

TAXATION

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VAT that never was

A tale of partial exemption told by PHILLIP HENWOOD shows how important it is to keep detailed records of control visits so that molehills don't turn into mountains.

The managing director and owner of a national residential development company based in north London, but operating in the southern half of the UK, is also a part time, voluntary tax commissioner presiding over HMRC Income Tax Tribunals.

The company has been operating since the 1980s. Originally it was an active developer, constructing and selling a range of new build housing. In the recession of the early 1990s the company was forced to scale back its activities. It became difficult to sell new properties and so, pending their eventual sale, in order to ensure some income, the properties were let to tenants. At the same time, the company continued to develop new homes using its land bank. Eventually, the land bank was exhausted and new development largely came to a halt. Where possible, properties continue to be sold either en-bloc to specialist landlords or individually to tenants or other open market buyers.

No special method

Originally our client recovered all the VAT on its activities as a developer, building new homes for outright sale. As its business model changed to encompass the property letting, it became necessary to restrict VAT on overheads and to operate some sort of partial exemption recovery mechanism.

At this time, the company sought advice from one of the then 'big five' VAT consultancies and correspondence was entered into with Customs.

For whatever reason, a formal special method was never finalised and our client was erroneously left attempting to operate an appropriate partial exemption special method. Eventually in 2006 our client received a VAT control visit and was then assessed for all its input VAT recovery for the previous three years plus interest and misdeclaration penalties.

According to the visiting officer, there was no special method in place and therefore our client had no right to recover any input VAT. Although full records were made available to the visiting officer, the entire control visit took somewhat less than an hour to complete. No records were consulted and the officer did not take the opportunity to speak to the client about the exact nature of the business.

KEY POINTS

- A business must know the VAT implications of its activities.
- Agreement should be reached with HMRC over any special VAT treatment.
- The business must keep detailed records of control visits, etc.
- Remember to deal with possible interest due on appealed assessments.

Incorrect assessment

Following receipt of the assessment, our client was unable to go back for advice to its original VAT consultancy, as both the particular office and the member of staff previously responsible for dealing with this matter had fallen victim to the same economic downturn. As a result, our client approached its accountant for assistance and the accountant subsequently referred the client to 4 Eyes Mtd for its particular expertise in land and property VAT.

Upon reviewing the papers and interviewing the client, it was clear that at least part of the assessment had to be invalid. HMRC had denied the client any right to recover overhead VAT. In the absence of a partial exemption special method being in place, a taxpayer making both taxable and exempt supplies should use the standard income based method of attribution. Accordingly, we appealed the entire assessment.

“

The matter was only resolved when we took it directly to his senior officer, thereby quite properly removing the original officer from the process.

As part of the appeals procedure, the matter was referred for departmental review by HMRC. The review officer agreed with our arguments and then referred the matter back to the originating VAT office for further consideration.

We completed accurate partial exemption calculations for each of the years and concluded that the original assessment, interest charges and subsequent misdeclaration penalties should be withdrawn.

Impasse

Strangely enough, the matter went back to the original assessing officer for action. At this point there was impasse as the officer was first unwilling to accept our analysis of the correct VAT due and then adopted an officious stance,



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demanding that before he would approve any calculations submitted by us, our client complete a detailed analysis of every single item of expenditure for the entire three-year period of the original assessment.

This was clearly unreasonable (both in terms of how partial exemption should normally operate and given that many of the records were by now in storage off-site). We were mystified why the original assessing officer was required to uphold his own assessment.

The matter was only resolved when we took it directly to his senior officer, thereby quite properly removing the original officer from the review/appeal process.

The moral is ...

Once the partial exemption method had been agreed, historically and for future use, we completed the exercise up to the present date. This review resulted in a significant VAT repayment rather than an assessment.

The points that arise from this sorry tale are:

- A business must constantly monitor its activities. If the nature of the business changes significantly, there may be VAT implications requiring immediate attention.

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- Partial exemption can be complicated and businesses are advised to seek specialist advice. For the same reason, generalist accountancy practices may wish to avail themselves of expert assistance to ensure that the most beneficial recovery method is identified and then correctly implemented.
- In this instance, the partial exemption special method was never agreed with HMRC. The rules have since changed to make the implementation of a special method potentially even more problematic as they are no longer formally agreed, thereby creating uncertainty.
- Once a method has been adopted, company accounts staff should be fully trained to ensure that it is operated effectively.
- When HMRC carry out a control visit, it is helpful to take a detailed note of what records were consulted and what exactly was discussed and agreed. Detailed notes will help in the event of subsequent dispute.
- If an assessment arises, unless the reason is obvious and uncontroversial, businesses should question the basis for it and check the background with their VAT advisers.
- In the case of a large assessment, it is possible to delay payment pending appeal. This will not, however, stop interest accruing on any amount subsequently found to be due. With this in mind, we advised the client to make a without prejudice payment to prevent further unnecessary interest costs from arising. (This amount was subsequently refunded.)

Unnecessary problems

This case shows that had the assessing officer conducted a detailed first visit, including consulting the client and its advisers, prior to raising a very large assessment, instead of carrying out only the most cursory of examinations, what two years later turned out to be a relatively trivial VAT matter could have been quickly dealt with.

Had our client paid the original assessment, this could have jeopardised its business and would have led to it adopting blatantly incorrect VAT accounting to its enduring detriment.

Detailed notes will help in the event of subsequent dispute. ”

One would think that HMRC officers would take particular care when dealing with taxpayers, accountants or other professionals when seeking to raise large assessments. In this case, the officer who raised the assessment was not prepared to afford the time and attention to detail in his official duties to the taxpayer resulting in unnecessary anxiety and expense for an otherwise tax compliant business. ■

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