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Not for Profit
VAT and Tax update Q4 2022

> The second half of 2022 has been very quiet from the point of view of the usual raft of case law developments, with only one case worth mentioning. However, it has been characterised by some very disappointing behaviour by HMRC.
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> As I set out some of these developments below, I can only hope that the coming year is better - both on the VAT front but, more importantly, for those struggling to get by in this country and elsewhere with the rising costs of living, and for the people of Ukraine.
>
> *Phil Salmon – January 2023*

VAT registration chaos

One might have hoped that 2022 would see HMRC performance improve in areas where staff returned to their normal duties after having been temporarily deployed on COVID-19 support measures. Sadly, that was not the case. I have previously praised the way the department responded to the pandemic and I think there was broad acceptance of the fact that performance elsewhere would suffer as a result.

But what we have now with regards to VAT registrations can only be described as chaos. Registrations are taking up to six weeks to be processed and group registrations up to two months, if not more. To cap it off, on 1 August, HMRC introduced a new VAT registration application system which, judging by the various flaws in it, was seemingly never tested. If ever there was a case of 'stop digging when you are in a hole', this was it – but not for HMRC.

This is not just something that affects new organisations, but existing ones too. For example, if a client is VAT registered as a VAT group with another company, which they wind up this means they have to deregister the group registration and re-register on a standalone basis. They now cannot issue VAT invoices for many weeks until they receive their new registration number.

Making Tax Digital (MTD) for all

I mentioned earlier in the year that MTD now applied to all VAT registered businesses, having initially been introduced only for businesses which were mandatorily registered.

The final move came on 1 November when the ability to submit returns via the old portal was switched off. With the exception of the small number of organisations who submit annual VAT returns, and whose last returns under the old regime will be due this coming spring, it is now only possible to submit a return via MTD unless you have exemption from using it – because of a lack of internet access, for example.

Options to Tax

The grant of an interest in non-residential property is exempt from VAT but it is possible to opt to tax it.

This means that if you sell or let a property, you would charge VAT on the selling price or the rent you charge your tenant. This allows you to recover VAT on costs related to the relevant property. The process of making an option to tax is a two-stage one, the first simply being the conscious decision to make an Option to Tax. The second is the notification of that Option to Tax. Only after 20 years (or in a handful of other circumstances) can an Option to Tax be revoked.

Clearly then, if you wish to sell a property, revoke an option or demonstrate to a tenant that VAT is properly chargeable, it is fairly vital that you know if you, or more commonly a predecessor, opted to tax a property and if so, on what date.

HMRC used to acknowledge receipt of notification of an option to tax and would generally respond to requests from taxpayers for confirmation of whether they had been notified of an option over a particular property. But, as with VAT registrations, there have been considerable delays in providing acknowledgements of receipt of options to tax.

HMRC's (un)helpful solution to the delays has been to announce that with effect from 1 February 2023, they will no longer issue acknowledgements of receipt of an option to tax. They will now only respond to requests for confirmation of whether they are aware of an option to tax having been made in certain circumstances, such as where the business believes one may have been made more than six years previously.

Business/Non-Business

The question of whether an activity is a business activity, and involves making taxable or exempt supplies for consideration; or is a non-business activity which does not, has always been relatively complex.

There is also an important point in that if an activity involves making taxable supplies by way of business, then VAT needs to be charged on the supplies, but is recoverable on the associated costs. Equally, if an activity is non-business, no VAT is chargeable and is usually not recoverable on the associated costs. However, it can mean certain reliefs become available.

Any clarification of HMRC's guidance is therefore welcome and HMRC did precisely that in late 2017. Representatives of HMRC attended our offices in early 2018 to speak to members of the Charity Finance Group and the amended guidance was broadly welcomed.

On 1 June last year, HMRC issued Revenue & Customs Brief 10 (2022) headed business and non-business activities. At first sight, this appeared relatively innocuous but from late summer onwards, we have come across a number of instances of HMRC officers citing this brief and using it to challenge the treatment adopted by our clients.

The old tests were originally derived from the Lord Fisher case in the 1970s. Lord Fisher organised shoots for himself, his friends and relatives. He accepted contributions from his guests towards the costs of organising the shoots. In other words, he made a supply in return for consideration. But for this to be VATable it also had to be made in the course or furtherance of a business. In the end, the Court held it was not, but in reaching its conclusion it set out what became known as the Lord Fisher tests.

The Court of Appeal in the Wakefield College case in 2018 refined these tests but not to the extent that they are substantially different. The updated tests set out in Wakefield are now reflected in the Revenue & Customs Brief. But the essential point remains that this is a two-stage test – firstly, is there a supply, and secondly, if there is, is it made in the course or furtherance of a business?

The Court of Appeal in Wakefield said "whether there is a supply...and whether that supply constitutes economic activity...are separate questions. A supply for consideration is a necessary but not sufficient condition for an economic activity. It is therefore logically the first question to address."

The Court went on to say that "satisfaction of the test for a supply for consideration...does not give rise to a presumption or general rule that the supply constitutes an economic activity". It went on to say that the answer to the question of whether there was a business activity required a "wide-ranging, not a narrow, enquiry". Both the Courts and HMRC guidance have also consistently said that motive is irrelevant in determining whether an activity is a business activity.

It is therefore somewhat concerning to see HMRC officers acting as though the Brief signalled some sort of major change when, in essence, the test remains the same. By way of example, I have had officers citing the Brief and then arguing that the fact that something is charged for automatically means it is a business activity, and other officers asking whether an activity is for the purposes of generating income without first ascertaining whether there has been a supply. These actions suggest that HMRC are still looking at this question from a narrow perspective and not the "wide-ranging" in-context view that the case law requires.

An example of this comes with the only case that I found interesting during the second half of the year, that of The Towards Zero Foundation. In essence, the case was about whether the organisation could recover all of its VAT because it only engaged in carrying out business activities, or only some of it because it also engaged in carrying out non-business activities.

The organisation is a charity whose primary objective is to achieve zero road test fatalities. It sought to achieve this through carrying out new car test assessments. In each jurisdiction where it set up these programmes, it purchased and crash tested individual models of cars manufactured for sale in that jurisdiction. The initial cars were purchased by way of a 'mystery shopping' exercise, with the purchase and the testing funded by the Foundation.

The results are published which informs customer buying behaviour which, in turn, drives manufacturers to improve safety features. Manufacturers then proactively seek and pay for further testing.

There was no dispute that paid-for testing was a business activity, but HMRC's view was that the initial testing which the Foundation carried out was a non-business activity and that it could therefore not recover all of its input VAT. In particular, they argued that the non-manufacturer funded tests could not be a supply, and that the purpose of carrying them out was to meet the Foundation's charitable objectives.

The Tribunal referencing the wide-ranging test in Wakefield and the two-stage tests found that you could not look at the 'free' tests in isolation, and that the critical question was whether the free testing was an independent activity. It found that on the basis of the evidence, it was clear that manufacturers would not have sought to have their vehicles tested on a paid-for basis without the initial testing having demonstrated flaws. As such, there was no separate non-business activity.

It seems that despite the helpful guidance released in 2017 and the confirmation provided by Wakefield, there is a two-stage test with similar questions being asked that were asked in Lord Fisher, HMRC still has a blind spot when it comes to ascertaining whether an activity is business or non-business.

At the heart of it, it seems to be that notwithstanding all the HMRC guidance stating that motive is not relevant, HMRC still seems to think it is, and that if you have a charitable motive for doing something, there is likely to be a non-business activity. This is despite all the case law to the contrary confirming that VAT is based on objective, not subjective, tests.

Take care with capital expenditure timing this year

There is a nasty trap affecting the amount of tax relief on capital expenditure in 2023 and early 2024 because of the interaction of the wind-down of the 130% super-deduction and the increase to the corporation tax rate on 1 April 2023.

It is not a simple case of pre-31 March 2023 qualifying capital expenditure obtaining relief at 130% @ 19% (effective tax relief rate 24.75%) and expenditure from 1 April 2023 onwards obtaining relief at 100% @ 25% (effective tax relief rate 25%).

Broadly, for companies with a **year-end other than March**, there are likely to be some months where the effective rate of tax relief dips. If expenditure cannot be brought forward to before 31 March 2023, **it may be better to delay expenditure until the start of the next accounting period**, if practical. The effect is most pronounced for year-ends close to (but not) March. Using a 30 April 2023 year end as an example (using months instead of days for simplicity to show the point):

Overall hybrid corporation rate for 30 April 2023 year end = (11/12 x 19%) + (1/12 x 25%) = 19.5%.

Super-deduction rate for 30 April 2023 year end = 100 + (11/12 x 30) = 127.5% (noting that the expenditure must still be incurred pre-31 March 2023 to qualify for the super-deduction).

This results in the following effective tax relief rate:

Period	Calculation	Effective rate
May 2022 - March 2023	127.5% x 19.5%	24.86%
April 2023	100% x 19.5%	19.5%
May 2023 onwards	100% x 25%	25%

The position would be even more acute for a 5 April 2023 year end, where moving capital expenditure by only a few days either way could make a circa. 30% difference to the tax relief received.

The simplest way to avoid this dip in tax relief would be to try and bring forward or delay capital expenditure, noting of course that this may not always be possible or commercially practical.

Holiday pay – consultation

The Government, via the Department for Business, Energy and Industrial Strategy (BEIS), has opened up a consultation on how holiday pay should be calculated for part-time workers who are employed on a contract, which can last for a full holiday year. This will typically include term-time workers within schools, with a greater impact on the charity and not-for-profit sectors, and those who are employed via a zero-hours contract.

The intention of the consultation is to address the anomalies following the Supreme Court decision in the Harpur Trust v Brazel case, which was published in July 2022. Currently, there is a disparity in the holiday pay entitlement between part-year workers and part-time workers who have a similar work pattern. Generally speaking, the case documents that part-year workers are potentially entitled to more holiday pay and leave, compared with colleagues who work on a part-time basis. This is a point which has been highlighted in the consultation.

Under the proposals, which are the subject of the consultation, holiday will continue to be calculated using a 52-week reference period with adjustments made where no work is undertaken.

However, for part-time workers and workers working irregular hours, the annual leave entitlement is calculated by a fixed reference period, with a worker's holiday entitlement being based on the actual time worked. What is being proposed is a two-step method of calculation:

Step 1: Employers will be required to calculate the total number of hours worked in the previous holiday year (including non-working weeks).

Step 2: Multiply the total hours worked by 12.07% to arrive at the worker's total statutory holiday entitlement in hours for the current year.

As previously mentioned, the intention of the consultation is to help resolve the unforeseen challenges which arose following the Harpur Trust decision. One of these challenges is that when reviewing the position over the previous 12 months, the employee may feel they are getting a lower level of leave to that which they believe they are entitled to.

The consultation closes on 9 March 2023.

If you have any queries on the above, please get in touch with your usual haysmacintyre contact or use the contact details overleaf.

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