

Business tax update (Lecture B1271 – 20.30 minutes)

Sideways loss relief denied

Summary - The purchase and sale of film rights was not a trade and so sideways loss relief was not available to carry back losses made against employment income in earlier years.

Having ceased employment with Morgan Stanley, Robert Poll set up a photography business as a sole trader using Premiere Picture Sovereign. He committed £650,000 to the business although only £125,000 of this was his own money. The remainder was provided by way of loan from GBF Capital Limited, a company connected with Premiere Picture.

As a result of the way film distribution rights are valued for accounting purposes, his accounts for the first accounting period showed a loss of £583,881 and in 2007/08 he made a claim to carry back these losses and set them against other income he had received in the previous three tax years.

His business generated further losses in the following two tax years of £22,149 and £9,798 respectively.

HMRC disallowed the loss claims, principally on the basis that the film business was not a trade or that, even if it was, it was not commercial.

Robert Poll appealed against HMRC's closure notices on the basis that he was carrying on a trade on a commercial basis. He also claimed that the closure notices were invalid as there was a delay of several years before the closure notices were issued.

Decision

The First Tier Tribunal confirmed that the closure notices were valid as there is no time limit for HMRC to issue such notices. Where the taxpayer considers that there is an unreasonable delay, they can apply to the Tribunal for a direction requiring HMRC to issue a closure notice.

Although Robert Poll had spent some 18 hours a week on business activities, he had effectively paid out a capital sum to obtain a possible future income stream. With the steps pre-arranged, the First Tier Tribunal found that the purchase and sale of film rights did not amount to a trade. He was not trading in film rights.

Finally, even if the business had amounted to a trade, the Tribunal concluded that it was not carried out on a commercial basis with a reasonable expectation of profits, so denying any sideways loss relief claim.

The appeal was dismissed.

Robert Poll v HMRC (TC08172)

CIS gross payment in error

Summary – By making gross payments to their construction works subcontractors without checking their CIS status, the contractors had failed to take reasonable care.

North Point (Pall Mall) Ltd and China Town Development Company Ltd were connected companies that engaged subcontractors to carry out construction works. Based on their understanding of the construction industry scheme, they made payments to the subcontractors without any deduction of tax on the basis that gross payment status applied.

After a review, HMRC told the companies they should be deducting tax from the payments to the subcontractors and they should register for the construction industry scheme. After taking advice, the taxpayers registered for the scheme.

In 2017, HMRC issued determinations under reg 13 of the Income Tax (Construction Industry Scheme) Regulations 2005. This was on the basis that the taxpayers had failed to take reasonable care.

The taxpayers appealed saying they had taken reasonable care to comply with the law and the failure to deduct tax was due to an error made in good faith. They had also claimed relief under reg 9(3), but HMRC refused.

Decision

On the reg 9(3) claim, the First Tier Tribunal noted that HMRC's guidance stated that the department had to consider giving relief under reg 9(3) before making a reg 13 determination. So, after a determination had been made under reg 13, neither HMRC nor the tribunal could grant relief under reg 9(3).

The Tribunal accepted the taxpayers made the error in good faith but said this did not amount to taking reasonable care.

The judges said:

'The test is whether the advice is appropriate to the issue under consideration. When numbers are big and the facts complicated, it is more appropriate to go to a tax silk than would be the case if the numbers are small and the facts are simple.'

They considered a reasonable director would have sought independent tax advice from an expert.

The appeal was dismissed.

North Point (Pall Mall) Ltd and China Town Development Company Ltd (TC8205)

Adapted from the case summary in Taxation (12 August 2021)

OECD model reporting rules for digital platforms

From January 2023, these rules will require platforms to report information about the income of sellers providing goods and services to help sellers get their tax right and to enable HMRC to deal with non-compliance.

Broadly, the OECD model requires platforms to collect details about their sellers, including information to identify who the seller is and where they are based, and report the information, including the seller's income, to the tax authority annually by 31 January. Platforms must also give that information to the sellers, so that they can use it to help them complete their tax returns.

The tax authorities then exchange information with other tax authorities where the sellers are resident and use the information to ensure that sellers are complying with their tax obligations and to tackle non-compliance if they are not.

The government is consulting on the implementation of the OECD's model reporting rules for digital platforms. The consultation sets out the details of the rules and invites views on the optional elements and the UK's proposed implementation. HMRC also asks for comments on how the information to be reported could be used to help taxpayers get their tax right, as well as on any practical issues.

Adapted from Taxation (5 August 2021)

<https://www.gov.uk/government/consultations/reporting-rules-for-digital-platforms>

Capital services, not capital goods

Summary – Input tax on building services supplied by builders was not recoverable as the company was operating VAT under the flat rate scheme.

Mr and Mrs Turner were equal directors and shareholders of Trans Wales Trails Ltd, a VAT registered company that ran a horse-riding holiday business. The company accounted for VAT under the flat rate scheme.

In 2013, the couple acquired a farm with a small cottage and two flats. The plan was to convert the properties into guest accommodation to be used to house customers of the horse-riding business in the summer but also to provide bed and breakfast accommodation in the winter.

Work undertaken by two builders was invoiced to Trans Wales Trails Ltd, with total input VAT suffered of £9,856.14. On the advice of their accountant, the company claimed the input tax on their VAT return. HMRC denied the claim as the advice was wrong. Operating under the flat rate scheme, input VAT can be recovered on capital goods exceeding £2,000 but not on capital services such as building work.'

Subsequently, the couple were advised to register their guest accommodation business for VAT and reclaim the input tax through this partnership. Once again, HMRC disallowed the claim. This time on the basis that the partnership did not hold valid VAT invoices as the invoices concerned had been made out to Trans Wales Trails Ltd and not to the partnership. It was also the company, rather than the partnership, who had settled the invoices.

The partnership appealed to the First Tier Tribunal on the basis that the input tax related to the partnership activities and so should be recoverable.

HMRC stated that the services had been supplied to the company and so only the company could reclaim the input tax suffered, which in this case was not possible due the use of the flat rate scheme.

Decision

The First Tier Tribunal found that the partnership did not hold a valid VAT invoice nor could it provide alternative evidence of the supply being made to it. Had this been the case “HMRC could, using its discretion, treat (it) as alternative evidence of a supply (having been made) to it”.

In this case, the supply of services had been made to the company and the case was dismissed. Sadly, the horse had already bolted. Had the services been supplied and invoiced to the partnership, and not the company, the input tax would have been recoverable.

Blaenau Bach Farm V HMRC (TC08134)

Postal charges

Summary – To be able to reclaim input tax, a VAT invoice must be or have been held by the taxpayer that separately states the amount of VAT charged.

This is a test case in respect of supplies of services by Royal Mail that were wrongly treated as exempt. The total value of the claims made against HMRC amounts to between £500 million and £1,000 million.

Zipvit Ltd supplies vitamins and minerals by mail order. During the period 1 January 2006 to 31 March 2010, Royal Mail supplied Zipvit Ltd with a number of postal services under contracts which had been individually negotiated.

Article 132(1)(a) of the VAT Directive (Schedule 9, Group 3, paragraph 1 VATA 1994) provides that Member States are to exempt ‘the supply by the public postal services of services other than passenger transport and telecommunications services, and the supply of goods incidental thereto’.

Initially, this was interpreted as covering all postal services supplied by Royal Mail. However, in *TNT Post UK* (C-357/07, EU:C:2009:248) it was found that the postal services exemption did not apply to supplies of services for which the terms had been individually negotiated. Such services should be standard rated and so in this case, Royal Mail should have charged Zipvit Ltd a total price plus standard rate VAT and Royal Mail should have accounted and paid the VAT over to HMRC.

Zipvit Ltd sought to recover the uncharged input VAT from HMRC. The claim was disallowed on the basis that Zipvit Ltd did not pay any VAT.

Decisions at the First Tier Tribunal, Upper Tribunal and Court of Appeal found in HMRC’s favour. The Supreme Court, prior to Brexit, requested a preliminary ruling from the CJEU, which is the subject of this case.

Decision

The CJEU held that to be able to make a valid reclaim of input tax, the taxpayer needed to hold, or have held, an invoice that separately stated the amount of VAT being charged.

Zipvit Ltd was never issued with a valid VAT invoice setting out the VAT charged on the services.

Zipvit Ltd v HMRC Case C-156/20

Best judgment assessment

Summary –HMRC’s best judgment assessments had been raised on a reasonable basis using the evidence that had been presented to them.

Kingsley Douglas was a sole trader who ran a business selling cigarettes, tobacco, and newspapers and was almost permanently in a VAT repayment position.

Considering this to be highly unusual, HMRC initiated an enquiry into his VAT affairs and ultimately made best judgment assessments on the basis that Mr Douglas did not have the till rolls relating to sales made in his business. HMRC raised assessments for the VAT quarter to 09/09 for £7,319.17 and for the VAT periods 06/10 to 12/13 totalling £132,693.00.

The taxpayer appealed to the First Tier Tribunal who concluded that in the absence of full records, HMRC were correct that the only option available was to carry out a business economic exercise and that reasonableness was a matter that had been taken into account.

Kingsley Douglas appealed to the Upper Tribunal, claiming that the First Tier Tribunal had erred in making findings outside the agreed issues and in concluding that there was no evidence upon which they could conclude that Mr Douglas had shown the assessments to be wrong.

Decision

The Upper Tribunal stated that it was clear that the reliability of Mr Douglas’s records 'was front and centre in the appeal'. The Tribunal concluded that the First Tier Tribunal had ‘clearly considered all of the evidence in the round’.

It was a matter for the First Tier Tribunal as to what weight to attach to any particular piece of evidence and, it was not for Upper Tribunal to interfere with the First Tier Tribunal’s evaluation where the evidence had been properly taken into account.

There was clearly evidence before the First Tier Tribunal on which it was entitled to make the finding that it did.

The appeal was dismissed.

Kingsley Douglas v HMRC [2021] UKUT 0163 (TCC)

Construction of new dwelling

Summary – Retrospective planning consent for the construction of a new dwelling was not enough to permit zero rating of the construction services provided.

CMJ (Aberdeen) Limited is a joinery and construction services company.

In June 2012, an initial planning application was made for the “demolition of existing dwelling and garage and reinstatement with new build dwelling and garage”. To gain approval, the application was amended and referred to as ‘an extension and a garage’ with the newly designed house sitting within the same footprint as the existing house and retaining two of its original walls.

In February 2013, when the roof was taken off, it was discovered that the walls were not suitable to hold the weight of the proposed new extension and so they were demolished and rebuilt with modern replacements.

On 10 November 2014 the Council granted full planning permission for “Demolition of existing steading and erection of new dwelling house (retrospective) at [the property]”.

In summary, this meant that when construction started, the planning permission in place did not relate to the construction of a new dwelling but rather 'alterations and extension' to the existing dwelling. However, the final result was that the company supplied construction services to build a new dwelling with retrospective planning permission granted.

For the construction services to be zero rated under Schedule 8 Group 5 VATA 1994, one of the conditions is that 'statutory planning consent' must have been granted for a new dwelling before the work starts. As this was not the case, HMRC raised an assessment, treating the supplies as standard rated.

The company appealed arguing that statutory planning consent had been obtained for the construction by dint of a combination of the planning consent and a construction building warrant which it had obtained from the relevant authority and which allowed for the construction of a new building.

HMRC's view was that a building warrant was 'not sufficient' for zero-rating purposes because it was not statutory planning consent.

Decision

The First Tier Tribunal agreed with HMRC confirming that verbal planning consent and a building warrant granted before the work started was insufficient.

On a strict interpretation of note (2), zero rating was not allowed.

The company's appeal was dismissed.

CMJ (Aberdeen) Limited (TC08140)

Black cab taxi hire and insurance

Summary – The taxpayer made a mixed supply consisting of standard rated vehicle hire and exempt insurances services.

Black Cabs Services Limited leases London Hackney cabs to self-employed drivers. By leasing rather than buying black cabs, the drivers do not have the hassle of maintaining, financing and insuring the vehicle themselves.

The black cabs are insured under a “motor fleet policy” taken out by Black Cabs Services Limited and all cabs owned by the company are covered. There is usually no requirement for the details of the drivers to be sent to the insurer. Although drivers have the option of using their own insurance, his drivers have never used their own insurance policies as the company's policy was cheaper and had more benefits than an individual driver could negotiate himself.

Insurance formed a small part of the overall cost of running a vehicle (£30) with the majority of the cost comprising finance and maintenance. No invoices were issued to the drivers, just receipts with the cost of insurance set out separately.

Having originally treated the insurance element as a taxable supply, they later claimed that this was a mixed supply and that the insurance element was an exempt supply. Consequently, Black Cabs Services Limited submitted a VAT error correction claim for £43,245 for the 12/2013 - 03/2016 periods.

HMRC disagreed and determined that the company was making a single standard-rated supply of a fully insured taxi and refused the claim. It would be artificial to split the costs.

The company appealed.

Decision

The First Tier Tribunal accepted that although the economic realities of the purchase of “block policy” insurance meant that this option was cheaper and so all drivers were insured under their policy, drivers were always given the option of using their own insurance.

Drivers were aware of the added cost of insurance because not only was it set out in the agreement, but the receipt separately set out the hire amount and the insurance amount. The First Tier Tribunal concluded that the average driver was likely to conclude Black Cabs Services Limited two supplies: an exempt supply of insurance services and a standard supply of vehicle hire.

HMRC were wrong to deny the repayment claim and the appeal was allowed.

Black Cabs Services Limited v HMRC (TC08141)

Effect of subsidy payments on input tax

Summary – In line with other decisions, a business making taxable supplies and receiving grants that were outside the scope of VAT did not need to restrict its input tax recovery.

Colin Newell traded as a hot air generating business and received periodic support payments under the renewable heat incentive scheme. It was accepted by both parties that these payments were outside the scope of VAT.

HMRC determined that, because the receipts were a significant part of Colin Newell’s business, and he would not be profitable without them, his input tax should be reduced by apportioning the input tax between the taxable and outside the scope supplies. HMRC raised an assessment disallowing 47% of the input tax for the period November 2014 to January 2017 and 29% for the period from February 2017 to April 2018.

Colin Newell appealed arguing that there was no need to restrict his input tax because he had no exempt supplies, only taxable business supplies.

HMRC claimed that all expenses were a cost component of the sales made by the business, as well as the periodic support payments that the business received. There was a direct and immediate link between costs and both income sources.

Decision

The First Tier Tribunal considered five historic cases heard in the CJEU and the question 'Is there an activity taking place that generates the subsidy income, or is the business only involved in making taxable business supplies?'

The Tribunal stated that there was a direct and immediate link between purchases and taxable supplies, as the goods and services on which input tax were incurred were used to generate heat and make taxable supplies. This forms the basis of the entitlement to recover his input tax. The Tribunal decided that the fact that the business might not be viable without the subsidies was 'irrelevant to his entitlement to deduct input tax'.

The appeal was allowed.

Neil Warren, independent VAT consultant, said:

'HMRC has always accepted that an activity can be either business or non-business but not both. Non-business income, for example some grant income, can be used to support business activities. This does not mean that the supported business activities become partly non-business and partly business. Using non-business income simply makes them subsidised business activities.'

Colin Newell v HMRC (TC08149)

Adapted from the case summary in Taxation (12 August 2021)