taxable self-employed income.

David Cation had worked in construction since 1983 and qualified as a chartered surveyor in 1990. He worked as an employee as a pre-sales director a sales role for companies until 2016 including Charles Henshaw & Sons Ltd, dealing with multi-million pound contracts in major city- centre projects.

In March 2012, he formed Glassal Limited, a specialist supplier and installer of bespoke glazing systems. David Cation was an equal shareholder with a former colleague, and in the initial years he continued to work full-time with Henshaw. David Cation provided his services to Glassal Limited in his personal capacity, trading as 'DC Consult', with DC Consult raising invoices to Glassal for payment of his service.

In 2014/15, DC Consult rendered invoices to Glassal generating total turnover to £70,000. Included in his deductible expenses was an amount of £30,000 that was said to have been paid to his father in return for his services acting as a mentor and advisor to his son, helping him to become self-employed, following up on quotations and chasing potential customers. The work covered a three-year period from August 2011 to March 2014. There was no formal agreement; the £30,000 was simply agreed as a fair value for the work undertaken over the period.

The £30,000 was settled over a number of years, with two payments of £10,000 being paid in January and February 2017, shortly after HMRC opened their enquiry into the return.

David Cation never confirmed the date of his self-employment commencing and there was a failure to notify liability in respect of the tax year 2013/14. His 2013/14 return was submitted in June 2017, after HMRC had opened their enquiry into 2014/15.

Following the enquiry, HMRC disallowed the £30,000 deduction arguing that it was not 'wholly and exclusively' for the purpose of his trade. There was no claim of expenses for 2013-14, but JGBA had advised that the payments to Peter Cation related to services provided from August 2011 to March 2014. No evidence was provided to suggest that his father provided services that merited the £30,000 payment. The single invoice dated 1 March 2015 gave no detailed account of the services provided. HMRC argued that "If there was a bona fide commercial agreement between the parties, particulars to evidence the services provided at a commercial rate should have been available."

Decision

With no written agreement, David Cation's defence relied heavily on the testimonies of his father and his own. The existence of a handwritten invoice and bank statements showing the flow of funds were insufficient evidence.

The First Tier Tribunal found that the assistance given by his father was occasional, non-technical and he did not expect to be paid. It was ad hoc and there was no regular work arrangement in place to engage his father's services to support the 2 days a week purported to have been worked leading to the £30,000 fees.

His father's experience was as a sales representative in polystyrene containers and fancy party outfits; nothing to do with bespoke glazing systems.

The Tribunal found that the 'mentoring' and 'coaching' by his father, referred to by David Cation as 'consultancy', was an overstatement. His father's business experience was limited while David Cation's own experience was far more relevant. He might have used his father as a 'sounding board' but little more. There was no evidence to support payment of £30,000 for consultancy services supplied.

The Tribunal noted that his father's evidence supported that the lump sum payments totalling £20,000 were unexpected, and he did not know whether they were a 'gift' or a 'salary'. The £20,000 was received by his father in 2017/18 but included in an amended 2015/16 return. The Tribunal concluded that on the balance of probability, the two lump-sum payments of £10,000 were triggered by HMRC's enquiry in January 2017, and explained why there was this mismatch in tax years for the relevant events such that the:

- claim of £30,000 was made in the appellant's 2014/15 return;
- two £10,000 payments were made in 2017/18 tax year;

- two £10,000 receipts were included retrospectively by amending his father's 2015/16 return.

The Tribunal rejected David Cation's explanation that 'accruals' were the reason for the mismatch in timing and that the payments in 2017, nearly two years after the supposed date of the hand-written invoice, was due to good trading results, which allowed him 'to settle his account'.

Having disallowed the £30,000, the First Tier Tribunal went on to consider whether the failure to notify a new income tax liability in 2013/14 was a deliberate act. The Tribunal concluded that David Cation clearly understood his obligation to file a Self Assessment return to declare his self-employed income for 2014-15 when his turnover reached £70,000. There was no good reason for not notifying and returning the £20,000 he had received in 2013/14 as self-employed income. HMRC were justified in charging the resultant penalty as being 'deliberate' as David Cation took no steps in January 2016 (when he was filing his 2014/15 return) to file his late 2013/14 return.

The appeal was dismissed

David Cation v HMRC (TC08253)

Professional fees deductibility

Summary - Banking and accounting fees were deductible revenue management expenses. It was not necessary to have formal board decisions at the company level in order to determine that investment activities had been undertaken and expenditure incurred in respect of them.

Centrica Overseas Holdings Ltd was an intermediate holding company, with a Dutch sub-group (Oxxio) in the group headed by Centrica plc. Centrica plc decided to sell the Oxxio businesses.

Following difficulties in the Oxxio sub-group, Oxxio sold one subsidiary and the assets of two further subsidiaries, with the remainder of the Oxxio sub-group remaining under Centrica Overseas Holdings Ltd.

Centrica Overseas Holdings Ltd claimed that £2.5m of the £3.8m professional fees incurred were expenses of management deductible from its profits as a company with investment business under s1219 CTA 2009. HMRC refused this claim.

The First Tier Tribunal rejected Centrica Overseas Holdings Ltd's appeal on the basis that the directors had not made specific, recorded decisions in their capacity as Centrica Overseas Holdings Ltd directors.

Decision

The Upper Tribunal concluded that the First Tier Tribunal had been wrong and that, while it might be preferable, it was not necessary, for the board of Centrica Overseas Holdings Ltd to have made formal decisions regarding its investment activity. The group head of tax and general counsel were heavily involved in the process from beginning to end. They were also directors of Centrica Overseas Holdings Ltd. The Upper Tribunal stated that s1219 CTA did not require this level of formality and that it was clear that the directors were 'participating in the strategic decision making in relation to Oxxio'.

The Upper Tribunal upheld the First Tier Tribunal's findings that the banking and due diligence fees incurred in relation to decision making rather than implementation were expenses of management,

confirming that it is not appropriate to use a single cut-off date, but rather consider the purpose of the expenditure. Further, the fact that the banking fees were contingent on completing the deal did not automatically render them non-deductible, and the banking and due diligence fees were not capital in nature.

However, with regards to the legal fees, the Upper Tribunal remitted the question of whether the fees were expenses of management to the First Tier Tribunal and overturned the decision that these fees were all capital, finding that, to the extent the First Tier Tribunal finds that some of the fees were expenses of management, they will also be revenue in nature because they informed the decision making in relation to the disposal of the Oxxio business.

The Upper Tribunal broadly allowed Centrica Overseas Holdings Ltd's appeal, allowing deductions for most of the expenditure incurred. Where a parent company is involved in managing an investment business, management expenses may still be deductible provided the company's directors participate in making the decisions.

Centrica Overseas Holdings Ltd v HMRC [2021] UKUT 200 (TCC)

Adapted from the case summary in Tax Journal (10 September 2021)

Don't forget to notify an option to tax

Summary – Although an option to tax the sale of a property was made, it was not notified to HMRC within the required time limit, making it ineffective for VAT.

William Newman was the tenant landlord of a pub. In 2014 the freeholder offered to sell it to him. Having found a buyer, on 22 May 2014 he bought the property and sold it on.

He was invoiced £1.3m plus £234,000 VAT on his purchase and invoiced on to his buyers for £1.8m with VAT of £360,000.

HMRC argued that he did not make an effective election to opt to tax his sale. Had he done so, he would have been able to reclaim the VAT on his purchase, leaving him with a net VAT liability of £126,000. With no option to tax in place, his sale was an exempt supply and his input tax was irrecoverable.

As an exempt supply, he could not properly give a VAT invoice to the buyer and the VAT shown on the invoice would be collectable from him under para 5(2) Sch. 11 VATA as a debt to the crown.

Strangely, no VAT return was made on time for the period 07/14 when he bought and sold the pub, although a later nil return was made. William Newman was not advised by his advisors to pay and did not pay HMRC the £126,000 within the prescribed time after the end of the period.

By para 20 Sch. 10 VATA, an option to tax does not have effect unless it is notified to HMRC "within the allowed time", which in non-COVID times is 30 days. William Newman did not notify HMRC by submitting form VAT 1614A within the 30-day period.

In October of the following year, HMRC received a form 1614H, requesting permission for a retrospective option, rather than the required form 1614A relating to the notification of an option already made.

On 11 November 2015 HMRC sent a demand under para 5(2) Sch 11 VATA for the VAT charged to his buyer and two weeks later followed up on the incorrect form that had been sent, which resulted in completed and signed form 1614A arriving on 4 December 2015.

William Newman appealed against HMRC's demand for £360,000.

Decision

The First Tier Tribunal concluded that it seemed clear that VAT accounting on both the sale and purchase had been mishandled in 2014 and early 2015 by those advising him.

The issue to decide was whether William Newman had made an effective election before 21 May 2014.

The Tribunal found that he had made an election in time as indicated by the VAT in the sale contract and other documentation. He delegated authority to his advisors to make the election on his behalf and to take such steps as were necessary to make it effective.

Having missed the 30-day notification deadline, the Tribunal concluded that the election could still be "effective" but only if HMRC allowed further time. However, it was clear that HMRC had not done so and the appeal was dismissed.

William Newman v HMRC (TC08147)

Compensation for mis-sold PPI

Summary - Compensation received on mis-sold Payment Protection Insurance (PPI) was not an VAT exempt insurance transaction.

Claims Advisory Group Limited made claims on behalf of individual customers who had been mis-sold PPI. Where claims were successful, the customers received compensation amounts that were equal to the PPI premiums they had paid together with interest, with Claims Advisory Group Limited receiving a percentage of the compensation as a fee for its services.

Claims Advisory Group Limited argued that the services it provided were exempt from VAT as insurance transactions or as services performed by an insurance agent related to insurance transactions (Group 2, Schedule. 9 VATA 1994).

HMRC argued that they were standard rated. The First Tier Tribunal agreed with HMRC and found that the supplies did not amount to insurance contracts, nor was the company an insurance agent or intermediary that made supplies related to insurance transactions. The exemption therefore did not apply.

The company appealed to the Upper Tribunal arguing that its services were insurance related as the cancellation of PPI, was required before compensation was paid out.

Decision

The Upper Tribunal examined the contractual arrangements. Claims Advisory Group Limited confirmed in the paperwork sent to potential customers that their services related to claiming compensation, and not to any insurance service. The Tribunal found that the economic purpose and commercial reality of the company's supplies was to claim compensation for mis-sold PPI; this was not an insurance transaction. There was no authority to support the Claims Advisory Group Limited's claim that the cancellation of an insurance contract was such a transaction.

The Upper Tribunal agreed with the First Tier Tribunal that Claims Advisory Group Limited was not acting between the insured and the insurer as an insurance agent, nor performing related services to an insurance transaction. The company was not involved in seeking insurance and had no relationship with the insurer.

Claims Advisory Group Limited's appeal was dismissed.

Claims Advisory Group Limited v HMRC [2021] UKUT 199 (TCC)

Reconstruction of listed building

Summary – The conversion of a large, listed property into 86 residential units was not a “substantial conversion” of a listed building, making the sale of the units exempt for VAT.

The Royal Star and Garter Home, a large, listed property in Richmond, was built in the early 1920s to provide nursing facilities for servicemen returning from service in the first world war. Changes in medical practice led the charity which owned the building to move its operations elsewhere and the building was then sold to Richmond Hill Developments (Jersey) Ltd

Over some 2.5 years the company converted the building into 86 residential units which it sold. The King's Room was converted into a swimming pool and gymnasium and the Queen's Room was to be converted into a communal sitting room, or for use for large receptions or dining.

The issue in this appeal was whether on sale, the residential units were zero rated or exempt. If zero rated, the company would have been able to recover the input tax on the conversion works. Under Item 1 Group 6 Schedule 8 VATA 1994, the supply of dwellings which are the result of a “substantial conversion” of a listed building are zero rated for VAT.

There was no doubt that major work had been carried out in this case but as the Tribunal stated the issue was whether Note 4 to Group 6 applied, which states:

“a [listed] building is not to be regarded as substantially reconstructed unless when the reconstruction is completed, the reconstructed building incorporates no more of the original building (that is to say, the building as it was before the reconstruction began) than the external walls together with other external features of architectural or historical interest.”

The reconstruction did leave the walls and roof substantially intact but also retained the chapel, a marble staircase, the substantial majority of the reinforced concrete floor slabs and the chimney stacks. HMRC argued that these retentions meant that the property sales were exempt supplies and not zero rated.

The company argued that the concrete floor slabs, vertical steels within the walls and the chimney stack, which were retained in order to maintain the structural integrity of the exterior, should be considered as part of the external walls and features for the purposes of Note 4 and that other retained features were de minimis.

The company also argued that the EU principle of Fiscal Neutrality required that a reconstruction of a listed building in which some part of the original structure was maintained should be treated in the same way as a reconstruction in which nothing other than the external walls was retained.

Decision

The First Tier Tribunal agreed that “external walls” included their foundations and a buttress which are needed for stability, have no other purpose and are closely attached to the wall.

The Tribunal stated that the:

- floor slabs served the purpose of providing floors on which to walk and place objects and extended from one outside wall to the opposite one. They were not part of the walls.
- vertical steels cast into the external walls were part of the walls but supported in part the upper floor slabs and their load, they did not serve only the walls or the roof and so could not be regarded as part of the external walls.
- chimney stack, started at ground level and rose through the building and supported the visible chimneys which rose above the roof. This could not be called part of the external features.

The Tribunal further concluded that, in the context of the building as a whole, the retention of the original marble lined grand entrance and staircase and the passage to the formal garden at the rear were three significant features both before and after the reconstruction and could not be regarded as 'trifling'. The de minimis exemption did not apply.

With evidence lacking, the Tribunal stated that they could not directly conclude that there were similar flats whose sales had been treated differently and so on that basis found that the principle of fiscal neutrality was not infringed. Further, considering theoretical flats and the views of a typical customer, the Tribunal concluded that the grand entrance hall, stairs, the associated entrance corridors and the Queen's Room would have had a significant influence on a purchaser's decision. On that basis they found the Fiscal Neutrality principle was not breached.

The appeal was dismissed.

Richmond Hill Developments (Jersey) Ltd v HMRC (TC08232)