

Who pays the tax bill?

It took ingenuity, as well as technical expertise, to find a good solution to the sub-contractor's tax tangle that followed a company acquisition

After a construction industry takeover, legal costs, penalties and mounting interest charges threatened to turn a disagreement about a disallowed six-figure tax deduction into an expensive and long-drawn-out nightmare. Clear thinking and a realistic identification of each party's true interests allowed Mari Scholes to persuade the tax authorities and the three companies involved to sign up to an arrangement everyone could live with. Even the firm that had to pay out was happy to bring the matter to a timely and satisfactory close.

The Challenge

When a medium-sized company in the construction industry bought a smaller private firm as a going concern, it took on all its assets and liabilities, including tax. The due diligence process had not included a specialist review of the books by a construction industry tax expert, and there was a serious dispute about who should pay the tax that was apparently due under the HMRC sub-contractor scheme.

The challenge was to find a solution that ensured the right tax was paid by the right people, ideally without adding to the problem with legal fees, fines, late payment charges and interest.

The problem surfaced soon after the takeover, when HMRC refused to allow a deduction for a six figure sum as an offsetting allowance in respect of tax already deducted by a third party (the main contractor) on behalf of the acquired company, as sub-contractor. According to the taxman, the main contractor had not paid the tax to HMRC, so the acquired company could not offset this amount against its own liability.

The acquired company had submitted correct returns, with a valid deduction. But while HMRC could have taken action against the main contractor to recover the tax, it was equally entitled to reject the deduction, as an easier and cheaper way of securing payment.

The purchaser had a problem and it seemed there were just three options:

- Take action against HMRC when refusal to pay the tax was assessable (costly and unlikely to succeed).
- Take action against the main contractor (problematical, as the liability was between them and HMRC).
- Claim under the purchase agreement with the vendor – also difficult, due to “reasonableness” and “buyer beware” clauses.

The Outcome

Acting as an independent intermediary, Aransa's top tax expert, Mari Scholes, was able to devise an ingenious agreement that was acceptable to all three parties.

HMRC agreed to allow the acquired company to become a “gross sub-contractor” under the scheme, and backdated this to a date prior to submission of the return. The effect of this was to waive the requirement for the main contractor to deduct tax from its sub-contractor and pay this to HMRC.



At the same time, HMRC issued a one-off direction to the main contractor to pay its sub-contractor the gross amount, thus giving the acquired company entitlement to the gross payment. This provided a clear claim for the purchaser against the main contractor, which the main contractor was obliged to settle. HMRC also agreed to allow deferral of the outstanding liability, without penalty but with interest.

This solution was timely, effective and efficient. It resolved the problem in a way that could not have been achieved through legal action. Even the main contractor, which effectively ended up paying the tax to the purchased company, was pleased that it did not end up with HMRC on its back and a lot of fines and other charges. Interest was payable on the outstanding sum, but no-one was out of pocket.

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