

Business tax update (Lecture B1391 – 23.58 minutes)

Failure to declare trading income

Summary – Having previously been found to be trading on eBay, the taxpayer continued to so, and deliberately failed to declare this income.

In 2014, HMRC enquired into Vitalie Milasenco's eBay activities, concluding that he had been trading under the name geminis73 and in January 2015, he was assessed to income tax for tax years 2009/10 to 2012/13 in relation to that trading activity. These assessments were not appealed.

Vitalie Milasenco submitted tax returns for 2013/14 to 2015/16 and declared income from employment as a security officer but no income from self-employment.

In 2016/17, he informed HMRC that he had no income from self-employment and as a result he was not required to submit a tax return.

In 2017, HMRC opened an enquiry into his 2014/15 return, finding that he was still trading on eBay trader. HMRC raised assessments for the years 2013/14 to 2016/17 as well as penalties.

Vitalie appealed, arguing that his eBay account had been hacked, which had resulted in unauthorised transactions.

Decision

The First Tier Tribunal found that the seller had items for sale on eBay ranging from electronic recording tapes to smartphones.

Vitalie's Milasenco's bank account contained payments to mobile phone suppliers as well as delivery companies and multiple deposits.

His bank account for 2014/15 showed deposits of £125,234 through PayPal and amounts transferred to others via PayPal of £48,164. Further, he had created a new online store on eBay and joined a wholesale trading platform.

The First Tier Tribunal found that Vitalie Milasenco's had traded on eBay since at least 2008 and, given the volume of transactions and PayPal deposits, he was continuing to trade between 2013/14 and 2016/17.

The appeal was dismissed.

Vitalie Milasenco v HMRC (TC08861)

Underdeclared puppy sales

Summary – Puppy sales between 2013/14 and 2017/18 were deliberately under-declared by the taxpayer who traded as both a sole trader and partnership during this time.

Sylvia Hook:

- traded as both sole trader (Sylml) and in partnership (Pinetrees) with her husband, claiming that each business dealt with different types of dog breed.
- was licensed to trade as a dog trader with her local council. The licence to own 43 breeding bitches, covered both the sole trader and partnership's businesses.
- had a dog breeder insurance account with Petplan and later Buddies. Each puppy was sold with four weeks of free insurance.

In June or early July 2017, HMRC opened an enquiry into Sylvia Hook's Self Assessment return for 2015/16. Concluding that her business records were insufficient, HMRC undertook further work, cross-referencing a sample of sales to the values submitted on the Petplan Insurance linked with each sale.

Sylvia Hook claimed that:

- the value recorded was often inflated for the insurance but a number of buyers confirmed they had paid the value as recorded on the insurance;
- under her licence, she was able to breed a maximum of 194 puppies a year but insurance policies showed that in one year that number was actually 297.

The taxpayer claimed that in 2015, there was a sharp increase in puppy sales by the partnership and virtually no sales by the sole trader business in the same period.

However, cashbook entries confirmed that:

- where the VAT threshold for Sylml was close to being breached, puppy sales were transferred to the partnership;
- not all money was paid into the business bank accounts, with unexplained cash deposits appearing in personal bank accounts.

On 18 July 2017, Sylvia Hook registered Sylml for VAT and by the end of the month the partnership was terminated.

Following their investigations, HMRC issued a closure notice for 2015/16 and discovery assessments for 2012/13 to 2017/18 for the businesses along with penalties for deliberate behaviour. The effective VAT registration date for both businesses was amended to 2011 for Sylml and 2015 for the partnership.

Sylvia Hook appealed.

Decision

Having reviewed the evidence, the First tier Tribunal concluded that:

- the dogs sold by each of Sylml and Pinetrees did not fall “readily fell into two categories” as claimed and there was cross-over between the two businesses;
- the business cash books were not “robust” and there were a large number of payments that did not go into the business bank accounts of either Sylml or Pinetrees;
- criticisms that HMRC made of the cashbooks were justified, and that the declared turnover of both businesses was a significant understatement of the true turnover;
- Sylvia Hook had allocated sales between the two businesses to prevent having to register for VAT.

The appeals were dismissed.

Sylvia Hook v HMRC (TC08859)

Payment on incorporation

Summary – With value of business on incorporation was reduced from £8.25 million to £1, intangibles relief claimed was reduced to £1 and the difference taxable as a distribution and not as a capital gain.

In 2007 Jasper Conran expanded his design range into branded eyewear. A limited liability partnership, Jasper Conran Optical LLP, was formed with him as a controlling member. It entered into a licensing agreement with Specsavers for the design, manufacture and sale of spectacle frames branded with the trademarked name 'Jasper Conran'.

In 2008, the business of Jasper Conran Optical LLP was transferred to JC Vision Ltd. Mr Conran subsequently received £8.25 million which he treated as a capital gain and paid capital gains tax. JC Vision Ltd treated the sum as a business expense which it amortised in its accounts and claimed intangibles relief.

HMRC considered the open market value of the assets transferred was overstated and revised the figure to £1. Therefore, no intangibles relief arose. It also considered that the payment of £8.25 million to Mr Conran was a distribution and subject to income tax.

The First Tier Tribunal agreed with HMRC about the market value but said the £8.25 million payment to Mr Conran was not taxable because he received it as a partner rather than a shareholder.

JC Vision Ltd and HMRC appealed.

Decision

On the valuation of the market value of the business, the Upper Tribunal found that the transfer did not include use of the trademark; no inclusion was necessary because JC Vision Ltd already had access to the trademark. This 'rendered the goodwill inoperable'. The judges agreed with HMRC that the open market value was £1 and JC Vision Ltd was not entitled to intangibles relief. The taxpayer's appeal was dismissed.

On the tax payable by Mr Conran, the Upper Tribunal agreed with HMRC that the £8.25 million payment amounted to a distribution. Mr Conran was the ultimate owner of the various entities and received the payment as indirect shareholder of the LLP. He was in effect 'simply moving his assets/cash around wholly controlled vehicles'.

The tribunal said the 'tax reducer clause – where if JC Vision Ltd did not get a certain tax treatment from HMRC the consideration reduced to £1 – showed Mr Conran was willing to protect shareholder value in that company at the expense of the LLP'. It was also consistent with Mr Conran being the architect and decision maker in the transaction. It was not consistent with a party acting at arm's length. The tribunal concluded the clause was far more consistent with the payment being made to Mr Conran as shareholder and not a partner.

HMRC's appeal was allowed.

HMRC v Jasper Alexander Thirlby Conran; JC Vision Ltd v HMRC [2023] UKUT 00166 (TCC)

Adapted from the case summary in Taxation (20 July 2023)

Leased accommodation to travellers

Summary – The supply of furnished and unfurnished apartments leased from landlords and let on to provide accommodation to travellers fell within the tour operator's margin scheme.

From 2017, Sonder Europe Limited provided accommodation in the UK to corporate and leisure travellers. Self-contained apartments, furnished and unfurnished, were leased from third party landlords and then sublet, with an average stay being five nights. The company made only cosmetic changes to the apartments before they were let in order to align the apartments with their brand's style. Occasionally, minor decorating work was carried out.

In VAT accounting periods ending 10/17, 01/18 and 04/18, the company accounted for VAT under the tour operator's margin scheme (TOMS), meaning VAT was accounted for on the net value of the taxable rent charged less the exempt leases from landlords.

In 2019, HMRC decided that the TOMS did not apply and sought to charge Sonder Europe Limited VAT at the standard rate totalling just over £250,000 on the rent charged to travellers, with no deduction for the exempt leases paid to landlords.

The company appealed.

Decision

The First Tier Tribunal disagreed with HMRC that to fall within the TOMS, the accommodation had to be holiday or hotel accommodation when bought in and when it was supplied onto the traveller. Nothing within EU or UK legislation suggested that this was the case.

To fall within the TOMS, the company needed to show that it provided services for the benefit of travellers which were the kind of services that were commonly provided by tour operators or travel agents.

The First Tier Tribunal stated that to do this the company must:

- acquire the accommodation for the purposes of its business;
- provide the accommodation for the benefit of travellers without material alteration or further processing.

The First Tier Tribunal found that the company:

- leased accommodation for the purposes of its business;
- provided serviced apartments on a temporary basis for the benefit of travellers, typical of the accommodation commonly provided by travel agents and tour operators.

Finally, the First Tier Tribunal found that the cosmetic changes made by the company prior to letting were not sufficient to make them 'material' or for them to be regarded as 'further processing'.

With Sonder Europe Limited satisfying the TOMS Order requirements, the appeal was allowed.

Sonder Europe Limited v HMRC (TC08853)

Cancellation of Flat Rate Scheme

Summary – HMRC had correctly applied best judgement but were wrong to retrospectively cancel the trader's ability to use the Flat Rate Scheme.

Pierre Divisia was a trader based in France who sold products via the Amazon retailer website. With some stock that he sold held in a UK warehouse, he was registered for VAT. Further, HMRC had authorised him to account for VAT under the Flat Rate Scheme.

Following a compliance review, HMRC:

- discovered errors;
- retrospectively cancelled the trader's ability to use the Flat Rate Scheme under its power 'to protect the revenue';
- issued a best judgment assessment based on Amazon VAT transaction reports for the periods April 2018 to April 2020, with output tax calculated based on 20% of UK sales.

Pierre Divisia appealed.

Decision

The First Tier Tribunal sympathised with the taxpayer. Had the goods stayed in France and only been sent to the UK to fulfil orders from UK customers, the taxpayer would have had no UK VAT liability 'as his "distance sales" to the UK would be below the threshold'.

However, with no control over how Amazon moved his goods, once stored in a UK warehouse, this created a VAT liability.

The Tribunal stated:

“Amazon moved his goods around between warehouses and, to the extent Amazon brought goods to the UK, this brought transactions in, or movements of, goods into the scope of UK VAT. As Amazon forced him to register for VAT in the UK, it brought his distance sales to the UK into the charge for VAT.”

The Tribunal found that HMRC had applied best judgment correctly using material submitted by the taxpayer and adopting a methodology that was carefully reviewed internally.

However, HMRC was wrong to withdraw Pierre Divisia from the Flat Rate Scheme as it was not clear to the Tribunal how terminating his authorisation retrospectively would protect the revenue. There had been no abuse but rather a misunderstanding leading to compliance failure. Terminating authority to use the Flat Rate Scheme would not help resolve this.

As a result, HMRC’s assessment was reduced to reflect the additional supplies as determined by HMRC, but the VAT had to be recalculated using the applicable Flat Rate Scheme rate.

The taxpayer's appeal was allowed in part.

Pierre Andre Divisia v HMRC (TC08843)

Share sale with a direct and immediate link

Summary – Although the share sale was exempt, the reason for selling the shares was to raise funds to be used to make taxable supplies, meaning that the input tax on the professional fees was recoverable.

Hotel La Tour Ltd sold its 100% subsidiary, Hotel La Tour Birmingham, to fund a new hotel in Milton Keynes. The company sought to reclaim input tax on professional fees of approximately £77,000.

HMRC refused the claim on the basis that as the sale of shares was exempt from VAT, it broke the direct and immediate link to taxable supplies.

On appeal, the First Tier Tribunal agreed that the direct and immediate link to “downstream” taxable activities with the construction of the hotel in Milton Keynes was not broken by the exempt share sale transaction.

HMRC appealed to the Upper Tribunal.

Decision

The Upper Tribunal agreed that Hotel La Tour Ltd sold the shares in order to raise funds which were used to facilitate future taxable supplies.

Consequently, the input tax on the professional fees related the company’s economic activity and not the exempt share sale. With a direct and immediate link between the services and the company’s “downstream” taxable economic activities; the chain was not broken by the sale of the shares.

The input VAT was recoverable. HMRC's appeal was dismissed.

HMRC v Hotel La Tour Ltd [2023] UKUT 00178 (TCC)

Time limits for VAT and penalties

Summary – Input tax claimed was denied for VAT periods December 2013 to June 2014. HMRC were out of time to claw back the input tax previously claimed in earlier periods.

Maxxim Residential Design Ltd carried on an architectural business and submitted repayment returns for the VAT periods from 03/13 to 06/14. The repayment returns for the periods 03/13 to 03/14 were paid to the company. However, the repayment return for the VAT period 06/14 was selected by computer for checking before payment was released.

On cross-checking two invoices where input tax of £2961.67 and £2,765 had been claimed, HMRC discovered that both the description and totals on the invoices had been changed. The suppliers had charged only £50 and £80 of VAT respectively.

In October 2015, unable to arrange meetings or contact the sole director and shareholder, HMRC:

- declared the company as a missing trader;
- cancelled the company's VAT registration;
- issued assessments to cancel all input tax claimed on returns for the periods March 2013 to June 2014.

Maxxim Residential Design Ltd appealed, arguing that the assessment was out of time as it had been issued more than 12 months after HMRC had sufficient facts available to raise an assessment.

Decision

The assessments were made on 28 October 2015 covering the VAT period 03/13 to 06/14.

S.73(1) VATA 1994 requires that assessments "shall not be made later than" the time limits set out in s.73(6) VATA 1994. These time limits were:

- two years after the end of the prescribed accounting period; or
- one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge."

The First Tier Tribunal confirmed that HMRC were in possession of the full facts on 4 August 2014, when they discovered the false input tax claims. With the 12-month deadline being 4 August 2015, the assessment dated 28 October 2015 was out of time.

However, the VAT periods from 12/13 to 6/14 were not out of time as they were periods which were less than two years after the end of the prescribed accounting period.

As a result, the assessments were:

- withdrawn for periods March to September 2013;
- upheld for periods December 2013 to June 2014.

Maxxim Residential Design Ltd (TC8834)