

Business tax update (Lecture B1331 – 23.36 minutes)

Unexplained payments

Summary – Unexplained payments made to shareholders were taxable as self-employment income and not a loan.

Martyn Arthur ran a business providing advice and representation for taxpayers appealing to Tax Tribunals in respect of decisions made by HMRC. The business had run through two companies, Martin F Arthur Limited and Martyn Arthur Forensic Accountant Limited, which he had controlled and partially owned. His wife was a shareholder in both companies and had previously been a director. The companies ran into difficulties and were closed down.

In May 2020, Martyn Arthur was convicted of cheating the public revenue over the period up to 2012/13. This appeal was concerned with establishing what, if any, undeclared tax liabilities of his arose in respect of the tax years up to 2015/16. HMRC argued that the couple had underdeclared their income from the companies, which resulted in them issuing a number of assessments and penalties for deliberate inaccuracies in their returns in respect of the tax which they said had been underdeclared.

According to the tribunal:

“The confusion arose as a result of the chaotic state of the affairs and records of the Companies and the numerous transfers of money that had taken place involving the Companies and both the Appellants.”

Comparing the couple's bank statements to the companies' bank statements, HMRC created a list of untaxed money received by the couple from the companies, which HMRC regarded as being taxable as being profits from self-employment.

The couple argued that the money movements between the bank accounts should be treated as loan account debits and credits. Any net balance owing to the companies should be subject to tax under s.455.

Decision

The First Tier Tribunal found that Martyn Arthur treated both companies' money as the couple's asset, with no need to accurately record amounts paid and received or indeed, any requirement to repay the net sums received. The companies' loan balances were not an accurate reflection of the monies owed by the couple and further, when the companies were dissolved, there appeared to be no attempt to repay any outstanding amounts due. They were therefore amounts taxable as self-employment income and not a loan.

Moving to the penalties, the tribunal did not accept that Martyn Arthur's mental health issues and alcohol dependency made his actions careless rather than deliberate. His penalties were therefore upheld.

The tribunal stated that by 2015/16, his wife was aware of HMRC's criminal investigation into her husband's affairs, but she continued to allow him to submit her own returns, without checking. This was deliberate behaviour. However, before this time, it could not be shown that she was aware of her husband's criminal investigation, and consequently her penalties for her 2014/15 inaccuracies were recalculated on the basis that they were careless and not deliberate.

Martyn and Denise Arthur v HMRC (TC08539)

LLPs and salaried members legislation

Summary – For the salaried members legislation to be avoided, a member must have significant influence over just part of the LLP's affairs rather than the LLP's affairs as a whole.

Bluecrest Capital Management (UK) LLP managed investment funds as well as provided support services to other group entities. Certain members ran the investment portfolios with capital allocated for them to invest at their discretion. Other members had no such allocations. The members' remuneration included variable bonuses that were determined by reference to their performance as well as the performance of the business as a whole.

Under the salaried members rules, where certain conditions are breached, members are deemed to be taxable as employees liable to PAYE and NIC, rather than as self-employed. The legislation is designed to ensure that LLP members who are effectively providing services on terms similar to employment are treated as employees for tax purposes.

For the rules to apply, an individual must satisfy three conditions. It was common ground in this appeal that Condition C applied but that Conditions A and Condition B were disputed.

- Condition A - Were the bonuses variable without reference to the profits of the LLP?
- Condition B - Did the members not have significant influence over the LLP's affairs?

HMRC believed that these conditions were met and issued the LLP with PAYE and NIC determinations covering five years.

Bluecrest Capital Management (UK) LLP appealed.

Decision

The First Tier Tribunal considered the variable bonus remuneration. Condition A is met if it is reasonable to expect that at least 80% of the amount paid by an LLP to an individual member is disguised salary. This includes amounts which are variable but vary without reference to the overall amount of the profits or losses of the LLP, or are not, in practice, affected by the overall amount of those profits and losses. The Tribunal found that the LLP had not established a satisfactory link between the LLP's profits and the variable remuneration paid. It was not good enough that 'if there were fewer profits available for distribution, an individual member would receive a lesser amount'. This condition had been met.

However, LLPs could still fall outside of the salaried members legislation if they had significant influence over the affairs of LLP's affairs.

The First Tier Tribunal found that this influence did not have to be over the LLP's affairs as a whole; the influence could be over one or more areas of the LLP activities and this included financial influence. Members who were LLP heads of departments as well as those who managed portfolios of at least \$100m were found to have the required influence. However, other members did not, meaning that their bonuses did not vary enough with profit and should be treated as disguised salary.

The appeal was allowed in part.

Bluecrest Capital Management (UK) LLP v HMRC (TC08529)

Care home 'transferable goodwill'?

Summary - the Court of Appeal allowed HMRC's appeal against the Upper Tribunal's decision on the valuation of leasehold interest in two nursing homes granted to two companies on the incorporation of the taxpayer's business.

Dr Denning owned the freeholds of two nursing homes running both as a sole trader.

In 2010, she incorporated a group of three companies, two as wholly owned subsidiaries of a parent in which she was the sole shareholder.

She then transferred the businesses to the two subsidiaries. The transfers included the grant of five-year leases of the properties, one to each company, with no premium. The sale agreement also included deeds assigning the goodwill of the businesses to the companies for a total of £1.8m.

HMRC challenged the figures for goodwill, arguing that the consideration was in reality part of the open market value of the leases. The issue for the court was therefore what was the amount of that open market value.

Both parties called expert evidence and the experts agreed that the care homes were trade related profits so that the leasehold interests had to be valued on the profits method of valuation. Applying the guidance given by the Royal Institution of Chartered Surveyors in VGPA 4, the experts agreed capital values.

HMRC argued that those values represented the open market values reflecting trading potential, but Dr Denning's argument was that the values included both the value of the leasehold interests and also transferable or business goodwill. Since the value of the leasehold interest was simply the market rent, the agreed capital value related solely to the goodwill.

The Upper Tribunal had agreed with Dr Denning.

Decision

However, the Court of Appeal held that VGPA 4 was aimed at the valuation of property interests. That they were valued by reference to trading potential did not mean that two separate assets were being valued. There was only one asset, the leasehold interests, and the profits method of valuation was no more than a method of arriving at the value of the property. The fact that the leases were at a market rent was concerned only with the transaction between the landlord and tenant. It did not mean that an assignee of the lease would pay nothing for it.

HMRC v Denning and others [2022] EWCA Civ 909

Repayment of participator loan

Summary – The GAAR Advisory Panel found that arrangements involving the repayment of participator loans through transactions involving group companies were reasonable. Unlike some of the previous referrals to the Panel in this area, there was no marketed pre-packaged scheme with unusual and apparently non-commercial steps involved.

M was the majority shareholder of Z, the parent of an active group of companies; for the period ended 31 May 2014, it recorded a post-tax profit of over £60m.

At 1 June 2015 M's Director's Loan Account with Z was in credit to the amount of £188,415.49. However, during the next 12 months there were various debits which resulted in a balance on the DLA of £9,994,451.97 being owed by M to Z at 31 May 2016.

If this balance were to be outstanding at 28 February 2017, that would result in a tax charge equivalent to Corporation tax on Z on the amount of the loan under s.455 CTA 2010.

Further loans were made by another group company, Y, to M. The Advisers accepted that these transactions in February 2017 were made to allow M to repay the Z loans, so preventing the s.455 charge.

HMRC argued that this created a tax advantage for the company. However, the advisors argued that the Y loans were not 'abusive' as they were made charging a commercial rate of interest. They believed that it made no difference as to whether M borrowed money from a third party or from another group company.

Decision

The Panel stated that it was aware that HMRC regularly challenges cases that seek to eliminate a liability to tax under the Loans to Participators legislation.

Here, it was common ground that there were arrangements to avoid a s.455 tax charge and that under the GAAR legislation, the Panel was required to assume they were 'tax arrangements'.

However, the cases that they had previously seen involved 'artificial means of creating repayments or value passing out of the company'. The Panel concluded that this was not the case here but was the omission in the legislation regarding loans made by groups and group companies to clear other loans something to which the GAAR should apply?

The GAAR Advisory Panel accepted the Advisers' point that M's loans from Y were made at a commercial rate of interest and concluded that this did not involve contrived or abnormal steps. The Panel did not see that there had been an extraction of value that meant tax would be avoided.

The Panel concluded that the arrangements did not involve contrived or abnormal steps and that entering into them was a reasonable course of action.

<https://www.gov.uk/government/publications/gaar-advisory-panel-opinion-of-26-april-2022-repayment-of-a-participator-loan-through-transactions-involving-group-companies>

Football pitch hire (Lecture B1331 – 23.36 minutes)

Summary - The supply of football pitches and league management services was a single composite exempt supply of the right to occupy land.

Netbusters (UK) Limited organised 5-a-side football and netball league matches. To do this, the company:

- managed all aspects of league administration;
- hired pitches from third parties and made them available to the teams to play their league matches.

The pitches were also hired out separately to members of the public.

Netbusters (UK) Limited sought to reclaim output VAT totalling £414,622 on the basis that its supplies were:

- 87.5% exempt as the supply of the pitch or court which should be treated as the hire of a sporting facility (Schedule 9 Group 1 VATA 1994);
- 12.5% taxable as the supply of league administration services of organising fixtures and providing referees and bibs for the matches.

HMRC disagreed and refused the claim, arguing that the company's supplies were standard rated supply of the 'organisation of football and netball leagues' and so was competitive league sports management services.

The First Tier Tribunal found in the taxpayer's favour, finding that the services represented a single composite supply of the right to occupy land which did fall under Schedule 9. Group 1. The supply was exempt.

HMRC appealed to the Upper Tribunal, arguing the lower tribunal had erred in law and had failed to consider and apply the "passivity principle" of the letting of land or the objective character or economic reality of the company's supplies. HMRC considered the supply not to be the grant of a licence to occupy land nor the hiring out of pitches but rather the supply of league administration services.

Decision

The Upper Tribunal found that the First Tier Tribunal had applied the correct tests. Letting of immoveable property could be a low value, passive activity. However, in this case, the First Tier Tribunal had considered all of the relevant case law and had correctly identified two supplies (pitch hire and league administration). They acknowledged that both enhanced the other but the character of the supply was predominantly the hire of land, and the administrative services were viewed as ancillary. As a result, the First Tier Tribunal had not erred in law and had reached a reasonable conclusion.

The Upper Tribunal confirmed that the supplies made were a single composite supply, exempt from VAT. The appeal was dismissed.

HMRC v Netbusters (UK) Limited [2022] UKUT 00175 (TCC)

Construction of house

Summary – As the house was not demolished, the building work was not zero-rated. However, the work qualified for 5% VAT as the house had not been lived in during the two-year period prior to the work starting.

Under Schedule 8 Group 5 note 18(b) VATA 1994, building work on the construction of a house can be treated as zero-rated where the previous property is demolished. The legislation permits such zero-rating where a single façade is retained, but this retention must form part of the planning consent or other statutory requirement.

In this case, Northchurch Homes Limited claimed zero-rating, with only a single façade being retained.

However, in reality, other parts of the original property were retained including part of the roof as well as the ground floor bay, the gable and other sections of walls. HMRC refused the claim

Northchurch Homes Limited appealed and also included a second argument, should zero-rating not apply. The company argued that Schedule 7A group 7 VATA 1994 applied as the house had not been lived in during the two-year period prior to work starting. As a result, the work qualified for the reduced 5% VAT rate.

Decision

Not surprisingly, the First Tier Tribunal found that the works did not amount to the “construction of a building” because the original building did not cease to be an existing building. “What was retained was, as a matter of fact, and for several reasons, more than 'a single facade'”. The supply was not zero-rated.

However, the First Tier Tribunal accepted that the house had been empty for more than two years before the work started, meaning that the supply should have been at the reduced 5% rate. The judge stated:

“I am entitled to consider the correct rating if there is sufficient evidence before me to permit me to determine the issue. I am not bound to find that, if the rating was not zero rating, then it should be standard rating. In this case, there is sufficient evidence before me.”

Northchurch Homes Limited v HMRC (TC08526)

Paid for and free crash tests

Summary – The free crash tests carried out by the charity did not represent a non-business activity meaning that recovery of general overheads was not restricted.

The Towards Zero Foundation was a charity whose primary objective was to achieve zero road traffic fatalities.

The charity initially bought new cars by way of a “mystery shopping” exercise and then undertook crash testing.

Where test results were substandard or unsatisfactory, the charity published and influenced customer buying behaviour. This drove manufacturers to improve their safety features. Having improved safety in this way the manufactures proactively seek and pay for further testing and so gain improved ratings in the market.

HMRC enquired into whether the charity was appropriately restricting input tax attributable to non-business activities.

Both parties agreed that the testing undertaken and paid for by the manufacturers was a business activity involving the making of taxable supplies giving rise to input tax recovery.

However, HMRC considered that the initial free testing funded by the charity represented a non-business activity and so no input tax could be claimed on the charity's expenses and overheads for this activity. HMRC raised assessments by reference to the information available on the basis that there should be a 40% restriction on general overhead input tax recovery.

The charity appealed the assessments, arguing that it did not undertake any non-business activity as the free testing was not a separate activity in its own right. It was initial work that led to the subsequent charged testing work.

Decision

The First Tier Tribunal agreed with the charity.

The free testing was an “inherent and integral part” of the charity’s business activity. It was not part of the organisation's charitable aims as laid out in its Articles of Association.

The appeal was allowed.

The Towards Zero Foundation v HMRC (TC08547)