

## **Business tax update – December 2024 (Lecture B1466 – 20.56 minutes)**

### **Anonymity allowed**

*Summary – Discovery assessments arising as a result of the taxpayer failing to keep business records and to notify HMRC of his liability for almost two decades were upheld but the taxpayer's details were anonymised*

The taxpayer made an application for the appeal to be heard in private and the decision to be anonymised.

He stated that he was financially assisted by family in a country with a poor record regarding human rights, known to take action against residents who provided support to family members in countries such as the UK. He was concerned that there would be significant risk to his family in that country if the decision was not anonymised.

The First Tier Tribunal accepted the taxpayer's argument. Given the circumstances, this risk to the taxpayer outweighed the principle that justice should be done in public. As a result, the hearing was heard in private and the decision anonymised. The taxpayer is referred to as Mr E throughout

Mr E was a well-educated man, who had undertaken several courses of university study in the UK. He operated a takeaway food business which commenced business at some in 2000/01. However, he failed to notify HMRC that he was chargeable to tax and kept no business records for almost two decades. This was not disputed.

HMRC opened an investigation into Mr E's tax affairs in June 2018 and later, issued discovery assessments covering the tax years 2000/01 to 2018/19, together with associated penalties.

Mr E appealed but gave unusual and inconsistent explanations as to why he had not filed tax returns or kept business records.

He believed that he was not required to file tax returns because he was trading well below the VAT threshold but also claimed that he would be paid state benefits if he filed returns and he had decided not to file because he did not want to be a burden on the state.

With regards to his business records, he did not consider that it was reasonable for him to be expected to have kept business records after all this time.

Further, given his family obligations and situation, he should not have been expected to have kept any business records and also that due to his family obligations being onerous, he did not have the time or resources to keep business records

### *Decision*

The First Tier Tribunal stated that, given the inconsistencies in his arguments, Mr E knew that he was required to comply with tax obligations but chose not to do so. He made no attempt to confirm and comply with his income tax obligations when starting the business.

The First Tier Tribunal found that Mr E had been negligent meaning that the assessments were validly raised. His behaviour which led to the loss of tax was deliberate. Any disclosure was clearly prompted by HMRC's enquiry.

The First Tier Tribunal found that the penalties were correctly assessed as “deliberate and unconcealed”. Further, there was no reasonable excuse and no special circumstances applied.

Having considered the evidence presented, the First Tier Tribunal stated that it could not rely on any of Mr E's evidence that the shops were not capable of generating the turnover assessed by HMRC. He failed to meet the burden of proof on him to displace HMRC's assessment of turnover for the periods under appeal. The same applied to his deductible expenses, although small amendments were agreed.

The assessments and penalties were upheld as amended and the appeal was dismissed.

*E v HMRC (TC09307)*

## **LLP in business and tax transparent**

*Summary - The LLP was carrying on a "business" with a view to profit and so satisfied s.59A(1) TCGA 1992 at the relevant time. There was therefore no tax to assess relating to a transfer of loan notes to the LLP by its members.*

Gregory Hutchings, who worked in senior positions at Tomkins Plc until 2000, was the trustee of three family trusts. The trusts and GCH Corporation Ltd, which Gregory Hutchings controlled, built up substantial shareholdings in Tomkins Plc.

When a possible takeover of Tomkins Plc was announced, Gregory Hutchings sought advice on the sale of the trusts' and company's shares and decided to incorporate GCH Active LLP. The LLP's activities were limited, but it did purchase five unconnected shareholdings (two of which were disposed of shortly afterwards) financed by (what was subsequently documented as) a £200,000 loan from Gregory Hutchings.

When the takeover of Tomkins Plc completed:

- the trusts exchanged all their Tomkins Plc shares, and the company some of its shares, for loan notes issued by the buyer;
- the trusts and the company, as members of the LLP, sold the notes to the LLP at a 2% discount to face value;
- the LLP was then liquidated, redeeming the notes and selling its remaining three shareholdings.

The use of the LLP in this way was part of a tax mitigation strategy, which was disclosed to HMRC under the disclosure of tax avoidance scheme (DOTAS) rules. In summary, the intention was there would be no tax on capital gains on the transfers to the LLP, as it was tax transparent at that point; but it would become opaque on appointment of the liquidator, meaning it would be treated as having acquired the loan notes at the price paid by the LLP.

The result was an estimated £2.7 million tax saving (dwarfing the LLP's profits from other activities).

It was common ground that, if the LLP was tax transparent at the time of the notes transfer, the transfers were contributions of capital (rather than disposals of the notes) and that no additional tax would be payable by the appellants. This turned on whether the LLP was carrying on a trade or business with a view to profit.

HMRC said the LLP was not carrying on a trade or business and raised assessments.

### *Decision*

Although the LLP was established and liquidated primarily for tax purposes, the First Tier Tribunal found it was also established as a vehicle for an intended hedge fund-type business to which Gregory Hutchings devoted some time.

The First Tier Tribunal had little hesitation in concluding that the LLP was not trading. It then considered the case law drawn from various contexts on the meaning of 'business' and the statutory context in this case. It concluded that 'business' in the context of s.59A TCGA 1992 should be given its ordinary commercial meaning, which is broader than the meaning of 'trade' and does not exclude investment business. The First Tier Tribunal held that the LLP was in business and had a subjective intention to make a profit. It was therefore tax transparent at the time of the transfers of the notes, which were treated as tax neutral contributions of capital to the LLP by its members.

Note: a proposed change to the rules, effective for liquidations that commence on or after 30 October 2024, was announced in the Budget which inserts new s.59AA TCGA and deems that a disposal arises when an LLP is liquidated and assets a member has contributed are disposed of to the member, or to a company or other person connected to them.

*GCH Corporation Ltd and others v HMRC (TC09318)*

*Adapted from the case summary in Tax Journal (1 November 2024)*

## **Spotlight 65 – GDPR provision**

HMRC has highlighted that some tax agents are advising companies how to reduce their corporation tax liability by claiming a deduction for a GDPR provision in the company's accounts. HMRC do not believe that these claims are legal and will challenge those making such claims. Where such invalid claims have been made, HMRC may seek to recover the tax and charge both interest and penalties.

The spotlight includes HMRC's guidance on the action that a taxpayer should take if they have made an invalid claim.

### *How the provision works*

Companies are being incorrectly advised that:

- given the risks involved for non-compliance with the GDPR rules, companies should set aside a sum to provide for a potential breach of the GDPR rules.
- this accounting provision should be included in the latest tax return to reduce the tax payable for the period, or alternatively, the provision should be made by amending the previous year's tax return and so generating a tax refund.

HMRC say that agents are charging fees for this advice, calculated as a percentage of the tax saving/repayment, sometimes in excess of 30%. By the time HMRC make enquiries, the agent has disappeared.

On occasion, agents may try to link the claims to the process for claiming Research & Development tax credits, in order to falsely inflate the size of the R&D credit.

### *HMRC action against agents*

Tax agents that encourage or facilitate taxpayers making false claims for expenses, rebates, or tax credits may face penalties, suspension of their ability to make claims on behalf of clients and prosecution.

*<https://www.gov.uk/guidance/general-data-protection-regulation-gdpr-provision-used-to-reduce-tax-liability-spotlight-65>*

### **Spotlight 66 - 'The Partnership Model'**

HMRC is aware of a tax avoidance scheme called 'The Partnership Model', targeted at companies who have employees and designed to avoid the payment of Corporation Tax, as well as the PAYE deduction of Income Tax and NICs from their employees.

#### *How the arrangements claim to work*

An employee enters into an agreement, whereby their employment contract can be changed or terminated in exchange for a compensation payment.

An LLP is created and the employee becomes a partner of the LLP.

The employee's employment is terminated and/or varied under the terms of the agreement and compensation payments are 'made' to the employee but in reality, the employee never receives these payments as they are treated as a capital contribution to the LLP.

The LLP pays the employee as a partner in the LLP, allowing the company to disguise employment income and reduce its tax and national insurance liability.

HMRC's view is that this scheme does not work. Under the scheme, users continue to be employees and payments made to them from the company should be treated as taxable employment income.

*<https://www.gov.uk/guidance/limited-liability-partnerships-arrangements-used-to-disguise-employment-income-spotlight-66>*

### **Subsidised R&D expenditure or not?**

*Summary – With a commercial contract between the parties in place and no clear link between the price paid by the client and the expenditure incurred, R&D relief was available.*

Collins Construction Limited was an SME that designed and carried out refurbishment projects for large companies. Work tenders did not specifically include any research and development work but, on occasions, the company had to develop an innovative solution to deal with a specific problem. One example cited was an issue with reverberation, for which a bespoke method was devised. There was no dispute that this (and similar) expenditure had been incurred on research and development.

The dispute was over whether relief was prevented because the expenditure was subsidised.

S.1138 CTA 2009 defines subsidised expenditure as being expenditure that falls into one of three categories, being broadly where the expenditure is met by the provision of State Aid, a grant/ subsidy or the 'extent that it is otherwise met directly or indirectly by a person other than the company'.

HMRC claimed that the company's expenditure was subsidised as it fell into the third of these categories. The company incurred the R&D expenditure in the course of providing construction services to its client and was paid by the client. The R&D costs were effectively met by the end users and so the expenditure was subsidised.

The company argued that the contractual bargain with its clients was for an agreed price for carrying out works. It had to meet any costs of the R&D work out of the contract price and would often not know whether or not expenditure on R&D had to be incurred until work started. The company did not have a contract under which it was reimbursed by its clients for incurring specific costs.

### *Decision*

The First Tier Tribunal agreed with the company, stating that a very similar matter had come before a differently constituted tribunal in Quinn [2021] UKFTT 437 (TC). Although not bound by that decision, the principle of judicial comity meant that it should be followed unless a tribunal considered it to have been wrongly decided. Here, it did not believe that the decision in Quinn [2021] UKFTT 437 (TC) was wrong.

The key question was what was meant by the word 'otherwise'. In Quinn [2021] UKFTT 437 (TC), the First Tier Tribunal had interpreted those words narrowly, saying that they are meant as a sweep up provision for situations similar to state aid or grants and not as applying more generally to commercial situations.

In adopting the same approach, the First Tier Tribunal agreed that the expenditure incurred by the company had not been subsidised and therefore there was no restriction on the availability of relief. The company's "clients (did) not agree to pay or reimburse the appellants for particular costs... (and the company) did not agree to carry out the relevant R&D on being paid or reimbursed by the client for doing so."

*Collins Construction Limited v HMRC (TC09332)*

*Adapted from the case summary in Tax Journal (8 November 2024)*