haysmacintyre

Not for Profit VAT and Tax update Q2

Everything starts with good intentions, and I had hoped to be able to write this quarterly. It was all going so well, but then Q1 of this year did, of course, clash with our year end and somehow, I never recovered sufficiently to write anything in April, and then the last two months have flown by. But here we are with a Q2 update covering the various developments since I last wrote in January.

At the time I wrote this the weather was a mixture of sunshine and showers but as I put the final touches to it we are in the middle of a heatwave, so I am not sure whether going outside to read this is necessarily wise. Anyway I hope you enjoy the rest of the summer.

- Phil Salmon, June 2022

City YMCA – a case of whatever you are doing, HMRC won't like it

On 17 December, the First-tier Tribunal handed down its decision in the case of City YMCA, though the case was not released publicly until January. City YMCA is a client of haysmacintyre and we were involved in the early stages of the dispute, though the case itself was defended by another firm. The question was: what rate of VAT should it charge on its supplies of accommodation to residents, and could it reclaim VAT on costs?

Accommodation in an hotel, inn, boarding house or "similar establishment" is subject to VAT at the standard rate. Where stays are for a continuous period of use in excess of 28 days, a reduced valuation provision applies. This effectively gives a reduced VAT rate as VAT is only applied to services provided in addition to the accommodation, subject to a minimum 20% which gives an effective minimum VAT rate of 4%.

HMRC's guidance confirms it regards hostels as "similar establishments", and so City YMCA had charged VAT at this effective lower rate of VAT for residents after the initial period of 28 days, before which they charged VAT at 20%. This was previously quite common and uncontroversial but over the last few years, HMRC had been arguing in a number of other cases that it should not be the case for various different reasons.

City YMCA commenced building a new hostel, incurred VAT and recovered it on the basis that it would be making taxable supplies of long stay accommodation to its residents at the effective 4% rate. HMRC initially accepted this. But HMRC then decided in 2017 that it was not providing accommodation but was instead providing welfare which is exempt from VAT. HMRC then sought to deny the recovery of VAT on the costs of construction of the new hostel.

It did not meet any of HMRC's usual tests for providing welfare such as having individual care plans and whilst residents were homeless and in need of support, it essentially provided this support through signposting residents to other service providers, rather than providing any sort of welfare itself.

We assisted in drafting correspondence to HMRC refuting this and HMRC reverted to accepting the supply was standard-rated, but subject to the reduced valuation provision

HMRC then started arguing, contrary to their own guidance, that hostels were not similar to hotels. In effect, this meant it was providing some sort of residential accommodation but different to a hotel and it was therefore exempt (again), so VAT could not be recovered on the construction costs. Correspondence between HMRC and City YMCA continued and HMRC then changed their mind again. This time they argued that since the licence agreement did not give exclusive possession of the resident's room, the supply was not in fact exempt, but standard-rated, but not capable of benefiting from the reduced valuation. This left the YMCA having to pay 1/6th of each resident's Housing Benefit over as VAT which meant they would struggle to house homeless people.

The case was eventually heard in March 2021, but judgement was not handed down until December 2021.

Dr. Poon, the Tribunal judge found that "As a matter of fact, the temporary nature of the accommodation provision is the very essence of the Supply..... [It] therefore falls to be a supply by a 'similar establishment of sleeping accommodation'".

She rejected the HMRC argument that members of the public could not just book accommodation as irrelevant, so after four years, City YMCA was back to its starting position.

This was an important case because HMRC had been successful in their argument with several other hostels in the last seven years or so, but when I was reviewing earlier case law, a fairly cynical pattern emerged as prior to the recent spate of cases, six earlier cases had considered the position of a hostel for homeless people.

In four cases where the appellant argued that they were providing exempt welfare, HMRC argued that they were providing taxable accommodation on the basis the accommodation was similar to that provided in an hotel

In two cases where the appellant argued that they were making taxable supplies in order to claim back VAT on construction work, HMRC argued that they were making exempt supplies, and in one of these cases, the judge specifically said the situation was likely to be unique because all the residents were from psychiatric institutions such that it was more like a care home than a hostel.

In the other case where exemption was found to be the answer, the appellant had no professional representation and the Tribunal was not alerted to all the other cases stating that the supplies were taxable. In addition, the position has been considered by the European Court on two occasions which said that the supplies were taxable.

If there is a more general message for charities who find themselves challenged by HMRC, stand your ground.

Early termination and compensation payments

The treatment of many payments which have previously been regarded as outside the scope of VAT because they represented compensation were thrown into doubt when HMRC released Revenue and Customs Brief 12 (2020). This brief indicated that following two European Court cases where the contract provided for a payment to be made to terminate a contract early, the payment was not compensatory by nature. Instead, it was simply additional consideration for the original supply.

Following what could fairly be described as an outcry, HMRC decided not to enforce this change of policy whilst they reviewed it. Their revised policy was set out in Revenue and Customs Brief 2 (2022). The Brief essentially said that HMRC were largely going to proceed with this change of policy but with effect from 1 April 2022 and not retrospectively.

It also said that dilapidation payments would remain outside the scope. Such payments are made when an outgoing tenant has an obligation under their lease to put a building back into a fit state, but instead of doing so, agrees with the landlord that they will instead make a payment to the landlord to carry out this obligation on their behalf. It was uncertainty over the status of dilapidation payments that had caused the biggest outcry to the Brief, as the factual pattern was entirely different to the European cases which HMRC were citing as supporting their change of policy.

Installation of energy saving materials – a Brexit bonus of sorts

The UK was obliged to amend its VAT rules on the installation of energy saving materials in 2019 following challenges from the EU as to whether the law as drafted went beyond what was permitted under the EU Directives.

The amended law allowed the reduced (5%) rate of VAT to apply to the installation of such materials where certain social policy conditions were met (supplies to people aged 60 or more or in receipt of certain benefits, housing associations or installations in accommodation used solely for relevant residential purposes), or where the cost of the materials did not exceed 60% of the total value of the supply. If the cost of the materials did exceed 60%, then only the labour element qualified to be reduced-rated.

These social policy conditions and the 60% test have been withdrawn from 1 April 2022. The reduced-rate has been replaced by the zero-rated until 31 March 2027 and wind and water turbines have been added to the list of energy saving materials which qualify.

Revised Business/Non-Business guidance – or is it?

On 1 June, HMRC published Revenue and Customs Brief 10 (2022). The Brief purports to be an update to their policy on what constitutes a business activity. It starts off by referencing the decisions in Yarburgh Children's Trust and St Paul's Community Project where the courts had found (and HMRC accepted) that nursery and creche facilities supplied by charities (for consideration fixed at a level designed to cover costs only) was not a business activity. It goes on to say, "In determining this [whether an activity is business] there should be no reliance on an organisation's overall objective or profit motive.".

It then went on to state the well known tests set out in the Lord Fisher and Morrison's Academy Boarding Houses Association cases saying how they have been used to decide whether an activity is a business activity, saying, "More recent judgements have helped to clarify that these criteria are only indicators and they cannot replace the principles set out by the courts in determining what constitutes a business".

Pausing there, I can't help but think, "Really?", (well actually I was thinking of a less polite phrase ending in Sherlock) as I am unaware of anyone ever thinking that they were anything more than indicators or a set of tools which help answer the question. The cases which HMRC are referring to are those of the Court of Appeal

in Longridge on the Thames and Wakefield College from 2016 and 2018 respectively. The reason I query whether this is revised guidance or not is that I am unaware of anyone who, in answering the business/non-business question, has not taken account of these cases along with the earlier ones.

The Court of Appeal in Wakefield set out what it referred to as a two stage test where stage one is to consider whether there is a supply made for consideration. If not, there is no business activity. The Court went on to say making a supply for consideration is a necessary condition, but not a sufficient condition for an economic activity.

The second stage was to ask whether the supply is made for the purpose of obtaining remuneration. The Brief states, "Simply because a payment is received for a service provided does not itself mean that the activity is economic. For an activity to be regarded as economic [business] it must be carried out for the purpose of obtaining income (remuneration) even if the charge is below cost.".

The Brief then has the sub-heading "Changes to HMRC's Policy" and then goes on to say "HMRC's long-standing policy has been that a business activity is possible even in the absence of a profit motive."

In light of the recent cases, as set out in this brief, HMRC will no longer apply the business test based on the 6 indicators from Lord Fisher and Morrison's Academy in determining whether an activity is business.

The 2-stage test given in this brief, is the approach that should be taken in determining whether an activity constitutes a business activity.

Businesses can no longer rely on the old "business test" to decide whether an activity is business or not, but it can be used as a set of tools designed to help identify those factors which should be considered."

Is this revised guidance? I don't think so. It is long settled case law that a profit motive is irrelevant for determining whether there is a business activity. The Fisher 'tests' were never more than a set of indicators or tools, and I don't think anyone has thought of them as anything other than that for years.

Longridge has been with us for six years now and has been factored into people's consideration of whether an activity is business or not. The test in Wakefield says, "For an activity to be regarded as economic [business], it must be carried out for the purpose of obtaining income".

So, if Yarburgh and St Paul's came before the Court's today, what would the answer be? I am not convinced the result would be any different because the 'purpose' of charging a fee was not to obtain income. That was not (to revert to Fisher) their predominant concern. Their predominant concern or purpose was to provide nursery and creche facilities. Charging the fee was a means to help them to do this as a necessary condition, but not a sufficient condition to make it a business activity.

So, if the purpose has to be something more than simply charging, what is it? It seems to me that in answering the question of whether there is a business activity, the old indicators in Fisher are still relevant, even if the answer is as elusive as ever.

Health and Social Care Levy – latest thinking

After much debate within the press, the Government has introduced the Health and Social Care Levy (the levy), with effect from April 2023. In the meantime, the first step towards introducing the levy has seen a temporary increase in National insurance of 1.25% for both the employer and the employee which came into effect from 6 April 2022.

The increase in the National Insurance rates will also apply to the Class 1/1A and 1B National Insurance rates as they will apply to the provision of benefits in kind or taxable expenses provided by the employer.

However, the following questions have been asked over recent months:

Q. Are charities or any non-profit sectors exempt from the levy?

A. No, there are no exemptions available to charities or other non-profit making organisations.

Q. What will the impact be from 6 April 2023?

A. For employers, the levy will be a standalone charge of 1.25% and, as previously mentioned, the increases in various categories of National Insurance will revert to their pre-April 2022 rates. Similarly, for employees, who are not in receipt of the state retirement pension, there will be no change in the combined level of National Insurance and Levy they are due to pay. However, for employees who are in receipt of their state pension and not due to pay employee's National Insurance, unless there is a change to the draft legislation, they will be liable to the 1.25% levy.

Q. Is there anything an employer can do to help mitigate the impact of the levy?

A. Yes. For employees who are participating in a defined contribution pension scheme, then the use of a pension salary exchange (also known as pension salary sacrifice) can help to mitigate the impact of the levy.

A pension salary exchange is a legitimate method of reducing not only employer and employee National Insurance liabilities, but also the salary upon which the levy charge will be calculated. The pension salary exchange works by agreeing with the employee to reduce their salary in exchange for the employer paying the equivalent amount in pension contributions on behalf of the employee.

Both the employer and employee will pay less Class 1 National Insurance and the Levy too! This is due to the fact that the liabilities are calculated by reference to the post pension salary exchange earnings.

Benefits of the pension salary exchange

The following provides a summary of the benefits which can be obtained by both the employer and any participating employees:

- As well as the National Insurance savings, the employee receives tax relief immediately at their marginal tax rate
- This is particularly beneficial for a higher rate taxpayer who then does not have to claim the additional tax relief via their Self-Assessment Tax Return
- The employer can share all or part of its National Insurance savings with the employees in the form of additional pension contributions; or
- Use the employer National Insurance savings to help fund part of the Health and Social Care Levy costs
- Provide additional funds to provide new staff benefits such as additional life cover or other minor benefits
- Can be used as both a recruitment and retention tool
- Enhanced duty of care-helping employees better prepare for their retirement with such income planning and, consequently, make a real difference to their employee's future.

Whilst the use of pension salary exchange should not be used for staff who are members of a defined benefit pension scheme, it should certainly be considered for staff with a defined contribution scheme or where any employer is in the process of closing its use of a defined benefit pension scheme and replacing it with a defined contribution scheme.

Whilst many employers will be familiar with salary exchange arrangements, it is important to ensure all aspects of the scheme are fully considered. HMRC places considerable emphasis on the employer making its employees fully aware of what it means which will typically include providing:

- Illustrative models
- Staff communications
- Guidance for employees
- Details of how the salary exchange are reported on an employee's payslip.

The use of salary exchange can also be used in conjunction with cycle to work schemes and electric vehicles too!

Job retention scheme, post payment pain!

During the pandemic, many organisations were reliant upon the support provided by the Government in the form of the Coronavirus Job Retention Scheme. We are now seeing HM Revenue & Customs (HMRC) commencing enquiries into the claims made, often more than two years after a payment was made!

Why are HMRC taking such an interest?

11.7 million employee jobs were furloughed through the scheme, at a cost of £70 billion . If we look back before the first version of the Treasury Direction was published on 15 April 2020, the guidance published by HMRC changed many times. This meant that employers could not make informed decisions and mistakes will have occurred during this very challenging time.

HMRC are now taking steps to recover the excess claims.

This article is not going to comment on fraudulent claims but will look at the points which HMRC are raising during the course of their enquiries.

Nudge letters – the first gambit

Back in the Autumn of 2020, HMRC issued approximately 26,000 'nudge' letters, effectively invitations to employers asking them to review the claims previously made and, where appropriate, correct any errors identified.

Where an employer has identified an error, it is possible to repay the overstated amount via the government portal.

HMRC enquiries

However, if we fast track to today, enquiry notices requesting significant amounts of information are being issued, with a typical request covering but not limited to:

- Name, address, and National Insurance number for the employees
- Furlough start and end dates for claims
- How the claims were calculated, including the employers National Insurance and pension contributions under the first version of the scheme
- Whether the amounts received by the employer were paid to the furloughed employee, with evidence to demonstrate the position
- Under the flexible furlough version of the scheme, how the employer determined each employees contracted compared with actual hours worked

The position can be further complicated where employees may have joined the employer ahead of 19 March 2020 (or 30 October 2020), for example, where a transfer under the TUPE regulations arose just before the country went into lockdown. HMRC are seeking to establish whether employers were entitled to receive grant payments for those employees.

What do employers need to do?

Unfortunately, ignoring any enquiry is not an option!

Once an employer has received a letter, consideration should be given the following:

- Who at the employer will take responsibility for dealing with the enquiry?
- Ensure you can meet any deadlines included in HMRC's letter
- If you do not believe you will be able to meet the deadline, consideration should be given as to when a complete response can be provided

Dealing with any HMRC enquiry should be approached with caution, and where appropriate, professional advice should be obtained.

Were employees working whilst on furlough?

Whilst HMRC will be looking at how claims were calculated, they also want to establish whether an employee was working (especially during the initial lockdown period) whilst supposedly placed on furlough:

- What notices and information were issued to employees when they were placed on furlough?
- Request access to email records to see if the employee was answering emails whilst on furlough
- Mileage records to establish if employees were driving on company business
- Building access, including CCTV records to see if employees were going to work whilst on furlough

Consequently, information requests may be very detailed and time consuming to collate. On a cautionary note, HMRC are taking a hard line and using the statutory powers available to them to issue formal notices to enforce deadlines for the submission of information. Failure to observe those deadlines can result in penalty notices being issued.

Liabilities are identified

During the course of an enquiry, where any failures are identified, the overstated claim will be recovered by HMRC via a notice of assessment, which will be raised only once the enquiry is concluded and all liabilities are confirmed.

HMRC can impose penalties where payment of the final liabilities is paid late on the following basis:

- Between 30 days and six months late, an initial penalty of 5% of the tax owed
- Between six months and 12 months late, the penalty above and a further penalty of 5% of the tax that is still owed
- 12 months late or more, both of the penalties above and a further penalty of 5% of the tax that is still owed

It is important that once liabilities are being agreed with HMRC, the business is aware of the cost implications should any business want to 'spread' the repayment of the overstated claims.

It is clear that HMRC are actively taking steps to see whether employees were working whilst on furlough. Employers must be mindful that, much in the same as with National Minimum/Living Wage enquiries, there is also the reputational risk of being 'named and shamed'.

Who is receiving enquiry notices?

Currently HMRC are issuing enquiry notices to a wide range of employers and not necessarily specific sectors. Examples of what could instigate an enquiry can include:

- Risk based review based upon the 'real time' payroll submissions
- Whether any corrections were made to claims whilst the scheme was running
- Any 'whistleblowing' made by an employee, or former employee

At present, no single industry sector is being targeted.

Conclusion

HMRC are starting to recover a small proportion of the excess claims originally overpaid. Where an enquiry notice is received, it should be actioned as soon as possible. Sadly, it is expected more enquiry notices will be issued over the course of this year.

Gift Aid and naming rights

Guidance issued by HMRC regarding Gift Aid and naming rights has recently been updated to help clarify an area of uncertainty.

In summary, a charity may offer a certain amount of benefits as a consequence of receiving a donation, in order to thank the donor for their gift. These benefits are valued using specific criteria and assessed against the level of donation received in order to establish whether the benefits fall below the limits allowed. Where the benefits fall below the limits, Gift Aid will be available (where the donation meets all other Gift Aid criteria). However, some benefits do not need to be valued at all for the purpose of these calculations and common examples include: literature about the charity's work, acknowledgements of the donor in charity literature and naming of buildings.

The guidance has now been updated to confirm that as long as the naming of the building or wing does not act as an advertisement or sponsorship of a business, then naming can be ignored for the purpose of the benefit rules. It goes on to confirm that a plaque recording the individual donor's name, and the fact that they made a donation to the charity, will not be considered a benefit.

The purpose of this guidance is to cover scenarios where a charity may wish to thank a donor that has made a substantial or otherwise generous donation to the charity. It is not designed to cover scenarios where a charity offers a 'right' to naming, for example theatre seats, in exchange for a specific payment, which may not be considered to be a donation at all. Care must be taken to distinguish between outright donations and payments in exchange for goods or services provided by the charity. The latter is the provision of goods or services and does not attract Gift Aid, regardless of the level of benefits given.

Theatre Tax Relief case

Theatre Tax Relief (TTR) has been with us for around eight years now, but there has been very little in the way of case law regarding these claims. However, we have now seen the details of a first-tier tribunal case from September 2021 on this very topic – SGA Productions Ltd v HMRC.

The claimant company, SGA Productions Ltd (SGA) produced live stunt and puppet shows at Legoland Windsor and Whipsnade Zoo. SGA were responsible for the staging, casting, running and management of the performances and subsequently made a claim for TTR in the region of £60k.

SGA ran a number of different performances each day to a live audience and under their contract with the operators of Legoland Windsor and Whipsnade Zoo, received payments for this service including payments based on running costs incurred. These payments were not dependent on visitor numbers and no payments were made directly by visitors to SGA for the performances. Visitors to the attractions did, of course, make a payment to enter the attractions for the day, but no part of that ticket price was advertised as relating to attendance of the live shows. The shows were effectively part of the attraction.

HMRC accepted that SGA met the requirements of being a production company and that the performances themselves were theatrical productions as set out in the legislation. However, HMRC contested the claim made and, in particular, argued that the commercial purpose condition had not been met.

In order to meet the commercial purpose condition, a production company must intend for the performances to be to *paying members of the general public*. For these performances, the only payments made to SGA were under its contract with the operators of the visitor attractions and no payments were made directly by the members of the public that attended the performances. It was noted that there was no distinguishable part of the visitor attraction ticket price specifically for admission to the live performances.

In summing up the case, the Judge concluded:

> *"I consider that the natural and ordinary meaning of "paying members of the general public" should, in the context of Theatre Tax Relief, be understood as meaning that the relevant members of the public have made a payment that is referable specifically to the theatrical production in respect of which a claim for relief is made."*

It was therefore clear that the attendees of the performance must make payment for such attendance, either via a direct ticket payment to the production company, or via an agent, perhaps in this case, the visitor attraction. In this case, however, no such payment had been made. The judge did however indicate that had there been a separate charge to attend the live performances, then the claim may have been allowed.

This is a timely reminder that the detail of the legislation must not be overlooked when making this type of claim. Please contact us if you wish to discuss TTR or any other creative sector tax relief claims.

haysmacintyre

haysmacintyre
10 Queen Street Place
London EC4R 1AG

T 020 7969 5500
F 020 7969 5600
E marketing@haysmacintyre.com

www.haysmacintyre.com
@haysmacintyre

A member of
Global Alliance
Independent legal & accounting firms

We are a Living Wage Employer

Committed to Sustainability

Contacts

Phil Salmon
Partner, Head of VAT
T +44 (0)20 7969 5611
E psalmon@haysmacintyre.com

Nick Bustin
Employment Tax Director
T +44 (0)20 7969 5578
E nbustin@haysmacintyre.com

Louise Veragoo
Not for Profit Tax Director
T +44 (0)20 7969 5682
E lveragoo@haysmacintyre.com

Shortlisted 2019 National Firm of the Year

Shortlisted 2019 Tax Team of the Year

Highly Commended Partner of the Year

Winner: Audit Team of the Year

Winner of the Bronze Award for 2018 and 2017

Top adviser to the top 5,000 charities, Charity Financials' league table 2021

Top ten by audit fees in the 2020 Charity Finance Audit Survey