Tax Updates – January 2024

Highlights

- HMRC has published the outcome of its consultation on a proposed reform of the UK's TP, PE and DPT regime.
- HMRC will start sending nudge letters to businesses selling via online marketplaces asking them to provide evidence that they are established in the UK.
- The Court of Appeal has published its decision in *HMRC v Dolphin Drilling Ltd* on the taxation of oil contractor activities.
- A few interesting VAT decisions have been issued on dual use and apportionment of residual input tax, the VAT treatment of Walkers Sensations Poppadoms, and whether cosmetic treatments constitute medical care.

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1. Upcoming hearings

UT: *Basic Broadcasting Ltd v HMRC* (Case ID: UT-2023-000018) – Hearing date: 5-9 February 2024 – IR35, contracts and conducting business on own account.

CA: *Northumbria Healthcare NHS Foundation Trust v HMRC* (Case ID: CA-2022-002498) – Hearing date: 6/7 February 2024 – VAT exemption on car parking services provided by an NHS trust.

UT: *Silverdoor Ltd v HMRC* (Case ID: UT-2022-000133) – Hearing date: 14 February 2024 – VAT financial services exemption.

UT: *Gary Lineker Media v HMRC* (Case ID: [2023] UKFTT 340 (TC)) – Hearing date: 19-20 February 2024 – IR35, partnership and direct contracts dispute.

UT: *Burlington Loan Management DAC* (Case ID: UT-2022-000144) – Hearing date: 19-23 February 2024 – Double tax treaty and main purpose test.

UT: *Invicta Motors Ltd v HMRC* (Case ID: UT-2022-000028) – Hearing date: 27-28 February 2024 – VAT overpayment claim

CA: *Blackrock Holdco 5 LLC v HMRC* (Case ID: CA-2022-001918) – Hearing date: 5 March 2024 – Unallowable purpose on loans and transfer pricing.

CA: *Hargreaves Property Holdings Ltd v HMRC* (Case ID: CA-2023-001517) – Hearing date: 12/13 March 2024 – UK withholding tax on interest.

SC: *Centrica Overseas Holdings Ltd v HMRC* (Case ID: UKSC 2022/0183) – Hearing date: 19 March 2024 – Capital allowances.

CA: *HMRC v Hotel La Tour Ltd* (Case ID: CA-2023-001883) – Hearing date: 10 April 2024 – VAT recovery on professional fees incurred from subsidiary share sale.

CA: *Kwik-Fit Group Ltd & Ors v HMRC* (Case ID: CA-2023-000429) – Hearing date: 16-17 April 2024 – Unallowable purpose loan relationship regime contained in the CTA 2009.

CA: *Beech Developments (Manchester) Ltd v HMRC* (Case ID: CA-2023-000952) – Hearing date 23-24 April 2024 – Construction Industry Scheme.

2. Legislation and consultations

Freeport tax sites: SI 2024/71 comes into force on 13 February 2024, designating areas in Humber as freeport tax sites. Tax reliefs available at such sites include SDLT reliefs, capital allowances on structures, buildings, plant and machinery, and business rates reliefs.

Consultation – IR35: HMRC has launched a technical consultation on draft regulations setting out the mechanism by which HMRC will be able to account for or offset tax already paid by individuals and their intermediary on income received from off-payroll working when recovering tax due under PAYE from the employer. The consultation closes on 22 February 2024.

Consultation outcome – International tax: HMRC has published its response to the consultation on proposed reforms to the UK's transfer pricing, permanent establishment and DPT regime. Changes are proposed to TP legislation to make the rules simpler, more certain, and better aligned with international tax treaties. The government intends to consider whether to align the definition of PEs with the OECD, and to bring the DPT regime within the CT framework. Stewarts have published an article on this.

Consultation outcome – Digital pound: The Treasury and Bank of England have published their response to a consultation from 2023 on the case for the potential introduction of a UK central bank digital currency for use by households and businesses for making everyday payments. The response concluded that primary legislation would be introduced before any introduction of a digital pound, which would guarantee users' privacy and prevent the Bank of England and government from controlling how a digital pound could be used.

Consultation – Alternative refinancing on property: HMRC has launched a consultation exploring proposals that would address the difference in CGT and capital allowance treatment which occurs when a commercial or residential property is refinanced using alternative rather than conventional finance methods. The consultation is part of a package of measures that aim to simplify the tax system and closes on 9 April 2024.

3. HMRC guidance, campaigns and other news

Supreme Court practice note: Lord Reed has issued a practice note announcing changes to the UKSC Practice Direction 3 (Applications for permission to appeal), Practice Direction 6 (The appeal hearing) and Practice Direction 7 (Applications, documents forms and orders). The changes largely relate to a move from the requirement for paper copies of documents to electronic copies and include a new requirement in PD 6.3.1 for permission to be obtained to file Appellant's and Respondent's cases longer than 50 pages.

ADR: HMRC has updated its guidance on the use of alternative dispute resolution in settling tax disputes to state that large businesses (most businesses with a turnover of more than £200 million or complex businesses) no longer need to contact their Customer Compliance Manager or caseworker before applying for ADR. If the business has made a tax appeal, it can apply for ADR after receiving an acknowledgement letter from the Tribunal.

Capital allowances: HMRC has updated its guidance to confirm that partnerships with corporate partners are able to claim capital allowances that are available only to companies within the charge to corporation tax, including first year allowances such as full expensing and the 130% super-deduction. Claims made via the partnership's CT computation will benefit the corporate partners of a partnership in proportion to their share of partnership profits. Individual partners who are subject to income tax will not benefit.

Horizon Shortfall Scheme: Postmasters in the Horizon Shortfall Scheme who did not receive their top-up payment in good time to file their self-assessment return before 31 January 2024 will not pay late filing or late payment penalties or interest. The aim of the top-up payment is to ensure that postmasters are put in the position they otherwise would have been in if their compensation payment had not been unduly reduced by tax. The top-up payments themselves are exempt from income tax. HMRC has set up a specialist support team for postmasters.

Nudge letters – Online marketplaces: An upcoming campaign of nudge letters will be issued concerning the place of establishment status of businesses selling via online marketplaces. HMRC will shortly be writing to businesses registered at agent or serviced office addresses asking them to provide evidence they are established in the UK. Businesses not established in the UK must be registered for VAT even if their annual turnover drops below the threshold of £85,000. The campaign is to ensure overseas traders operating through online marketplaces in the UK cannot undercut legitimate traders by not paying VAT.

R&D disclosure facility: HMRC is considering introducing a dedicated disclosure facility for R&D tax relief claims, as discussed at a meeting of its R&D Communication Forum. The facility will be designed to assist taxpayers in correcting mistakes outside of the 2-year time limit for re-submitting corrected accounts and may reduce any associated penalties.

Creative industries: From 1 January 2024, Audio-Visual and Video Games Expenditure Credit (AVEC or VGEC) has replaced the previous film, high-end TV, animation, children's TV and video games tax relief schemes. Tax credits will be calculated from qualifying expenditure instead of the previous rules which adjusted taxable profits. HMRC has now published guidance on the requirements for making a claim.

VAT grouping: HMRC has updated its VAT Notice 700/2 "Group and divisional registration". The main changes include the addition of a section on the interaction between VAT group changes and late submission penalties, as well as practical changes to group applications.

VAT & insolvency: HMRC has updated its VAT Notice 700/56 "Insolvency" to reflect the new penalty regime and the removal of the default surcharge. A few other practicalities are noted, for example, around how to submit a notice of intended dividend.

Value of tax penalties at record high: Research conducted by UHY Hacker Young has found that the value of HMRC tax penalties has increased by 25% in the last year, up from £681m in 2021/22 to £851m in 2022/23, the highest total value on record. The firm notes that a significant number of fines are withdrawn when challenged, with around half of penalties being withdrawn on appeal.

4. Recent decisions – Direct tax

"Incidental" use: *HMRC v Dolphin Drilling Ltd* [2024] EWCA Civ 1 (For HMRC: David Ewart KC and Quinlan Windle. For the taxpayer: Nicola Shaw KC.) - This case forms part of long-running litigation in the context of the oil contractor activities regime and the deductibility of vessel hiring costs when calculating profits for ring-fenced corporation tax. The dispute turned on whether it was "reasonable to suppose" that accommodation services provided by a multi-purpose vessel were "unlikely to be more than incidental to another use" in offshore drilling. After the FTT and UT both sided with the taxpayer, the case reached the CA which found for HMRC.

Although important in the specific context of the offshore oil industry, the CA's analysis of the term "incidental" will be of wider interest. After reviewing past authorities on its meaning, the court ultimately concluded that the accommodation function was "an independent aim in itself" and therefore could not be purely incidental. This arguably brings it into line with the approach for "main purpose" tests found in other legislation. Stewarts have published an article on the case.

Privacy in the FTT: *HMRC v The Taxpayer* [2024] UKUT 12 (TCC) (For HMRC: Hui Ling McCarthy KC and Barbara Belgrano. For the taxpayer: Michael Firth.) – This case involved an appeal by HMRC against FTT directions granting privacy and confidentiality orders in the taxpayer's favour in relation to procedural hearings. The order was intended to keep the taxpayer's identity secret until a future date when a decision could be made on the basis of evidence submitted by the taxpayer about whether such an order should be granted in relation to the substantive hearing.

Re-emphasising the "fundamental" presumption in favour of open justice, the UT overturned the FTT's decision. It rejected the taxpayer's arguments that the directions were necessary to prevent any future order from being "futile" on the basis that privacy in the procedural and substantive hearings were separate issues. It was also disproportionate to issue far-reaching directions without evidence against the vague promise of a future hearing. Privacy is a hugely important consideration for many taxpayers. Although the exact circumstances of the case were unusual, it emphasises the high barrier to such applications and the need for the taxpayer to adduce substantive evidence to support their arguments. Stewarts have written an article on the case for *Taxation*.

Late R&D claims: *Bureau Workspace Ltd v HMRC* [2024] CSOH 1 (For the taxpayer: Philip Simpson KC.) – This case concerned a taxpayer's judicial review of HMRC's refusal to allow a late claim for R&D credit. The original claim had been rejected because the taxpayer had not filed a CT computation until 20 days after the expiry of the deadline. Sch 18 FA 1998 did not explicitly require computations to be filed but did specify that the claim must be made in HMRC's required form. HMRC's published guidance imposed the requirement.

The court rejected the taxpayer's arguments that HMRC had acted unlawfully in failing to process the claim as well as a more interesting secondary argument that HMRC's refusal to use its discretion to accept the claim "out of time" was an example of *Wednesbury* unreasonableness. Reliance on the factors set out in HMRC's published guidance and emphasising the importance of the finality created by the statutory deadline was not unreasonable.

IR35: *PD & MJ Ltd (in liquidation) v HMRC* [2024] UKFTT 38 (TC) (For the taxpayer: Michael Firth. For HMRC: Georgina Hirsch.) – This case concerned whether Phil Thomson, a sports commentator working predominantly for Sky Sports through a personal services company, fell within the scope of the "intermediaries legislation". As usual, the issue turned on whether Thomson would have been an employee under the terms of the "hypothetical contract" posed in s. 49 ITEPA 2003. The FTT applied the recent authorities around the multi-factorial assessment of the taxpayer's circumstances and working arrangements under the *Ready Mixed Concrete* test. After reviewing the facts, the FTT concluded that the hypothetical contract would have been one of employment.

Commentators have contrasted the case with the opposite outcome in *S&L Barnes Ltd v HMRC* [2023] UKFTT 42 (TC) which concerned one of Thomson's fellow commentators at Sky Sports whose "actual contract" with Sky Sports was substantially the same. The difference illustrates the particular importance of circumstantial factors in establishing the terms of the hypothetical contract and therefore also the difficulty of planning around the regime.

5. Recent decisions – Indirect tax

Dual use: *HMRC v Hippodrome Casino Ltd* [2024] UKUT 27 (TCC) (For HMRC: Matthew Donmall. For the taxpayer: Andrew Hitchmough KC and Ronan Magee.) – The taxpayer operated a casino, bars and restaurants within the same building. It had originally recovered input tax on overheads based on floorspace, but HMRC refused its VAT claims on the basis that it should have used the standard method based on turnover. The FTT agreed with the taxpayer, but the UT allowed HMRC's appeal and held that the standard method provided a more precise measure of economic use of the facilities. This is because the restaurants and bars served a dual purpose: making taxable supplies of food and drink and also providing important amenities for the exempt gaming business.

The decision provides a useful analysis of the standard method and when it might be overridden, although given the UT's findings, it is difficult to envisage a situation where a different method might be more appropriate than one based on turnover. The analysis around what constitutes an ancillary supply is also worth a read.

Poppadoms vs crisps: *Walkers Snack Foods Ltd v HMRC* [2024] UKFTT 31 (TC) (For the taxpayer: Max Schofield. For HMRC: Giselle McGowan.) – This case concerned the VAT liability of Walkers Sensations Poppadoms. The taxpayer argued that they should be zero-rated on the basis that they did not fall within any of the exceptions to the zero rate. HMRC argued that the products were excepted from the zero rate as they were "products [similar to potato crisps, potato sticks, potato puffs] made from the potato, or from potato flour, or from potato starch" and were "packaged for human consumption without further preparation". The FTT agreed with HMRC on the basis that they were similar to potato crisps and the principle of fiscal neutrality would not be breached if they were to be standard rated.

This is a useful example of the application of the multi-factorial assessment that is often used when comparing the nature of different food products to determine their VAT liability. The decision is also an entertaining read, not least as it clarifies that Monster Munch is not "generally reserved as a food for monsters". The FT has reported on the case.

Cosmetic treatments: *Aesthetic-Doctor.com Ltd v HMRC* [2024] UKFTT 48 (TC) (For the taxpayer: Melanie Hall KC and Ciar McAndrew. For HMRC: Neale Tosh.) – The FTT held that supplies of cosmetic treatments by the taxpayer did not qualify for exemption as they did not constitute "medical care". Although the FTT accepted that some cosmetic treatments could qualify as medical care, they would have to be regarded as "diagnosing, treating and, in so far as possible, curing diseases or health disorders", as held by the CA in *Mainpay Ltd v HMRC* [2022] EWCA Civ 1620. The aim of most of the cosmetic treatments in question was to prevent or address ageing, which the FTT held was not a disease.

This the latest in a line of recent cases where taxpayers have tried to test the boundaries of what constitutes medical care. The FTT has so far not been persuaded to extend that definition to include cosmetic treatment of any kind. It will be interesting to see if any other taxpayers try their luck or if any of these cases end up before the UT or the higher courts.

Repayment supplement: *Bollinway Properties Ltd v HMRC* [2023] UKUT 295 (TCC) (For the taxpayer: Michael Ripley. For HMRC: Peter Mantle.) – This case concerned a property business group that acquired Toys "R" Us Properties Ltd ("TRUP"). TRUP sold 27 properties to the taxpayer, who sought to recover input tax on the purchase and claimed credit against its output tax. Bollinway claimed repayment supplement on the basis that HMRC had not paid the VAT credit promptly. The UT found in favour of HMRC as it was making reasonable enquiries into the claim and so there had been no delay. Due to this finding, it did not need to consider an argument around whether repayment supplement is available where a VAT credit is due as a result of the set-off of input tax against output tax.

Repayment supplement is available where HMRC delays a repayment for more than 30 days after a claim (subject to certain conditions, such as the fact that it was making reasonable enquiries). It is set at 5% of the repayment, which can be a sizeable amount – here, it was around £3.5m. In such cases, the Tribunal will have to undertake a day-by-day examination of the correspondence and HMRC activities over the relevant period, and any Tribunal decisions that help with that analysis are welcome.