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Corporate
VAT and Tax update Q4 2022

> Happy New Year and best wishes for 2023.
>
> The second half of 2022 has been very quiet from the point of view of the usual raft of case law developments. However, it has been characterised by some very disappointing behaviour by HMRC.
>
> *Stephen Patey – 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.

New interest and penalty rules

As a reminder, the new interest and penalty rules for VAT come into effect from 1 January 2023. Although this is technically a Q4 2022 update, I just wanted to remind people of the new position as you are reading this in January 2023.

The new rules have been brought in to replace the existing Default Surcharge regime and is a combination of a late payment penalty and interest for late VAT payments, and a separate penalty for late submission of a VAT return.

The new rules will apply to VAT return periods beginning on or after 1 January 2023, so returns ending in January and February 2023 will fall under the old rules. In most cases, the first relevant return period will be for the March 2023 quarter, though businesses that submit monthly returns will be caught by the new rules now.

I will cover this area further in the next update, but in the meantime, these rules were discussed in more depth in our article published in November 2022 here.

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.

Where are we on the IR35 rules?

The turbulence created by the announcements made during Liz Truss' ill-fated time as Prime Minister, especially concerning the decision to repeal the changes to the IR35 legislation, came as a major, unexpected surprise.

However, following the appointment of Jeremy Hunt as the Chancellor, the repeal has been reversed, but it has left many confused. This article attempts to make things a bit clearer and at the same time make some suggestions on what organisations should be thinking about as we head towards the later stages of the 2022/23 tax year.

What is IR35?

The IR35 legislation, which was first introduced in April 2000, was an attempt to reduce the loss of income tax and NI for contractors who provided their services via an intermediary - typically a personal service company (PSC). HMRC always felt that the level of compliance was very low, as the responsibility for considering the application of the legislation fell upon the contractor. Furthermore, challenging the status of contractors was, in HMRC's view, highly time consuming and expensive for all parties as often cases were referred to the tax tribunal to consider.

The changes which came into effect from both 2017 (public sector) and 2021 (private sector) saw the introduction of the Off-Payroll Worker (OPW) legislation, with the shift of responsibility for implementing the legislation moving away from the contractor and over to the engager, such as a school. The adoption of the OPW legislation in the private sector was delayed by a year, as part of the Government's response to assisting businesses during the pandemic. Furthermore, HMRC applied a 'light-touch' for the first 12 months before the private sector legislation came into effect.

Many organisations took the opportunity to review their existing arrangements and introduced processes to help with the decision-making procedures which needed to be in place. Examples of some of the changes which were introduced included:

- Centralising who has oversight of the contracts
- Undertaking reviews of the contracts
- Issuing status determination statements
- Putting in place a disputes resolution process

If an organisation has not put any procedures in place, then this is something which should be considered to help mitigate any potential challenges from HMRC or the worker themselves. We are expecting to see an increase in HMRC activity during 2023 - it is important that organisations regularly review their OPW and wider contractor arrangements on a regular basis.

HMRC has a wide range of anti-avoidance measures at its disposal, which it is expected to use post April 2023 to attack any perceived non-compliance in the supply chain. Furthermore, organisations will be required to retain copies of the decisions for up to six years in case of any HMRC enquiries.

Employment status

However, it is our experience that the more significant challenge is where any engagements are with the individual directly, as opposed to, for example, any PSC they may operate through. The question of employment status has always been present and will remain unaffected by recent developments.

At present, there is no statutory definition for income tax or NI purposes as to what is 'employment' or 'self-employment'. Consequently, it is necessary to take guidance from case law, provided by both tax and employment tribunals which has helped to identify several key characteristics to consider in determining whether a worker is employed or self-employed.

In the absence of any statutory guidance, to help differentiate between an employee and someone who is self-employed, the Courts have directed that all the facts of an engagement need to be ascertained and a holistic overview taken to determine the correct and true position.

The income tax and NI treatment for workers who are either employed or self-employed can prove significant in terms of, for example:

- Date when the tax is due for payment
- The class of NI due for payment
- The nature of tax-deductible expenses which can be claimed. For example, for someone who is self-employed, the expenditure must be incurred "wholly and exclusively" in the performance of the trade; whereas
- For an employee the expense must be incurred "wholly, exclusively and necessarily in the performance of the duties of the employment"

As well as the difference in the income tax and NI treatment, the school has the responsibility to ensure that where appropriate, all workers who are deemed to be employees should be put on to your payroll. Failure to do so could expose the engager with paying any additional tax and NI, as well as being exposed to interest and penalty charges. There may also be reputational risk associated with any non-compliance.

All the facts relating to the engagement need to be carefully considered and an overall picture obtained before a decision is reached, which will typically include, but not limited to:

- The measure of control over how the work is undertaken by the individual
- Provision of equipment
- Length of engagement
- The right to provide a substitute
- The extent of any financial risk the contractor will be exposed to

Once all the facts have been established, it will then be necessary to consider whether the contractor leans more towards employment or self-employment. In cases where there is a lack of clarity, either the use of HMRC's Check Employment Status for Tax Tool (CEST) or seeking professional guidance, will help the engager reach a sensible decision. However, the obligation to correctly determine the tax status of any worker sits with the organisation as the engager and not the contractor who is providing the services.

The Courts have also considered the question of the terms of an engagement.

Whilst a contract may stipulate, for example, that a substitute can be provided, HMRC will want to understand the working reality of any such arrangement. Where the facts of any engagement vary from those of the contract, then facts will take priority.

It is recommended that organisations should ideally review contracts before any work is undertaken, certainly before any payments are made.

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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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

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