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Corporate
VAT and Tax update Q2

Welcome to our quarterly VAT and Tax update for corporate entities. If you wish to explore any of the topics below in further detail and how they may impact your business, please contact a member of the team.

VAT

Fixed establishment

In the European Court case of Titanium Ltd, a Jersey company owning and letting property in Austria, the Court decided that as the company had none of its own staff in Austria and the property management was sub-contracted to a third-party property management company, the company had no fixed establishment in Austria.

The significance of this judgement is that while the place of supply rules state that a supply can be made or received where the supplier or customer belongs, a supplier or customer can only belong in a country if they have a fixed establishment in a country which is most closely linked with the relevant supply.

A fixed establishment can be created if an organisation has sufficient human or technical resources to make or receive supplies, so this judgement states that outsourcing work to a third-party does not give you sufficient resources to make or receive supplies.

Potential changes to VAT as it applies to land and property

HMRC issued a call for evidence on 12 May 2021 on simplifying the VAT exemption for land and property. This is most relevant to the property industry, but it could have a significant knock on effect to businesses in all sectors, not just for businesses who own properties but also businesses who rent properties.

The essential purpose of the call for evidence is to simplify the VAT exemption in this area. Alone that is unobjectionable, but the document revives a number of possible options which had previously been ruled out.

At present, most interests in land and property are exempt from VAT, but a person with an interest in land can choose to make an election to opt to tax to a property where the property in question is not residential.

The freehold purchase of a new non-residential building is automatically subject to VAT regardless of whether an option to tax has been made, except where the building is intended to be used solely for a relevant residential or charitable purpose.

The Office for Tax Simplification (OTS) had previously looked at this area and one of the options previously rejected by the OTS but now seemingly back on the table is the abolition of the option to tax. At first glance, this would be helpful for the property sector, but property developers would be unable to recover VAT on the construction of buildings which cannot be opted and would simply pass their irrecoverable VAT on to tenants through higher rent or purchase prices. So, in practice this may not benefit tenants as much as it would appear to.

An alternative option suggested is to reverse the position and remove the VAT exemption and subject all supplies of land and property to either the standard or a reduced rate of VAT, but with an option to exempt supplies. This would appear to increase the VAT burden across the sector and as it simply reverses the current position it simplifies nothing.

Another new option that has been suggested is whether one should define a short-term or minor interest in land. The issue here is that a bare letting of land would, subject to an option to tax, be exempt from VAT. However, if services are provided with the letting, then it makes it taxable, eg a business providing serviced office accommodation.

If all short term lets become taxable this change would achieve simplicity and remove the confusing borderline between what is exempt and what is taxable. However, if this will have an impact on the people using these short-term lets, eg non VAT registered start-ups simply wanting the use of an incubator space for an hour or so each week, care will need to be taken here.

The above is not an exhaustive list of the issues which could arise, and businesses are invited to send in their own suggestions as to what changes might be made.

Import One Stop Shop

Businesses trading with the EU should be aware of the further changes which were introduced from 1 July 2021 for cross border B2C ecommerce activities. From this date, the EU has abolished the existing distance selling thresholds and replaced them with an EU wide threshold of 10,000 Euros, which means that sales over this value are subject to VAT in the country of the customer.

Furthermore, the VAT exemption for low value consignments of a value up to 22 Euros will be removed, meaning that all goods imported into the EU will now be subject to VAT.

For UK businesses continuing to send goods, valued less than 150 Euros, from the UK to non-business customers in the EU, they will now benefit from the Import One Stop Shop (IOSS). This allows a UK retailer to register for VAT in one EU country and to register for the IOSS at the same time. The UK retailer would then charge the relevant VAT rate in the country where the goods are being sold, but these sales would be declared on a single IOSS return. This removes the requirement for businesses to register in every EU member state they are selling to and avoids the need to pass on responsibility for the importation to the customer.

Alternatively, if a UK retailer has opted to hold stock in one EU country and sends the goods to customers around the EU, they must register for the One Stop Shop (OSS) in the country where the stock is held. The key difference for UK retailers is the need to charge the relevant VAT rate in the country where the goods are being sold rather than the VAT rate applicable in the country where the stock is held.

Charging of electric vehicles

As the use of electric vehicles becomes more popular, HMRC have released a brief to confirm that supplies of electric vehicle charging at charging points in public places is subject to the standard rate of VAT and is not subject to any zero rate reliefs.

HMRC have also confirmed that input VAT incurred in respect of charging electric vehicles can be recovered if the vehicle is used for business purposes. In much the same way as petrol usage, a record must be kept of the business and private mileage of the vehicle with only the business usage allowing input VAT recovery.

Case law

Zero rating of construction of new building – change of use

On 31 March 2021 the Supreme Court released its decision on the case of Balhousie Holdings Ltd (Balhousie). The first grant of a major interest in a building designed as a dwelling, or a building which is intended for use for a relevant residential or relevant charitable purpose is zero-rated.

However, if there is a change of use such that the building is no longer used for a qualifying purpose, or the recipient disposes of its entire interest in the building within ten years from receiving a zero-rated major interest, then there is a form of clawback which imposes a VAT charge on the recipient.

Balhousie acquired a zero-rated new building which was intended for use as a relevant residential purpose, namely a care home. Instead of financing its acquisition by way of bank borrowings, it did so by entering into a sale and leaseback transaction. HMRC sought to argue that the sale of the building meant that it had disposed of its entire interest in the building and thus the clawback was triggered. In a fairly dismissive judgement, the Supreme Court rejected this argument since it had simultaneously leased the building back and therefore at no point did it not have an interest in the building.

Loan servicing by third party - not exempt

The Court of Appeal unanimously ruled that outsourced loan servicing is not exempt from VAT when the services are only performed after the loan has been granted. Target Group argued that HMRC and the Upper Tribunal had interpreted the exemption too narrowly in respect of UK and EU case law (when considering the services in respect of transactions concerning payments or debts, or as the operation of a bank account).

It was worth noting that the Court followed arguments put forward by HMRC, that it should adhere to the most recent Court of Justice of the European Union (CJEU) decisions, now reflected in UK law in accordance with the European Union (Withdrawal) Act 2018 following Brexit. Whilst the legislation allowed the Court to depart from such retained EU case law, it should do it only in narrow circumstances and in this case the Court decided to apply the EU case law.

Therefore, the Court closely followed CJEU judgments, most notably DPAS, which it felt clarified that Target Group could not rely on FDR and instead, it needed to be considered if Target Group's services as a whole, fulfilled the essential functions of a financial transaction. Ultimately the Court decided that they did not, therefore, exemption could not be allowed.

In lieu of an appeal to the Supreme Court this will form a precedent in UK law, so those providing third party loan servicing will need to review their own facts and decide whether they are adopting the correct VAT treatment.

Employment tax

Hybrid working arrangements

Throughout the COVID-19 pandemic it was possible for many office-based employees to be able to work from home.

Whilst the Government introduced an exemption for employer reimbursed expenses to cover the cost of relevant home-office equipment, the exemption will come to an end on 5 April 2022. Under the terms of the exemption employees will receive the full reimbursement for the purchase of equipment to enable them to work from home.

What are the wider implications employers need to consider where consideration is being given to the future of flexible, or hybrid-working arrangements? Now that the pandemic restrictions are being lifted the reason for working from home will primarily be a matter of personal choice where the employee will come into the office say two/three days each week and work the remainder of their time at home. Where this is the case, the office will remain the place of work and the cost of travelling to the office will not qualify for any tax relief.

However, where offices have been permanently closed, for example, as part of a significant reorganisation of the organisation, then consideration will need to be given to the following:

- What are the employee's duties?
- Where do they carry out their duties?
- Are they an area-based employee, responsible for say the East of England?

Whilst technology has moved on and the ability to work remotely is now so much easier the underlying tax and National Insurance rules associated with employee travel were last reviewed in 1998. Consequently, employers will need to consider the impact of the legislation as part of introducing any hybrid working arrangements:

1. Do any of the expenses associated with working from home incurred by the employee satisfy the 'wholly, exclusively and necessarily in the performance of the duties' conditions found in the legislation?
2. What are the income tax and National insurance implications of travelling to the office?
3. What can be reimbursed to area-based employees?

Meeting the wholly, exclusively, and necessarily test can prove challenging as all parts of the test need to be fulfilled; specifically the costs need to incurred in the performance of the duties and not simply to put the employee in a position to be able to carry out their duties. The strict application of the test was the reason why the aforementioned exemption was introduced for the reimbursement of home-office equipment during the pandemic.

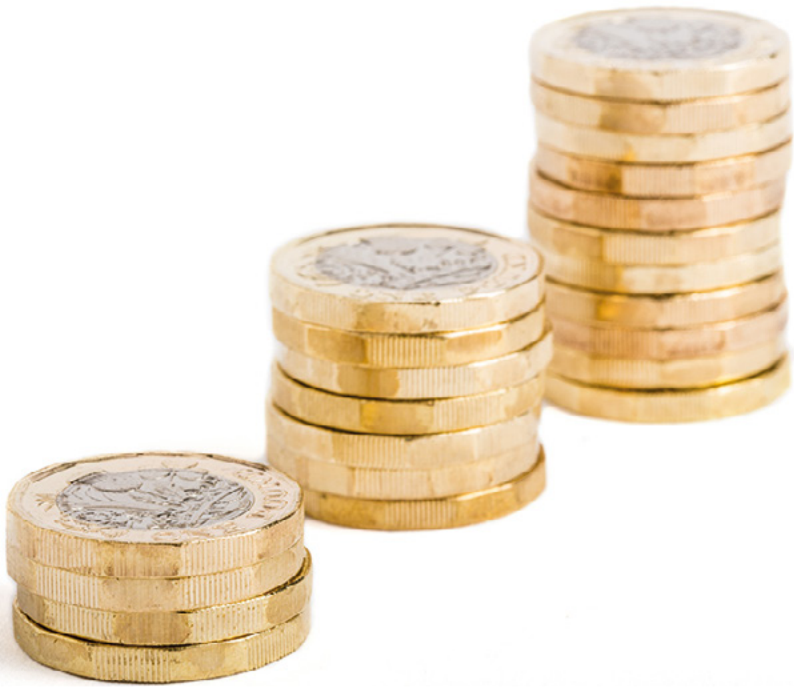
For a claim for tax relief to be substantiated it must be possible to demonstrate that it is a requirement of the employment that duties can be carried out at home and cannot be performed elsewhere. It is not sufficient to show that it is convenient, or even more efficient for them to be carried out at the employee's home. Consequently, travel from the employee's home to their normal place of work will be a cost of commuting and will not be allowable for tax purposes. The same restrictions will also apply to any journey which is substantially the same as the employee's normal commute.

For area-based employees any travel they undertake in their area will be allowable for tax purposes. However, where the employee lives outside of their designated work area, travel into the that area will be considered a cost of commuting.

Whilst the rules may initially seem fairly straight forward, employers need to ensure all internal staff policies and guidance clearly set out the following:

- The basis upon which all hybrid working arrangements will be applied
- State where the employee's normal place of work will be
- What costs the employer will reimburse to its employees

For many organisations the post-pandemic era will present a real opportunity to revise employee working practices especially where they can work, helping to provide a better work-life balance. A further benefit is the possibility to extend the catchments area for recruiting new employees and not being restricted to candidates based within reasonable commuting distance of the office. Where new policies are being introduced, we recommend they are fully reviewed to ensure they are compliant with current income tax and National Insurance legislation.



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Capital allowances - super deductions

At the Budget on 3 March 2021, the Chancellor announced the introduction of new temporary 'super' capital allowances for companies incurring qualifying capital expenditure in the period from 1 April 2021 until 31 March 2023. This incentivises companies to invest in new plant and machinery by enhancing and/or accelerating the tax relief available in the year of acquisition.

The changes made to the capital allowances regime introduce two types of increased relief for expenditure on plant and machinery:

1. Super Deduction: providing relief of 130% in the year of expenditure on most new plant and machinery that would have ordinarily qualified for the main rate writing down allowance of 18% per annum. *Examples: furniture, fittings and equipment, welfare facilities, security systems, etc.*
2. Special Rate Allowance: providing a first year allowance of 50% on most new plant and machinery that would have ordinarily qualified for the special rate writing down allowance of 6% per annum. *Examples: electrical systems (including lighting), cold water systems, air conditioning, space or water heating systems, lifts and external solar shading.*

There is no maximum limit on the amount of Super Deduction or Special Rate Allowances that can be claimed in the two year period to 31 March 2023. These new reliefs are, however, only available to companies within the charge to UK Corporation Tax and not sole traders, partnerships or LLPs.

The expenditure must be incurred on new unused plant and machinery to qualify and only where the contract was entered into after 3 March 2021 even if the expenditure is incurred after 1 April 2021. Expenditure on used or second-hand assets is excluded from the new reliefs along with assets falling within certain exclusions such as cars and plant and machinery used for leasing.

The above exclusion of leased plant and machinery in the original draft legislation created a barrier for landlords being able to benefit from these enhanced allowances on fixtures within a building that is let. There was, however, welcome news for property companies last month with a late amendment made to Finance Bill 2021 at the report stage to extend the Super Deduction and Special Rate Allowance provisions to background plant and machinery in leased buildings.

Background plant and machinery within a building is defined to be plant or machinery of a type that might reasonably be expected to be installed in the building and whose sole or main purpose is to contribute to the function of the building. This will therefore include the type of expenditure landlords typically provide such as electrical systems, lifts, heating and air conditioning systems and sanitary fittings.

There are special rules that apply on the disposal of assets on which the Super Deduction or Special Rate Allowances have been claimed to treat the disposal receipts as balancing charges, instead of being taken to the capital allowance pools. The balancing charge will be taxed at the Corporation Tax rate applicable at the time of the disposal. A company may therefore be taxable on a balancing charge at the main Corporation Tax rate of 25% on a disposal occurring after 1 April 2023 when the original relief was given at the current 19% corporation tax rate. Furthermore, if any asset on which the Super Deduction has been claimed is disposed before 1 April 2023, the disposal value for tax purposes will be 1.3 times the sale proceeds of the asset.

The Super Deduction and Special Rate Allowance will operate alongside the annual investment allowance (AIA), which currently provides 100% relief on £1m of qualifying plant and machinery per annum. The Super Deduction provides more tax savings than claiming the AIA, giving a tax allowance of £1.3m when qualifying expenditure of £1m is incurred. It will however generally be preferable to claim the AIA rather than Special Rate Allowances on the purchase of special rate pool assets where the expenditure is below the AIA threshold.

The Chancellor also extended the carry back of losses to three years at the Budget, which means that where a company cannot fully use the allowances available it may be able to carry back the losses for three years. The introduction of the Super Deduction and Special Rate Allowances have made the tax reliefs for companies investing in capital expenditure in the UK more generous than at any time in history and make it a positive time to be investing in qualifying expenditure from a tax perspective. The capital allowances regime and these new changes are complex so it is important that appropriate professional advice is obtained where you are looking to incur significant capital expenditure.

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Shortlisted 2019 National Firm of the Year

Shortlisted 2019 Tax Team of the Year

Highly Commended Partner of the Year

2021: Best auditor
2020: Best outsourced finance service

Winner: Audit Team of the Year

Top 15 auditor to quoted companies in Adviser Ranking Listing

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