Lessons from the courts

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I think it is important that advisers read the judges' reports of major tribunal cases heard in the various courts. A VAT case a day keeps the doctor away, so to speak. A decent case gives you three goodies for the price of one: you learn about HMRC's approach to dealing with practical issues; the strange interpretation of the law by some business owners; the decisions of experienced judges based on a close analysis of the legislation, usually VATA 1994.

Here are my top five learning points from recent cases.

Lesson 1 – You need to justify the zero-rated and exempt sales made by your business

Any income received by a business that is not subject to VAT must be fully justified and meet the necessary conditions imposed by either HMRC or the legislation. This lesson was learned by Adrian McKiernan (*McKiernan (t/a AMK Fuels)* [2023] TC 08713), whose inadequate record-keeping led to HMRC rejecting his argument that his retail sales of coal qualified for 5% VAT.

The taxpayer argued that HMRC should have considered the 'spirit of fairness' and recognised that he had overpaid VAT as a result of 'lack of knowledge of the law'. His representative claimed that HMRC should 'look at the situation from a lenient and sympathetic point of view'. The judge dismissed these arguments; it was all about the quality of the accounting records and nothing else. C'est la vie.

Tip. Now might be a good time – post-Covid, etc. – to ensure that all zero-rated, 5% and exempt sales made by your business meet the relevant conditions. For example, exports of goods are only zero-rated if the supplier holds proof that the goods have been shipped abroad.

Lesson 2 – Take care with the legislation on building work for charities

One of my favourite cases was*Paradise Wildlife Park Ltd* [2023] TC 08729 and whether construction services it supplied to a registered charity – Zoological

Society of Hertfordshire – qualified for zero-rating on the basis that they related to two new buildings that were solely used for a relevant charitable purpose (RCP), i.e. not for any business activities.

The first building was a new enclosure for lions but the second was described as a walkway through a densely wooded area, complete with life size animated models of dinosaurs. Apparently the dinosaurs even made loud cheering noises to add to the visitor experience, a bit like Manchester United fans during a big match at Old Trafford. Wow!

The charity earned £5m from zoo admission fees and the judge agreed with HMRC that the new buildings made it 'a more attractive place to visit' and therefore an important business function. The fact that both buildings partly had charitable objectives – conservation and educational – was not sufficient to meet the requirement of the legislation that a building must be used 'solely' for an RCP for builder services to be zero-rated.

Tip. HMRC's interpretation of the legislation allows a de minimis business use of 5%, which is helpful for, say a new charity building which allocates a small area for a cafe to generate catering revenue (VAT Notice 708, para 17.11).

Lesson 3 – Don't ask HMRC for a written ruling

Our favourite tax is fifty years old and it has come a long way since the 1970s when nobody was completely sure what was going on, a bit like a complicated plot in some TV dramas. However, HMRC's view is that there is now extensive published guidance on most complicated aspects of the tax – in public notices and internal HMRC manuals – which should allow a business to adopt the correct VAT treatment in most cases.

I felt sympathy for the taxpayer in the case of *The Young Driver Training Ltd* [2023] TC 08748, where the key issue was whether driver experiences provided to under-17s at a private site qualified for the temporary reduced rates of 5% and 12.5% during the pandemic as admission fees to 'shows and certain other attractions'.

The taxpayer claimed that its business was similar to an amusement park and fair, which both qualified but HMRC disagreed and issued an assessment for £125,013, treating the supplies as standard rated. The company had tried to get a written clearance from HMRC but the department refused, referring the directors to the published guidance.

Tip. If you ask HMRC for a written clearance, you will need to fully explain why the published guidance is insufficient to enable you to decide about the VAT treatment of a transaction.

Lesson 4 – HMRC's power to issue 'best judgment' assessments is frequently used

VAT enthusiasts refer to 'section 73' assessments, when HMRC officers use their 'best judgment' to either increase output tax declared on a return submitted by a business or – less frequently – to reduce input tax claims.

In the case of *Neoterick UK Ltd* [2022] TC 08652, HMRC issued a best judgment assessment for £45,025 to a Subway franchise business that it considered had overstated its zero-rated sales. The impressive fact was that the officer had three separate pieces of evidence to support her calculations: test purchases where hot food was incorrectly treated as zero-rated; twelve hours of invigilation at the trading premises spread over two separate days; a close examination of till rolls. The taxpayer's appeal was dismissed.

Tip. If you challenge a 'best judgment' assessment, you should carry out your own calculations to arrive at a figure of the correct tax that you think is payable.

Lesson 5 – a penalty for making careless errors can be suspended

A penalty for a careless error that has underpaid VAT on a past return can be issued by HMRC at a rate between 15% and 30% if it is discovered by an officer rather than alerted by the taxpayer. However, if HMRC and a business owner agree specific behavioural changes – aimed at improving accounting records and overall compliance – a penalty can be suspended if the conditions are fully met.

In the case of *London Drylining Ltd* [2023] TC 08671, the company claimed input tax on the purchase of a new car but HMRC disallowed it because there was nothing to stop the vehicle from being made available for private purposes; the officer issued an assessment and careless error penalty. The judge agreed that the error was careless but decided that HMRC had not considered suspending the penalty and this was an oversight. The hearing was temporarily halted while HMRC's representatives agreed upon three behavioural conditions for the directors to implement. They agreed to the conditions, so the appeal was allowed and the penalty was suspended for 12 months.

Tip. HMRC argued that claiming input tax on a car was not relevant for a suspension because it is a 'one off' transaction. But the judge disputed that conclusion, saying that buying and selling business vehicles was a common transaction.

Useful links

For commentary on ‘best judgment’, see *In-Depth* at ¶58-405.

For commentary on the input tax block applying to VAT incurred on motor cars, see *In-Depth* at ¶19-260ff.

For commentary on the temporary reduced rate, see *In-Depth* at ¶32-800, and for reduced rating, see ¶32-000.

For commentary on the meaning of ‘relevant charitable purpose’, see *In-Depth* at ¶33-185.

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