Seasonal tips: VAT saving opportunities

Indirect Tax

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We share some seasonal VAT tips, helped by the lyrics from the Twelve Days of Christmas and some important decisions reached by judges in the tax tribunals.

Key Points

What is the issue?

There are many VAT saving opportunities in the legislation. The article considers how VAT on the costs of a buy-to-let rental property can often be claimed because of the partial exemption de minimis rules and how penalties for late payments can be challenged if there is either a ‘reasonable excuse’ or ‘special circumstance’ that caused the lateness.

What does it mean to me?

Many businesses could benefit from voluntary registration and claim input tax on their expenses without losing competitiveness on their sales. Voluntary registrations can be backdated four years in most cases.

What can I take away?

Zero-ratings in the legislation are the best VAT outcome; i.e. no output tax is charged on sales but input tax can be claimed on related costs. However, record keeping needs to be strict to meet the conditions necessary to support these sales and the article highlights tribunal cases won by HMRC in 2024.

What are your biggest VAT memories of 2024? You will probably recall two major announcements. Firstly, the increase in the registration and deregistration thresholds on 1 April 2024, the first changes since 2017. Secondly, you might think of the government’s manifesto pledge to change the law on the liability of tuition and boarding fees supplied by private schools, which will be standard rated rather than exempt from 1 January 2025.

Were there any other major changes that whetted our taste buds? Probably not, so I will conclude the year with some festive tips.

Consider the benefits of voluntary registration

Why do so many clients have a fear of registering for VAT unless it is forced on them like a partridge in a pear tree having to leave its comfortable nest? The days of HMRC officers carrying out stressful compliance visits – with as much excitement as ten lords leaping up and down on a trampoline – are definitely in the past.

To share a tax-saving story about voluntary registration, a computer consultant trades as a limited company which only has overseas business customers. There is no compulsory reason to register for VAT because the place of supply for B2B services provided by consultants depends on the customer’s location. They are outside the scope of UK VAT.

However, the company incurs VAT on many expenses, including subcontractor and computer costs, so voluntary registration makes sense. However, there is more: a business can backdate its registration date by up to four

years as long as it has either made or intends to make taxable sales during that period of time.

Note: Even though the company's income is outside the scope of UK VAT, a business can still register and claim input tax because the services would be VATable if supplied to a UK customer. In VAT speak, this is often referred to as 'outside the scope with recovery.'

To share another story about voluntary registration, see ***Christmas book tale.***

Christmas book tale

Joseph was commissioned to write a book about the history of French hens on 1 December 2024, which will earn him a fee of £80,000 to be paid in four quarterly instalments by a publisher next year. His only expense is a 15% plus VAT commission payment to his literary agent.

Joseph will not need to register for VAT if this is his only income because his annual taxable sales are less than the registration threshold of £90,000 that has applied since 1 April 2024.

However, there will be an input tax windfall of £2,400 if he registers voluntarily; i.e. £80,000 x 15% x 20% VAT. The publisher will reclaim input tax.

Zero-ratings must be applied strictly

When I advise accountants about the nation's favourite tax, I always encourage them to ensure that clients are not complacent when it comes to holding supporting evidence about their zero-rated sales. Zero-ratings are an important tax privilege and many businesses fall short of the standard necessary to ensure that there is no potential challenge from HMRC. I have reviewed First-tier Tribunal cases for the last 12 months and the final score is... HMRC 5: Taxpayer 0.

Bottled Science Ltd [2024] UKFTT 592: A collagen-based drink called Skinade was a standard-rated beauty product rather than a zero-rated food. The judge placed an emphasis on marketing and packaging and noted that it would not be suitable for a supermarket aisle. The packaging was 'something that you might find in a chemist's shop rather than a grocer's'.

BJ Shere Khan Star City Ltd [2024] UKFTT 639: A restaurant overstated its zero-rated takings figures. The tills did not distinguish the liability of sales and the judge referred to the 'chaotic way that the tax affairs of the business was conducted'.

Mark Glenn Ltd[2024] UKFTT 715: A hair-loss procedure known as the Kensey System did not qualify for zero-rating as a supply of goods to a disabled person. The judge agreed with HMRC that the taxpayer had failed to produce any evidence that 'baldness in women is considered as a chronic sickness by the medical profession'.

DuelFuel Nutrition Ltd [2024] UKFTT 104: A sports nutrition bar did not qualify as a zero-rated cake. The judge noted that the ingredients were very different to those used in a cake; a cake was a treat but the bars had tastes and textures that were very different to a treat. As the product did not qualify as a cake, it had to be classed as confectionery. The decision is consistent with HMRC's VAT Food Manual at VFOOD4380.

Queenscourt Ltd [2024] UKFTT 460: Cold 'dip pots' were not a separate zero-rated supply in a hot take-away meal deal. Hot food is always standard rated.

What was the most important tribunal case in 2024?

The judges have been kept busy dealing with a range of VAT appeals and I keep a written summary of all important cases. I find that my notes are as essential as a strong pair of shoes for ladies dancing in the streets after a fun night out in a buzzing city centre. I have selected my favourite 2024 case and, as the drummers drumming in my office build up an exhilarating sense of anticipation, helped by pipers piping noisily in the background…

I can reveal that it is *HMRC v Hotel La Tour Ltd* [2024] EWCA Civ 564.

This case related to input tax on costs directly linked to the sale of shares and it has so far been considered by three courts. As I sit beside my Christmas tree writing this article – sipping a glass of mulled wine – I have just read that the taxpayer has appealed the latest Court of Appeal decision to the Supreme Court.

The Court of Appeal reversed the decision made in the earlier courts:

- The company sold shares in a trading subsidiary and used the sale proceeds to buy another hotel, claiming input tax on legal and professional fees linked to the share sale on the basis that the proceeds funded the purchase of a taxable business; i.e. a hotel.
- HMRC's view was that all costs were directly linked to the immediate exempt supply of shares and input tax could not be claimed. The First-tier Tribunal and Upper Tribunal agreed with the taxpayer.
- The Court of Appeal agreed with HMRC that the key question was to consider which supply the costs related to, and that could only be the share sale. It is not correct, the judges ruled, to make a decision based on whether the costs are incorporated into the price of a subsequent taxable supply.

Partial exemption de minimis limits: claiming input tax on buy-to-let costs

Rental income earned from a buy-to-let residential property is exempt from VAT, so input tax cannot be claimed on expenses such as property repairs and managing agent fees.

However, if the legal entity that owns the property is already registered for VAT because it has another business activity, there is an opportunity to claim input tax on property costs by utilising the partial exemption de minimis rules. There is a potential windfall of £7,500 input tax in each partial exemption tax year.

See ***Hairdresser Harry: Input tax windfall with partial exemption de minimis limits.***

Hairdresser Harry: Input tax windfall with partial exemption de minimis limits

Harry is VAT registered and trades from the ground floor of a salon he owns. The first floor is a two-bedroom flat that he rents out on a buy-to-let basis; i.e. rental income is exempt from VAT.

Harry must pay £30,000 plus VAT on urgent flat improvements; other annual costs linked to the flat, including agency fees, are £5,000 plus VAT. He completes calendar quarter returns.

Harry is likely to be de minimis for partial exemption purposes in the tax year ended 31 March 2025 because the exempt input tax will be less than £7,500 and also – hopefully – less than 50% of the total input tax claimed on his returns.

HMRC Notice 706 s 11

Is there a ‘reasonable excuse’ for late returns and payments?

Finally, my David and Goliath award for 2024 goes to solicitor *Sandra Krywald* [2024] UKFTT 895, who successfully convinced the First-tier Tribunal that she had a ‘reasonable excuse’ for failing to submit returns and pay tax on time.

This is the first case I have read about the new points and penalty regime introduced for periods beginning on or after 1 January 2023; it replaced the draconian default surcharge system that had existed for over 30 years. Late payments are penalised by virtue of Finance Act 2021 Sch 26. A 2% penalty is issued for tax unpaid on day 15 after the due payment date, with a further 2% penalty for tax still owed by day 30.

The taxpayer was badly let down by two external bookkeepers who failed to complete her returns. The first bookkeeper had to socially isolate due to Covid, so could not attend the business premises. The second bookkeeper had neither the ‘enthusiasm or alacrity’ to complete the outstanding returns.

The taxpayer contacted HMRC for advice and was incorrectly told that ‘opening balances’ were needed within the accounting system before the figures could be finalised. It was not until March 2024 that she approached a VAT expert who told her that she could produce and submit returns based on turnover and costs without worrying about opening or closing balances.

The judge noted that the legislation allows ‘special circumstances’ and a ‘reasonable excuse’ to be accepted by HMRC and concluded that the taxpayer had both. It was reasonable to rely on the bookkeepers to complete the returns and the department’s ‘failure to give correct advice’ was a special circumstance. The appeal was allowed and all penalties and points were reversed.

The message from this case? If you have a reasonable excuse for late returns and payments, you should make it known to HMRC as soon as possible. Happy new year to all readers!