VAT UPDATE JANUARY 2018

Covering material from October – December 2017

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VAT Update January 2018

Contents

1. INTRODUCTION

These notes contain a brief summary of some of the main VAT developments in the last three months – Tribunal and Court decisions, changes in legislation, Customs announcements. They are divided as follows:

- outputs generally;
- land and property;
- international matters;
- inputs generally;
- administration.

The same main headings will be used each quarter. If nothing has happened under a particular heading in a particular quarter, that heading will be omitted – but all headings will still carry the same number. That is why some headings are included with "nothing to report".

1.1 Appeals pending

It is not possible to compile a comprehensive list of cases under appeal, and some of those which are thought to be still "live" may be dropped without a hearing. The following is compiled from several sources, and is just an approximate guide to some of the arguments that do not appear yet to have been finally settled:

The HMRC website section which reports the progress of appeals originally said that it would be updated monthly, but it appears to be less frequent or regular than that. The list says "updated 4 December 2017".

Several of the "decision is final" items are still on the website list, but where they have already been reported in the update they are not reproduced below.

http://www.hmrc.gov.uk/vat/vat-appeal-update.pdf

- *DPAS Ltd*: HMRC appealed points from FTT decision to Upper Tribunal, which decided to refer questions to CJEU after considering the judgments in *Bookit* and *NEC* (Case C-5/17).
- *Dynamic People Ltd*: HMRC sought leave to appeal Judge Bishopp's FTT ruling that a special method continued until it was cancelled, even though the company had joined a group; the FTT decided to set aside its decision and rehear the case (listed for December 2017).
- *Findmypast Ltd*: HMRC have applied to the Court of Session for leave to appeal to the Supreme Court against the CS ruling that "credits" did not trigger a tax point at the time they were purchased.
- *Frank A Smart & Son Ltd*: HMRC are appealing to the Court of Session against UT's confirmation of FTT ruling that costs of Single Farm Payment Entitlements were business overheads and deductible (hearing listed for June 2017, decision awaited).
- *Gala 1 Ltd v HMRC*: Court of Appeal due to hear taxpayer's appeal against refusal of claims for repayment of output tax on bingo – FTT/UT both ruled that only the representative member of the group could make the repayment claim (not on the HMRC list).

- *Hotels4U.com Ltd*: HMRC have applied for the time limit to appeal to be extended while waiting for FTT to rule on whether to refer questions to the CJEU (directions hearing was listed for 30 November 2017).
- *Jigsaw Medical Services Ltd*: HMRC are appealing FTT's decision in favour of taxpayer in case about whether provision of ambulances qualified for zero-rating as passenger transport (hearing date to be confirmed).
- *KE Entertainments Ltd*: HMRC have applied to Court of Session for leave to appeal against UT decision that change of calculation of bingo takings constituted an "adjustment of consideration" within reg.38, rather than leading to a time-capped repayment claim under s.80.
- *London Borough of Ealing*: FTT referred questions to CJEU about exemption for local authorities providing sporting services: HMRC list notes that CJEU's judgment favours the Borough.
- *Marriott Rewards LLC and Whitbread Group plc*: both appellants' appeals dismissed by the FTT (TC05634) on place of supply issues. However, the FTT found against HMRC on the fundamental direction of supply point. Marriott and Whitbread have both appealed to the Upper Tribunal and HMRC have cross-appealed.
- *MG Rover Group Ltd*: taxpayer is appealing to CA for permission to appeal against UT's ruling that its *Fleming* claim could not succeed as it should have been made by the representative member of the group (hearing listed for January 2019).
- *Newey t/a Ocean Finance*: HMRC have been granted leave to appeal to the Court of Appeal against the UT's decision that the FTT was correct to find that the appellant's offshore business arrangements were not an abusive practice (hearing date listed as 30 January 2018).
- *Pacific Computers Ltd*: MTIC case remitted by the UT to differently constituted FTT for rehearing.
- *Privin Corporation Ltd*: the FTT found in favour of a MTIC appellant. HMRC were granted leave to appeal to the UT, but it was agreed that the case would be remitted to a differently constituted FTT for rehearing.
- *Stoke by Nayland Golf and Leisure Ltd*: HMRC are appealing to the UT against the FTT's ruling that a members' club did not fall foul of anti-avoidance provisions and qualified for exemption (hearing date to be confirmed).
- *Synectiv Ltd*: the FTT found in favour of a MTIC appellant. UT set aside the decision on "should have known" and the case will be remitted to a differently constituted FTT for rehearing (no longer on HMRC's list).
- *Taylor Clark Leisure plc*: HMRC have been granted leave to appeal against the Court of Session's ruling that the company was entitled to a repayment based on a claim made by a former member of its VAT group registration (Supreme Court hearing listed for 11 April 2018).

- *Tesco Freetime Ltd and Tesco plc*: HMRC are seeking leave to appeal to the UT against FTT finding in favour of taxpayer in relation to tax treatment of loyalty points scheme.
- *The Chancellor, Masters & Scholars of The University of Cambridge*: HMRC have been granted leave to appeal against the UT's decision that VAT incurred on investment management was residual input tax of the whole operation (CA hearing listed December 2017).
- *Totel Ltd v HMRC*: Supreme Court granted taxpayer leave to appeal against Court of Appeal's 2016 ruling on requirement to pay VAT before an appeal could be entertained (not on HMRC's list).
- *Volkswagen Financial Services (UK) Ltd*: Supreme Court has referred the main partial exemption issue to the CJEU but found against HMRC on a secondary issue.
- *Wakefield College v HMRC*: the college has appealed to the CA against the UT's ruling that it would use its building for a business purpose and therefore did not qualify for zero-rated construction (hearing listed for 7 February 2018).
- *Wetheralds Construction Ltd*: HMRC are appealing against the FTT's decision that certain works qualified for the lower rate as relating to insulation for roofs, not "insulated roofs" (hearing listed for 26 April 2018).

1.1.1 Decisions in this update

- *CCA Distribution Ltd*: the UT remitted matters in dispute back to the FTT; CA dismissed the company's appeal, but HMRC's list does not clarify whether the remitted matters remain outstanding.
- *E Buyer Ltd and Citibank NA*: HMRC won their appeals to the CA against UT's confirmation of FTT ruling that HMRC's statements of case were inadequate.
- *ING Intermediate Holdings Ltd*: CA dismissed company's appeal against UT's refusal of its claim to recover input tax based on foreign specified supplies rather than attributing the input tax to UK exempt banking business.
- *Iveco Ltd*: CA dismissed company's appeal against UT's decision in favour of HMRC in case about repayment claim based on alleged "adjustment of consideration".
- *LIFE Services Ltd*: HMRC are appealing FTT's decision in favour of taxpayer in case about fiscal neutrality and conditions for exemption of welfare services by commercial company (hearing October 2017).
- *Littlewoods Retail Ltd*: an overall win in the Supreme Court for HMRC on traders' entitlement to compound interest on historic repayments of overpaid VAT.
- *Mercedes-Benz Financial Services*: HMRC appealed the UT decision that the company's product was leasing rather than HP to the CA, which decided to refer questions to the CJEU: judgment in this update, before case returns to the CA.

- *Metropolitan International Schools*: HMRC successfully appealed to the UT against the FTT's decision that the taxpayer supplied predominantly printed matter with incidental services.
- *Praesto Consulting UK Ltd*: the FTT found in favour of company that had claimed input tax deduction on legal expenses relating to lawsuits against a director; HMRC won their appeal to the UT.

1.1.2 Other developments on appeals

- *Associated Newspapers*: both sides were refused permission to appeal to the Supreme Court, so the CA decision is final – HMRC describe this as a "partial win for HMRC", but it casts significant doubt on their interpretation of SI 1993/1507.
- *British Film Institute*: following the CJEU judgment (Case C-592/15), the CA formally allowed HMRC's appeal.
- *Brockenhurst College*: HMRC's list states that the CJEU (Case C-699/15) "found in favour of the taxpayer" and there is "no further appeal", so it appears the CA will not formally decide the case.
- *NT Advisors Partnership*: HMRC's list confirms that there is "no further appeal", so the FTT's decision in favour of the taxpayer is final – HMRC comment that the decision was "limited to the facts".
- *Temple Retail Ltd and Temple Finance Ltd*: HMRC's list confirms that there is "no further appeal", so the UT's decision in favour of the taxpayer is final.
- *The Queen's Club Ltd*: HMRC's list confirms that there is "no further appeal", so the FTT's decision in favour of the taxpayer is final – HMRC comment that the decision was "limited to the facts".
- *Will Woodlands*: HMRC's list confirms that there is "no further appeal", so the FTT's decision in favour of the taxpayer is final – HMRC comment that the decision was "limited to the facts".

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Link between payment and supply

Bank of Scotland (BOS), a member of the Lloyds Banking Group (LBG), closed its business in Ireland and transferred the winding-down operations to an Irish company, Certus. BOS made payments in relation to redundancy costs; HMRC ruled that these were in fact part of the consideration for services supplied by Certus to BOS and were therefore subject to a reverse charge in the UK. The amount of VAT in dispute was a little over £5.6m.

The company argued that the payments were made under obligations arising from negotiations with the employees' union; although they were paid in accordance with the service agreements entered into with Certus, they did not form part of the consideration for that company's services, either as a matter of contractual or commercial reality.

The Tribunal considered the history of the closure of the Irish operation, and noted that under the Transfer of Undertaking (Protection of Employment) regulations (TUPE), the obligation to pay redundancy to employees transferred to Certus. It was not surprising that the union insisted that the transferring employer should underwrite the full cost of the redundancies that were inevitably going to follow the transfer, given that Certus was a new company that might not be able to meet the full expectations and entitlements of the transferred employees.

The judge (Marilyn McKeever) noted that there is no definition of "consideration" in the PVD. Cases such as *Naturally Yours Cosmetics* and *Tolsma* have provided the principle that "a supply of services is effected 'for consideration' …and hence is taxable, only if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient." So in the present case, the making of the redundancy payments would only be part of the taxable amount if they were part of the value given by BOS in return for the administration services provided by Certus.

The judge went on to cite the CJEU's judgment in *Newey* as authority for the principle that the contractual terms had to be interpreted in accordance with the economic and commercial reality of the transaction. This was developed by Lord Neuberger in the Supreme Court in *SecretHotels2 Ltd*, and summarised as follows in the *Hotels4U Ltd* case:

- *One must start with the agreements themselves and identify the rights and obligations of the parties.*
- *To do this I must construe the words used in the context of the agreement as a whole and all the surrounding circumstances, but only in so far as they were known to both parties, and the construction must be in accordance with the commercial context.*
- *In the light of that construction, I must characterise the nature of the relationship between the parties, recognising that the labels attached to the relationship by the parties may be of little weight.*

- *One then checks whether the characterisation on that basis is in accordance with the economic realities.*
- *If prima facie the circumstances establish a particular relationship between the parties, one must then consider whether that conclusion is vitiated by facts which are inconsistent with that finding.*

The concept of the "economic purpose" of a transaction was considered in relation to the exemption for leasing or letting of immovable property in the cases of *Cantor Fitzgerald International* (Case C-108/99) and *Mirror Group plc* (Case C-409/98), in which the Advocate-General set out the need to identify the key features of a contract:

"*In order to identify the key features of a contract, however, we must go beyond an abstract or purely formal analysis. It is necessary to find the contract's economic purpose, that is to say, the precise way in which performance satisfies the interests of the parties. In other words, we must identify the element which the legal traditions of various European countries term the cause of the contract and understand as the economic purpose, calculated to realise the parties' respective interests, lying at the heart of the contract. In the case of a lease, as noted above, this consists in the transfer by one party to another of an exclusive right to enjoy immovable property for an agreed period.*"

The Tribunal set out key extracts from the successive agreements entered into between BOS and Certus. The appellant's representative argued that these showed that the redundancy payments were funded by BOS in accordance with a free-standing contractual obligation to the employees, and were therefore effectively disbursements for VAT purposes. He further argued that this was in accordance with *Redrow* and *Airtours*: not every payment made by a business is consideration for a supply to the business.

HMRC responded that the responsibility for making the payments legally fell on Certus, and the contracts reflected an agreement by BOS to pay Certus sufficient consideration for Certus to pay out what were its own costs. This, in HMRC's view, was enough to establish a sufficient link to the services, in contract and in commercial and economic reality. Separating out the redundancy payments and treating them differently was an artificial dissection of a single transaction.

The judge considered that the appellant's arguments were stronger. The contracts appeared to separate out the redundancy costs, which were to be funded independently of what Certus was being paid for its services. The incorporation of the redundancy payments into the contracts was part of the administrative machinery of paying them, but it did not make them part of the consideration for the supply. They were also paid in accordance with a different mechanism from the consideration for the supplies, in a manner consistent with them being disbursements.

That was the contractual position, and there was nothing artificial about it: it also reflected the economic and commercial reality. The appeal was allowed.

First-Tier Tribunal (TC06230): *Lloyds Banking Group*

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Pension fund management services

In October, HMRC issued a Brief stating that the exemption for pension fund management services, enjoyed by regulated insurance companies for many years, would no longer apply to defined benefit schemes from 1 January 2018. This was said to be the result of the CJEU judgments in *ATP Pension Services* (Case C-464/12) and *Wheels Common Investment Fund* (Case C-424/11), as well as the dropping of reform of the financial and insurance exemptions from the Commission's work programme in 2016. The Brief noted HMRC's understanding that the great majority of pension funds managed by insurance companies would remain exempt as they were defined contribution schemes.

On 20 November, a further announcement delayed the implementation of this change from 1 January 2018 to 1 April 2019. The Brief was reissued in exactly the same wording, apart from the change of effective date.

Revenue & Customs Brief 3/2017

2.3.2 Exemption for care homes

The UT has heard a judicial review application about HMRC's treatment of fees received by care homes. Before the *Kingscrest* case in 2002, HMRC regarded residential care homes as exempt. Kingscrest wanted to charge VAT to local authorities in order to be allowed to recover its own input tax, so its appeal was successful; but HMRC decided not to enforce the decision retrospectively against other care homes who had relied on the exemption (as well as later changing the law so that regulated welfare businesses would become properly exempt).

HMRC's policy was set out in Business Brief 28/2004. Broadly speaking the policy was that care homes did not have to register for VAT in respect of the pre-*Kingscrest* period because HMRC were prepared to remit any output tax that the care homes were liable to pay on the fees that they had charged their customers. However, a care home could register if it so chose and complete a single VAT return covering the whole period for which it was unwittingly making taxable supplies pre-*Kingscrest*. If it chose to register, the care home would then have to account for VAT to HMRC.

The applicants for judicial review did not apply for registration following BB 28/2004; however, on taking on a new adviser in 2011, they concluded that they had not been compensated for all the loss they had suffered in the pre-*Kingscrest* period, and the HMRC policy set out in the Brief was unfair. On the basis of advice, the applicants registered for VAT and submitted a long period return, claiming remission of output tax on a basis more generous than that offered by HMRC in the BB.

HMRC responded by refusing the claim, and ruled that because the applicants had turned down the treatment offered in the BB, they would not benefit from it at all; they were therefore liable for output tax on the normal basis. That would leave them much worse off than if they had not bothered to register at all.

The adviser's clients applied for judicial review. The action was taken by 25 claimants, and there were apparently some 120 further businesses that had requested remission of output tax on the same basis, but who had not yet received "decision letters" on the matter from HMRC.

The judge set out an example of how the claimants' approach would work. In effect, they wanted to have all output tax remitted, not just output tax that they had not charged to customers; they would still be able to reclaim the excess of input tax over the output tax that they had actually charged on supplies during the period. In the example, the particular claimants would have been entitled to a reclaim of £8,880.

The judge examined the arguments that continued between the adviser and HMRC from 2011 to 2016. On 20 July 2016 HMRC wrote to the adviser to confirm that they did not agree with his position on "detriment", and gave him a draft of the letter they proposed to send to his clients on the consequences of insisting that BB 28/2004 did not apply. These letters were sent out in August 2016. Judicial review proceedings commenced later that year.

HMRC contested the claim, arguing that:

- the grounds for the claim arose in 2004, and were therefore many years out of time;
- there was no legitimate expectation on behalf of the claimants that had been frustrated by HMRC;
- the claims for detriment were wholly speculative;
- there was no conspicuous unfairness, given HMRC's responsibilities to all taxpayers.

Mrs Justice Rose heard the application in July, and the decision was released at the very end of September. She accepted HMRC's argument on the first point: the issue of letters by HMRC to the claimants was not a "new event" that could be the basis for time starting. HMRC had not changed their stance on BB 28/2004, and time ran from its issue. There was no basis for extending time and no justification for allowing the applicants to challenge the application of the BB to their businesses.

That was enough to conclude the matter, but in case she was wrong on that, she considered the other grounds. She commented "I do not see how HMRC's conduct could even be described as 'a bit rich', let alone conspicuously unfair." HMRC had been entirely consistent in correspondence with the adviser and had given no grounds for any expectation of different treatment.

The only matter that gave the judge pause was HMRC's refusal to allow the taxpayers to default back to BB 28/2004, given that their more favourable claims were rejected. However, they had (encouraged by the adviser) explicitly and repeatedly refused the application of BB 28/2004; HMRC had clarified in BB 15/09 and again in RCB 07/16 that they had withdrawn the "misdirection class concession" that applied in BB 28/2004, and it would not be "routinely applied" to later claimants. The judge could see no reason why it should be applied here.

The judge refused permission for the application to proceed to a substantive hearing. It appears, therefore, that the claimants will all be worse off than they would have been if they had never joined the group action.

Upper Tribunal: *R (on the application of Raymond Clarke and others) v HMRC*

2.3.3 Welfare services

A non-profit limited company provided day care services for adults with a broad spectrum of disabilities, principally learning problems. Its clients included those with severe autism, Down's syndrome, severe behavioural difficulties, learning disabilities, and Crohn's disease. The company provided its services under a formal care plan agreed with the social services department of Gloucestershire County Council, and was approved and registered to provide these services by the council. About 50% of the Appellant's services were supplied to individuals in residential homes, 25% were paid for by individuals or their carers out of the personal budgets paid to them by the council, and 25% were paid for directly by the local authority.

The issue before the First-Tier Tribunal (TC05197) was whether the company qualified for exemption of its welfare services under Sch.9 Group 7 item 9 as a "state-regulated private welfare institution or agency". Note 8 provides that "state-regulated" means "approved, licensed, registered or exempted from registration by any Minister or other authority pursuant to a provision of a public general Act, other than a provision that is capable of being brought into effect at different times in relation to different local authority areas." The company believed that it qualified because it was exempted from registration under the Health and Social Care Act 2008.

In the first of two hearings, the Tribunal concluded that this was not the case. The company was not subject to a requirement to be registered, which meant it could not be exempted from registration. The expression "exempt from registration" referred to certain bodies that fell within the Act but, owing to the specific services they provided, were specifically exempted from the requirement. This company fell within a class of entities that "may" be registered, but it was not required to be. This meant that the services were not exempt under VATA 1994.

The Tribunal then turned to the Directive, noting that art.132 has two provisions that refer to welfare:

(g) the supply of services and goods closely linked to welfare and social security work, including those supplied by old people's homes, by bodies governed by public law or by other bodies recognised by the Member States concerned as being devoted to social welfare;

(h) the supply of services and goods closely linked to the protection of children and young persons by bodies governed by public law or by other organisations recognised by the Member State concerned as being devoted to social welfare;

Art.133 permits member states to make the granting of exemption under certain paragraphs of art.132, which include para.(g), to bodies other than those governed by public law subject to one of four conditions (one of which is that the supplier be non profit making). Art.134 provides that a supply shall not be granted exemption within, among other paragraphs, (g) if it is not essential to the transaction exempted, or where the basic purpose of the supply is to obtain additional income through transactions in competition with commercial enterprises.

On this basis, the company advanced an argument that the UK law breached fiscal neutrality by exempting all welfare supplies provided by charities, but restricting identical welfare supplies provided by non-profit bodies such as the appellant.

The Tribunal noted that where the supply was made to the local authority, there would be no issue of fiscal neutrality, because the authority could claim the VAT back under s.33. This was the case even if the authority failed to do so, or failed to adjust the budget allocated to the company in order to allow for the recovery. The issue was with the other 75% of the company's supplies.

The Tribunal considered the CJEU precedents of *Kugler* (Case C-141/00), *Zimmerman* (Case C-174/11) and *Kingscrest* (Case C-498/03) in detail. The PVD had changed the wording of art.132 to extend it to "bodies devoted to social welfare", whereas the 6th Directive restricted it to "charities". The UK's wording in Note 9 breached fiscal neutrality in allowing exemption in this area to any charity, but not to a body such as the appellant company. The appeal was allowed.

HMRC appealed to the Upper Tribunal. The company sought to introduce two new grounds of appeal, one adding the Care Act 2014 as a relevant regulation to which it was subject, and the other relying on Judge Mosedale's decision in *The Learning Centre (Romford) Ltd* that the welfare rules breached fiscal neutrality because of different regulatory environments in different parts of the UK. HMRC did not object to the first of these arguments being introduced, but did object to the second; the UT agreed that arguments about the devolution issue should be deferred to when HMRC's appeal in the other case is heard by the UT.

HMRC's grounds for appeal involved criticism of the FTT's approach to the application of art.132(1)(g) PVD and also the FTT's application of fiscal neutrality, extending to the possibility of giving Group 7 item 9 a conforming construction.

The UT agreed with HMRC's argument that not all charities could benefit from the exemption at item 9. The wording did not imply that all charities were regarded as "bodies devoted to social well-being": only those charities with relevant objects could supply welfare services, and only those charities would fall within the exemption at item 9.

The UT also agreed with what appeared to be a contradictory alternative argument, that actually all charities are devoted to social welfare in the required sense (regardless of their objects) because of the overriding requirement for charities to confer a public benefit. The expression "devoted to social well-being" should be given a wide meaning. The UT considered that the first alternative was probably the better one, but either succeeded for HMRC.

The next question was whether there was a breach of fiscal neutrality in denying the exemption to non-charities and extending it to all charities. Based on CJEU precedents in *Kingscrest* and *Zimmermann*, the UT concluded that basing the exemption on either regulation or charitable status was within the margin of discretion allowed to member states – both were rational criteria for determining the scope of art.132(1)(g). This meant that there was no need to apply a conforming construction of the law, because the law conformed to the PVD anyway.

Lastly, the UT went on to consider whether the company could be regarded as "state regulated" under the requirements of the Care Act 2014. This permits a local authority to delegate some of its functions in caring for vulnerable people; there is a requirement for the local authority to carry out due diligence on the delegate and to monitor and inspect their operations. The UT did not think this went far enough to constitute "approval" within Note 8 of Group 7.

HMRC's appeal was allowed, subject only to the possibility that the company might succeed if the devolution issue was decided in the taxpayer's favour in *The Learning Centre (Romford)*.

Upper Tribunal: *HMRC v LIFE Services Ltd*

2.3.4 Not sport

The English Bridge Union is a non-profit company that receives subscriptions and entry fees in relation to bridge. It claimed that these fees should be exempt within art.132(1)(m) PVD on the basis that bridge should be treated as a "sport". The FTT considered that bridge involved high-level mental skills such as logic, lateral thinking, planning or memory, and that playing duplicate bridge regularly promoted both mental and physical health; it therefore referred questions to the CJEU about the meaning of "sport" for the purposes of VAT.

The CJEU held that the wording and the context of art.132(1)(m) meant that activities with only a negligible physical element were excluded. It might be possible to bring such activities within the "cultural services" exemption in art.132(1)(n), if the activity, in the light of the way in which it was practised, its history and the traditions to which it belonged, in a given member state, held such a place in the social and cultural heritage of that country that it could be regarded as forming part of its culture. This seems relatively unlikely, and was not the result the EBU wanted.

CJEU (Case C-90/16): *English Bridge Union Ltd v HMRC*

2.4 Zero-rating

Nothing to report.

2.5 Lower rate

Nothing to report.

2.6 Computational matters

2.6.1 Party plan sales

The CJEU has now ruled in the *Avon Cosmetics* case about the lawfulness of the UK's rules on selling through unregistered agents. The FTT found in 2014 (TC03311) that the UK rules were not allowed by a particular derogation, and questions were referred to the CJEU.

HMRC subsequently issued *Revenue & Customs Brief 19/2014* stating their position: the derogation has been correctly applied in the UK, but they acknowledged that the CJEU (alone) has jurisdiction to consider whether an EU legal measure is lawful. They noted that the remedy initially sought by Avon – to direct HMRC to exercise a power to allow Avon a deduction for the tax on demonstration items – was rejected by the Tribunal as depending on a power that HMRC do not have under the law.

The FTT case

A company reclaimed some £14m of VAT, complaining among other things that the UK's rules on "party plan sales" in Sch.6 para.2 VATA 1994 are in breach of several EU legal principles. The FTT was invited to consider this proposition in principle, without regard to the detailed calculations of the amounts involved for any period.

The rule is operated under a derogation authorised by the EU Council in 1985 (Decision 85/369), later extended indefinitely by Decision 89/534. The effect of the derogation has been to permit the United Kingdom to require traders selling through such representatives to compute their output tax liability by taking the open market retail sales prices receivable by the representatives in place of the lower consideration actually received on the prior sale to the representatives by the traders. The grievance was that the derogation completely disregarded any costs incurred by the representatives, and thus disregarded any input tax in respect of these costs which would have been deductible had the representatives been VAT-registered.

The principles that were alleged to have been breached were those of the neutrality of the tax for businesses, in that it created "sticking tax", and therefore proportionality in that the total VAT collected would exceed the appropriate fraction of the amount paid by the final consumer. The company argued that the cost to it exceeded the VAT that might have been avoided under the previous rules, which meant that the derogation could not have been justified.

Although the sticking tax point would apply in principle to any VATable costs incurred by the sales representatives, the appeal was advanced in particular in relation to one that was fundamental to the business model: sales of demonstration products by the company to the representatives. These were undoubtedly an input of the representatives in making their sales; charging output tax both on the full retail selling price of the products they sold, and on the demonstration products used in making those sales, clearly imposed a VAT cost at the business level.

The Tribunal saw a problem in devising a remedy for the company. The derogation was granted in terms which clearly envisaged the legislation as it stands, so any unfair result had been authorised by the Council. It was therefore inevitable that a reference to the CJEU would be required.

The Tribunal noted that HMRC had agreed variations on its original Notice of Direction under Sch.6 para.2 to reflect the fact that:

- some products were sold for the representative's own use – these should only be charged to VAT on the amount paid, not the retail price;
- some representatives gave a discount to their own customers – these should only be charged on the discounted price, not on the full retail price.

These amendments were not in contention; the Tribunal simply noted them to record that the parties were in agreement about the need for practical measures to adapt the Direction to fit the circumstances.

The Tribunal was "astonished" to find that HMRC and the company had agreed, to an accuracy of two decimal places, the proportion of demonstration products that had been:

- bought by representatives for their own use – the VAT was not a sticking cost at the business level, because the representative was in effect a final consumer;
- bought and used for demonstration purposes – although it was already agreed by HMRC that the Direction should not apply to these, because they were not for sale, the output tax charged to representatives who were not VAT-registered contravened the principles of the tax.

HMRC apparently suggested that the problem would "go away" if the company gave its demonstration products to the representatives rather than selling them at a profit, as Boots does to its employees. The Tribunal described this suggestion as "completely misplaced", because Boots' employees were not a separate person in a chain of supply. In any case, there were sound business reasons for the way the company operated, and HMRC's alternative was impractical.

HMRC also suggested that all Avon ladies could become VAT-registered, which the Tribunal described as "even more extraordinary". This would surely lead to most of them ceasing to be Avon ladies, with the resultant disappearance of the whole business.

The Tribunal noted that Portugal has a derogation for similar businesses which transfers the responsibility for VAT accounting from the representative to the main business. Although the situation is different, in that the lower registration threshold means that the representatives are likely to be taxable persons, the end result was the coherent one that Avon wanted in the UK: the main business could deduct the input tax incurred by the representatives.

The Tribunal accepted the appellant's contention that Sch.6 para.2 created unfair competition in that companies selling cosmetics to registered retailers such as Boots and other high street stores did not suffer the same sticking cost. The Tribunal considered that fair competition required similar businesses acting in the same way to be taxed in the same way. It was possible for traders to choose to carry on their business in a different way and be taxed differently as a result, but that was not the case here. It might be that the derogation had originally been introduced to prevent unfair advantages to party plan sellers, but it appeared to have swung the pendulum the other way.

The company asked for the "simplest solution", which was to give an effective deduction for the VAT in the demonstration goods, probably by implying into any Notice of Direction a requirement to make an adjustment for such goods in calculating the uplifted output tax. The Tribunal noted that a "principled approach" would take into account all VATable costs incurred by agents, not just the demonstration goods.

The Tribunal concluded that HMRC's defence of the current treatment was "completely untenable". The effect of the system was "unfair", not "in some vague manner", but in the very specific sense of creating a fiscal distortion.

"*What we mean by unfair is that the derogation does not counteract the perceived avoidance of VAT in the case of sales through non-VAT registered representatives in a proportionate manner. It imposed more additional tax than any realistic calculation of the VAT said to be 'avoided'. It occasioned 'sticking tax', or a lack of neutrality by not reflecting the inputs associated with the purchase of demonstration items, in the ultimate calculation of VAT payable by the Appellant. It created an element of potential unfair competition between the Appellant and its representatives and all other entities selling through taxable retailers. The derogation therefore needlessly and wrongly undermined two fundamental tenets of the VAT system in order to occasion this unfairness, and there has not been mentioned to us any conceivable reason why that was thought necessary or appropriate.*"

The Tribunal concluded that it would be necessary to seek guidance from the CJEU on how to deal with what appeared to be the UK's compliance with a derogation that contravened fundamental principles of VAT and which therefore should not have been granted in the terms it was. HMRC initially declared that they would appeal to the UT to try to prevent a reference; the Tribunal questioned whether that was a matter on which an appeal to the UT was possible, and it would defer considering the terms of reference to the CJEU until it was clear whether HMRC would appeal. HMRC subsequently abandoned the idea of an appeal.

The CJEU

The CJEU did not regard the matter in such a serious light. It appeared to regard the two sides of the problem as quite distinct from each other: on the one hand, the derogation was intended to prevent the avoidance of tax that arose from selling through unregistered agents, and it did exactly what was necessary to achieve that result; on the other hand, the deduction of input tax was covered by art.17(2) PVD, and that was unrelated to the derogation or to the calculation of the output tax. Any interference with the amount of input tax deductible would be an unauthorised derogation from art.17(2). The inability to deduct arose because the party plan sellers were not subject to VAT. There is an implication that the problem arises from allowing small businesses to escape the VAT system, and the problem is caused by the businesses choosing to take advantage of that.

The CJEU also rejected an argument that Customs had not provided the Commission with sufficient information when applying for the derogation (i.e. had not explained the problem that the Tribunal considered was so unfair). The derogation was validly applied for and validly given, and the UK law was in compliance with it. A subsidiary question, about measuring the loss of tax permitted under a derogation, was ruled inadmissible as not being sufficiently relevant to the company's liabilities.

CJEU (Case C-305/16): *Avon Cosmetics Ltd v HMRC*

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

2.8.1 Distance learning courses

A commercial provider supplied distance learning courses in various trade subjects such as electrical and plumbing work, and animation and "games" courses, enabling people to become proficient in designing and animating computer and iPhone-type games. A dispute arose with HMRC over the liability of the supplies. Both sides argued that the courses were a single supply: the appellant claimed it was a zero-rated supply of manuals, while HMRC argued that it was a single supply of education by a non-eligible body, and therefore did not qualify for any relief.

In the FTT (TC04675), Judge Howard Nowlan started by commenting that "*we have found it difficult to rationalise all of the relevant authorities and to arrive, with confidence, at the correct tests to apply in identifying the nature of the single supply. While we regret this observation, we consider that this case may well be one where there will be appeals to a higher court, and quite possibly a referral to the ECJ for guidance.*"

There were subsidiary questions, including a secondary argument by the company that if it was supplying education, there should be a large zero-rated element for the manuals. HMRC accepted that the manuals were not an "ancillary supply", but considered that this did not change the fundamental nature of the company's offering.

Other issues arose from the history of the dispute and the way in which HMRC had changed their views over time. Up to 2009, it had been agreed that there were two separate supplies, and the taxpayer and HMRC reviewed from time to time the methodology underlying the accepted split of the consideration received into zero-rated and standard rated portions. Generally the result was 75% zero-rated. HMRC had formally agreed a method in 2000; this was withdrawn with retrospective effect in 2009 in relation to the refusal of an additional repayment claim for 2006. Shortly before judicial review proceedings were due to commence, HMRC decided not to pursue the past assessments, but nevertheless to sustain their view of the correct position going forward. Certain points in the judicial review proceedings remained unresolved, but Mr Justice Warren ordered that the case be remitted to the Upper Tribunal and should stand behind the FTT litigation in relation to the substantive issues.

When HMRC dropped the retrospective assessments, they agreed to pay the repayment claim. However, they refused to add interest, arguing that this was not properly "VAT" but a payment to reflect the trader's legitimate expectations. The trader maintained a claim to interest.

A particular point outstanding from the judicial review dispute was the treatment of VAT payable under "continuous supply" provisions. The company had always fixed its VAT liability on 3-year courses when the customer signed a contract. However, VAT was only collected on courses paid for through a finance company when each instalment fell due. This meant that changing the liability from 25% to 100% standard rated during the 36-month period of a course would have an unfair effect on the company – it would have to account for output tax when it had no means of adjusting the charge to the customer. HMRC argued that the FTT had no jurisdiction to consider this point.

The judge concluded that the jurisdictional issues would fall away if the principal point in dispute were to be decided in favour of the taxpayer –

the repayment in 2006 would become VAT, and there would be no need for any adjustment in the middle of a course. He therefore proceeded to deal with that first; adopting the following approach:

- *first to give a general description of the Appellant's trade;*
- *then to amplify the description of the two types of example course that were considered extensively during the hearing, and to indicate the elements of non-book supplies that were offered in relation to each;*
- *then to summarise the marketing of the courses, and the way in which specialist "interviewers" were involved in selling the courses;*
- *and then to describe the relevant features in relation to exams and qualifications that customers might wish to pass and to obtain.*

In describing the business, the judge commented that it appeared the "tutorial support" element of the courses might have been over-emphasised in the marketing material. The essence of what was offered was a great deal of self-taught reading material. The appellant claimed that tests were marked by a computer system, and "tutors" who could be contacted by telephone would only refer the caller to the appropriate part of the manual. There was no intention to add anything to the manuals themselves.

The judge noted that at any time the company might have between 40,000 and 60,000 customers engaged on courses. It only had 14 employees, of whom only 8 dealt with "tutor support". Although there was some dispute about the importance of the tutor support, the judge concluded that it was clear enough that only a tiny minority of customers sought tutorial support on only a trivial number of occasions. The appellant suggested that a customer needed to spend 500 to 750 hours working on the material; in comparison, any "service" element was immaterial.

The judge distinguished the *College of Estate Management* case, which had 100 staff including academics who undertook assessment of students through written assignments, and where there was considerable classroom contact to which the printed materials were ancillary. In this case, the judge concluded:

"*...we consider that the manuals are the Appellant's principal provision and all other items are ancillary. This results not only from the fact that the manuals in isolation are intended to be, and we consider them to be, sufficient to achieve the customers' desired end in itself, and the "add on" items are irrelevant in this context, but the majority of customers continued with the courses and continued to receive and, presumably, to study the manuals, yet many (indeed we were told a considerable majority) made no use of the "add-on" functions whatsoever. This is not to say that they were not available and part of the contracted supply. Of course they were. But if the end could be, and often presumably was, attained without resort to any of the "add on" functions, this demonstrates that the add-on functions must have ranked as ancillary.*"

The judge went on to analyse the law, commenting that it is not entirely clear. He considered that in a dispute between "two separate supplies" and "one supply with two elements", the tests are "relatively straightforward" – it is necessary to consider all the circumstances from an economic point of view, and from the perspective of a typical consumer. If one element is the principal supply and the others are ancillary and for its better enjoyment, it would be artificial to split the supply into different elements. If each is an aim in itself for the customer, it will be necessary to apportion the consideration.

There is more difficulty in deciding the nature of a single supply, if it is concluded that there should be no apportionment. In some cases, it will take its nature from the principal supply to which the other elements are ancillary (described as "test 1"). However, this will not always be the case, as illustrated by the restaurant meals in *Faaborg-Gelting Linien* and the vaccination of patients in *Dr Beynon & Partners*. Where a customer wants a particular service which encompasses the principal element (e.g. "a meal in a restaurant" encompassing "the food"), that will be a different single supply from the principal element (described as "test 2").

"Test 3" was derived from *Deutsche Bank*, where the CJEU held that both the supply of investment research (standard rated) and transactions in investments (potentially exempt) were of equal importance; neither was subsidiary to the other. However, the composite supply could not be said to fall within the exemption.

"Test 4" applies where there is an apt description of the overall supply which differs from the component elements. This includes the cases referred to under test 2, and also *College of Estate Management*, where the overarching supply was "education". The judge examined the reasoning of these cases in detail, and also *Byrom t/a Salon 24* and *Finnamore t/a Hanbridge Storage Services*.

In summary, HMRC argued that test 4 was the appropriate one to apply, and the appellant's supply should be regarded as "education". The appellant contended that the European precedents applied tests 1 to 3, and the UK precedents in which test 4 had been developed were of less binding force. The judge noted that he could not derive the correct legal principle with confidence, and it might become necessary to refer questions to the CJEU for guidance. However, he was satisfied that test 1 was the appropriate principle in this case. He applied it in some detail to the various arguments raised by HMRC, but concluded that the case was very different from *College of Estate Management*. There was a supply of books, to which all the added-on elements were ancillary and incidental.

Turning to the other issues, the judge gave opinions that would become relevant if the decision on the principal issue is overturned on appeal. In his view, HMRC's refusal to add interest or repayment supplement to the "concessionary" repayment of the 2006 claim would be correct: there would be no "VAT credit" that would carry a statutory right to such additions. The protection of legitimate expectations was outside the VAT Act provisions.

As regards the judicial review point in relation to the change of liability of contracts in progress, the judge considered three separate arguments advanced by the appellant in support of the FTT having jurisdiction to hear such a matter, and rejected all of them. However, he also went on to express the decision he would have given if he had jurisdiction: if HMRC had been correct in 2009 to change the treatment agreed in 2000, they should have allowed the company to continue that agreed treatment for contracts in progress, because that reflected a legitimate expectation. To require the company to change the treatment when it had no means of changing its charges to its customers was effectively retrospective taxation.

The company's appeal was allowed, and HMRC appealed to the Upper Tribunal. In case it lost on the main issue, the company cross-appealed on the secondary issues. This included the issue that the FTT did have jurisdiction to consider the legitimate expectation point in relation to the "run-off" period of contracts in progress.

The Upper Tribunal also considered the principal issue first. It noted that the FTT had decided that there was a single supply on the question of whether the lesser elements were ancillary to the main one, but would have come to the same conclusion on the second test, of whether it would be artificial to split the supply into its constituent elements. HMRC argued that the FTT had come to the wrong conclusion by asking the wrong question: by considering how the supply was used, rather than how it would be objectively viewed by the typical customer and whether each element would be regarded as an end in itself or independently provided education. HMRC also argued that the FTT's conclusion on "predominant supply" arose simply from the conclusion that the manuals were the principal supply, and did not consider the economic purpose of the typical customer. The FTT had also made some errors of fact and had come to an unreasonable conclusion that was not open to it on the basis of the evidence.

The most recent CJEU case to consider the issue, and to develop the concept of "predominance", was CJEU (Case C-18/12): *Město Žamberk v Finanční ředitelství v Hradci Králové*. That mainly concerned whether "unorganised sport" could fall within the exemption, but it also posed the question "whether art 132(1)(m) of the VAT Directive must be interpreted as meaning that access to an aquatic park which offers visitors not only facilities for engaging in sporting activities but also other types of amusement or rest may constitute a supply of services closely linked to sport." The CJEU repeated the usual phrases from *Levob* and *CPP*, but went on apparently to introduce a new test of "predominance".

"29. In order to determine whether a single complex supply must be categorised as a supply closely linked to sport within the meaning of art 132(1)(m) of the VAT Directive although that supply also includes elements not having such a link, all the circumstances in which the transaction takes place must be taken into account in order to ascertain its characteristic elements and its predominant elements must be identified (see, to that effect, in particular, *Faaborg-Gelting Linien A/S v Finanzamt Flensburg* (Case C-231/94), paras 12 and 14; *Levob Verzekeringen* and *OV Bank*, para 27; and *Bog*, para 61).

30. It follows from the case law of the court that the predominant element must be determined from the point of view of the typical consumer (see, to that effect, in particular, *Levob Verzekeringen* and *OV Bank*, para 22, and *Everything Everywhere Ltd (formerly T-Mobile (UK) Ltd) v Revenue and Customs Comrs* (Case C-276/09), para 26) and having regard, in an overall assessment, to the qualitative and not merely quantitative importance of the elements falling within the exemption provided for under art 132(1)(m) of the VAT Directive in relation to those not falling within that exemption (see, to that effect, *Bog*, para 62)."

The UT interpreted this as meaning that the necessary objective assessment of the intention of the typical consumer has to be carried out first by assessing whether there is a "predominant" element. If that can be done, it characterises the supply. It will often not be possible to conclude that one element predominates. Sometimes that is enough to settle the legal issue: a supply with no predominant characteristic will probably not fall within any of the exemptions, as in *Deutsche Bank*.

HMRC's representative argued that there was a further test, of whether there is an "over-arching" supply. She cited *Faaborg-Gelting Linien* as an example of this. The judges were not convinced that this was a separate test, considering rather that the services in that case "predominated" (even if not described in those terms). The judges considered a number of UK precedents for authority for an "over-arching" test, and came to the following conclusions:

(1) The *Mesto* predominance test should be the primary test to be applied in characterising a supply for VAT purposes.

(2) The principal/ancillary test is an available, though not the primary, test. It is only capable of being applied in cases where it is possible to identify a principal element to which all the other elements are minor or ancillary. In cases where it can apply, it is likely to yield the same result as the predominance test.

(3) The "overarching" test is not clearly established in the ECJ jurisprudence, but as a consideration the point should at least be taken into account in deciding averments of predominance in relation to individual elements, and may well be a useful test in its own right.

HMRC's representative referred the Tribunal to a number of FTT decisions that had concluded similar supplies were "education", but the judges commented that their decision would depend on the particular facts of the present case, and those cases were not particularly helpful.

The judges examined the FTT's reasoning. It appeared that the FTT had considered both the "principal/ancillary" test and the "predominance" test, and had come to the same conclusion on both: there was a single supply of zero-rated books. These were the correct tests, so the only way to overturn the decision would be to show that the conclusions were not open to the FTT on the basis of the evidence before it. That required HMRC to show either that there was no evidence which could properly support the findings made by the FTT or that the determination reached was one that no Tribunal properly instructed could have reached (*Edwards v Bairstow*).

HMRC's criticism of the FTT's conclusions was based on a number of features of the supply that were typical of a supply of education, not a supply of books:

- control of access to the course;
- monitoring of progress through testing;
- requirement for tests to be passed before further manuals would be issued.

The FTT had not considered examples of student progress reports that were in the evidence bundles, and did not appear to understand the process of controlling access to the "virtual room" that was part of the electrical course.

HMRC also argued that the FTT had failed to give the appropriate weight to the tutorial support provided, and its importance to the students. The criticisms were numerous and listed under several further headings.

The school's representative responded by reiterating the justification for the FTT's decision, and rebutting various points made by HMRC.

The judges grouped HMRC's arguments under four headings:

- failure to take into account the element of control which the School had over the entry of students on to courses and over progress of students through the course;
- findings that incorrectly downplay the significance of tutorial support in the supply made by the School;
- findings which diminish or fail to reflect the importance of the other components in the supply;
- findings which relate to the manner in which a customer would have perceived the supply that the School was offering to make.

The UT appeared to regard the first two of these as finely balanced – the FTT had correctly recorded the factors that led to its conclusions, but there was some force in some of the criticisms. However, in relation to the third and fourth groups, HMRC's case was much stronger. The FTT had been wrong to dismiss important elements of the courses as "add-ons"; in particular, a course on computer games and animation made no sense at all without the software element. Similarly, it was an error to attach "little importance" to the marketing of "courses" rather than books. Overall, therefore, the FTT decision had thoroughly considered the facts, but had failed to give adequate weight to a number of matters. Although the overall evaluation of the facts is a matter for the FTT, the UT held that the shortcomings in its decision justified the conclusion that the decision was not sustainable.

This was particularly the case in relation to the application of the principal/ancillary test. The manuals could not be described as the "principal" element of the supply as that term is used in the case law. It may have been the main element, but the legal use of the term "principal" requires that the other elements of the supply were not "an end in themselves" but were "for the better enjoyment" of the manuals or "subservient, subordinate or ministering to" the provision of the manuals.

That meant that the FTT decision had to be set aside, and the UT proceeded to consider its own decision. The principal/ancillary test failed to help the school, and the "predominance" test was no better. The manuals were quantitatively predominant, but that was not the correct test. Objectively assessed, the course was "blended". The school was contractually obliged to provide, and did provide, all the different elements. Those other elements could not be classified as "books", and they were too significant to ignore.

The UT briefly considered whether the FTT had also been wrong to conclude that there had been a single supply. It had held it to be so using its incorrect application of the principal/ancillary test; but it had also concluded that the supplies were economically inseparable, and this alternative basis justified the same conclusion. HMRC's appeal was allowed, and the whole supply would be standard rated.

There were then two further issues to be considered, which became "live" only if the FTT had been wrong on the main issue:

- whether HMRC should be prevented from applying the changed position to the 3-year run-off period of courses for which the school was contractually committed to a price determined on the basis of more zero-rating;
- whether HMRC should pay repayment supplement in respect of a delayed repayment in relation to a period where HMRC had initially effectively applied the new treatment retrospectively, and then decided to apply it only going forward.

The UT dismissed the taxpayer’s position on both points. Although the agreement reached with HMRC could create a legitimate expectation that it would not be withdrawn retrospectively, it could not reasonably be expected that HMRC would be bound to follow it for such a long period into the future. Although there was apparent merit in the school’s case for repayment supplement, on the technical reading of the law HMRC were correct: the repayment was not a “VAT credit”, but a discretionary payment that was not VAT, made to settle a dispute about the fairness of changing the position retrospectively. Only a repayment of VAT was eligible for repayment supplement.

Upper Tribunal: *HMRC v Metropolitan International Schools Ltd*

2.9 Agency

2.9.1 Holiday lodges

A company owned and operated three holiday parks in southwest England. It sold holiday lodges to customers who were generally private individuals and who did not own the lodges in connection with a business. The lodge owners paid a sum to purchase the lodge and an annual site fee and other charges for utilities, insurance, maintenance and repairs.

The lodge owners were permitted to let their lodges on a short-term basis using one of two schemes operated by the company. Other lettings were not permitted, although lodges could be lent free to friends and relations.

Under the first scheme, the lodge owner made the lodge available to the company for letting for a set number of weeks. The company arranged for cleaning and other changeover operations, paying for them and recharging them to the owner. The company was paid 20% of the rent receivable. It treated the recharge of costs as VATable, recovering input tax and accounting for output tax, and HMRC agreed that this was correct.

Under the second scheme, the owner made the lodge available to the company for 46 or 48 weeks a year in return for a guaranteed return, typically 6% of the original cost of the lodge. The company arranged for all the lettings and incurred all the costs; the owner did not have to pay the annual site fee or other annual charges. If the rental income exceeded the guaranteed amount, the lodge owner would be paid the excess, subject to deduction of the annual charges and a 20% commission. It was not clear how this was supposed to work, but according to the evidence, it had never happened. The correct treatment of this scheme was the subject of the appeal.

To start with, the company accounted for all income received as subject to output tax. In 2010 it submitted a voluntary disclosure claiming repayment of output tax on the basis that it was acting as an agent for the unregistered lodge owners. HMRC accepted this in relation to the first scheme, but ruled that it acted as a principal in relation to the guaranteed income scheme. Over the course of the next few years, HMRC issued assessments for output tax that was not being declared by the company.

The Tribunal agreed with both parties that it was necessary to start with an analysis of the contracts. However, some of the contracts were ambiguous and unclear; in particular, the contract between the lodge owner and the company was expressed as a legally binding agreement for 99 years in relation to a lodge, but it did not make clear what rights the lodge "owner" had. It was implied rather than explicit that the lodge could be placed on the company's site.

The Tribunal (Colin Bishopp) considered the High Court's judgment in *A1 Lofts Ltd* for guidance on the difference between agent and principal. In that case, the appellant had sold a package of services to the customer, who would not have been aware that he was contracting individually with tradespeople for subsidiary elements of a loft conversion. The High Court set out how the analysis of the contracts should be carried out; in the end, the FTT came to the same conclusion on the basis of the judge's instructions as it had earlier come to without them – the loft company was supplying the whole package, not just project management. The case has become a leading precedent on interpretation of agency contracts.

The company's representative argued that the agreement between the owner and the company established an agency relationship. It authorised the company to offer the lodge to holidaymakers, on behalf of the lodge owner, and to do so as his agent. It followed that the company was only liable to account for VAT on commission received. The other agreements – between the company and the holidaymaker, and between the company and the agency that marketed the lodges for it – were not relevant.

HMRC's representative argued that the effect of the guaranteed rental agreement was that the lodge owner supplied the lodge to the company in order for the company to let it to holidaymakers. The company set the rents and bore the costs; until the guaranteed minimum was exceeded, everything to do with the letting stayed within the company. He contended that it was not proper to ignore the agreement between the company and the marketing website (the only agreement that appeared to have been drafted by a lawyer) – it referred to the company as a principal.

The judge commented that it was surprising that the company appeared to make a loss on the guaranteed income scheme in every case. This suggested that it was more interested in attracting investment purchasers than operating a rental operation. The agreement between the company and the owner did not set out any details of the relationship between them, which suggested that it was not an agency contract. The only realistic conclusion, in the view of the judge, was that the lodge owner handed over the lodge to the company to let it as the company saw fit during the 46 or 48 weeks provided by the agreement.

The judge also commented that the guaranteed income did not rule out agency, but the absence of any direct link between the income actually earned and the reward to the principal made the existence of agency harder to sustain. Here, there was nothing else to support the proposition that an agency existed; the theoretical possibility of handing over excess income was not enough on its own.

The judge disagreed with HMRC on the significance of the agreement with the marketing company. The use of the term "principal" was suggestive but not conclusive. However, the burden of proof was on the appellant, and the rest of the evidence was not enough to show that it was acting as an agent. Indeed, the judge concluded that it was acting as a principal in letting lodges to holidaymakers, and it was not necessary to consider the consequences of the theoretical possibility of commission arising on excess income.

The appeal was dismissed.

First-Tier Tribunal (TC06136): *Wilson Leisure Developments Ltd*

2.9.2 TOMS

HMRC assessed a company to underdeclared output tax from 01/06 to 12/10 on the basis that it was acting as a travel agent and was therefore liable to account for VAT under the TOMS in the UK where it was established. The company argued that it was acting as a disclosed agent or intermediary, and was therefore not subject to TOMS.

The Tribunal (Judge Harriet Morgan) summarised the decision of Lord Neuberger in *SecretHotels2*, which she considered to be directly relevant. A travel agent acting solely as an intermediary fell within the second limb of art.306(1) PVD, and was not within TOMS. The application of TOMS was a matter of EU law, but the construction of the contracts was a domestic law issue. On the facts of that case, the appellant company was acting as agent for the hotelier in relation to the supply of accommodation, and therefore succeeded in its appeal.

Turning to the present case, the judge noted that there were several similar cases before the Tribunal, on which HMRC were seeking a reference to the CJEU regarding the proper interpretation of art.306. She ruled that the case could be heard and resolved on its own, subject to the outcome of that reference. Accordingly, she considered whether the company was acting as a principal or as a disclosed or undisclosed agent under English law.

There was a preliminary issue about whether HMRC should be allowed or required to amend their statement of case. They had suggested in January 2017 that the Tribunal should consider only a narrower range of issues, effectively conceding a number of points that they no longer wished to rely on. The company asked for the revised statement to be formally set out, rather than proceeding on the basis of the original statement with some items to be left out. After considering various arguments by the parties, the judge decided that there was insignificant prejudice to the appellant in allowing HMRC's case to proceed on the basis of the amended statement.

HMRC's narrower argument was that the company had not proved it was acting as an agent where the following circumstances applied:

a) The absence of contractual documentation containing terms and conditions and/or any terms and conditions stating that the appellant is appointed as agent, whether such documentation is missing/incomplete or unsigned.

b) Written agreements governed by foreign law as well as or instead of English law.

c) Agreements that are only “rate sheets” and do not refer to the terms and conditions between the parties.

d) Agreements where the “rate sheets” do refer to terms and conditions but do not expressly identify the terms and conditions.

The Tribunal examined the way the business ran in some detail, based on the bundle of documents and one witness for the company, who had left its employment in 2014 but who was involved in the relevant areas for an eight month period in 2010. HMRC sought to draw an adverse inference from the fact that the company only called one witness and he was not involved throughout the period, in particular in the drawing up of contracts. However, the Tribunal took due note of his account of how the business ran.

In concluding, the judge noted that it was not disputed that the appellant entered into binding contractual terms with travellers on the basis of the website terms, those terms were governed by English and those terms were, therefore, to be interpreted under English law. It was also not disputed that the effect of those terms, under English law, was that the appellant was acting as agent for the provider in its dealings with the travellers. The only question, therefore, was whether the arrangements between the appellant and the providers were consistent with that or demonstrate that supplies of accommodation were made by the providers to the appellant.

HMRC’s objections to the contracts with providers were rejected. Even if they were not in all cases signed, it was clear that they had been adopted by conduct, and the evidence supported the company’s view of how the business was carried on. On the balance of probabilities, the “standard provider terms” governed the way in which the company dealt with the providers.

There was then a lengthy consideration of the relevance of the “proper law of the contracts”, and who would have to put forward an argument based on the construction of contracts governed by foreign law. The Tribunal in *Hotels4U.com* had concluded that it could not rule on contracts governed by foreign law without expert evidence being presented. The judge’s view was that it was appropriate to apply the rule of evidence set out in the authorities and adopted in the courts, namely, that if neither party pleads and proves what the potentially applicable foreign law is, the court or tribunal can apply English law. On that basis, it was clear that the contractual arrangements with the providers were entirely consistent with the appellant acting as a disclosed agent. That characterisation represented the economic reality of the relationship in the light of the facts as set out in the decision.

The Tribunal therefore allowed the company’s appeal, subject to the resolution of questions that might be referred to the CJEU about the interpretation of art.306.

First-Tier Tribunal (TC06185): *Alpha International Accommodation Ltd*

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Goods or services?

An appeal arrived in the FTT in July 2012 relating to a ruling on a proposed product which was requested and given in 2006. The company had proceeded on the basis that its interpretation of the product was correct: the product – a new type of finance contract called 'Agility' – was offered to customers from 1 August 2007, so the company was therefore appealing against assessments rather than merely the ruling. The amounts involved up to 2008 exceeded £10m.

The FTT decision

The question was whether the contract constituted a supply of goods (in effect, hire purchase) or a supply of services (in effect, leasing). The company considered it to be different from its existing financial arrangements, offering a customer a choice of three options at the end of the normal lease term: purchase, return, and purchase plus part-exchange.

HMRC argued that the law regarded such a contract as a supply of goods, because the contract envisaged that title could pass at the end of the agreement. The company stated that this was only a possibility, not an inevitability, and it therefore made a supply of services – the contract was a rental agreement which would only become a supply of goods if the customer chose that particular option at the end.

Art.14 PVD provides that '*the actual handing over of goods pursuant to a contract for the hire of goods for a certain period, or for the sale of goods on deferred terms, which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment*' is to be treated as a supply of goods. The company argued that 'in the normal course of events' did not apply to the Agility contract, because it was not the most likely outcome.

HMRC responded by arguing that this was a misinterpretation of art.14. The phrase 'in the normal course of events' only referred to when the title would transfer under the particular contract, not whether it was more likely than not that tile would be transferred. Agility involved handing over goods pursuant to a contract for hire; in the normal course of events, title would transfer – if it transferred at all – upon payment of the final instalment.

The Tribunal quoted extensively from the recent CJEU decision in *Eon Aset Menidjmunt OOD* (Case C-118/11), in which it was decided that a lease contract is normally a supply of services, but could in certain circumstances be treated as a supply of goods. The company argued that the CJEU had considered the commercial perspective when giving guidance on the borderline between goods and services, and had also suggested that the accounting treatment was relevant. Under accounting standards, in distinguishing between a finance lease (treated as a transaction in goods) and an operating lease (treated as rental), a judgement had to be made at the outset whether the transfer of title was more likely than not.

By contrast, HMRC relied on the same decision, noting that, in setting out the features of a finance lease, the CJEU had apparently only required that the transfer of ownership is provided for as a possibility in the contract. HMRC also drew support from the GMAC litigation, in which a contract which provided different terminal options was nevertheless at all times treated for VAT as a supply of goods.

The company presented a detailed explanation of the commercial rationale for the Agility product. It was not designed with the VAT treatment in mind, and the uncertainty over the VAT treatment did not affect its introduction: the company considered that it should be treated for VAT in a manner consistent with the commercial reality and accounting treatment, i.e. as rental.

The Tribunal considered the different interpretations of ‘in the normal course of events’. It did not agree with the company’s proposal that it involved a greater than even probability that the option to purchase should be exercised; it also rejected HMRC’s suggestion that it qualified only the time at which title would pass. The Tribunal preferred to regard the expression as referring to the transfer of title as something that was central to the contract – that was envisaged by the contract as a normal outcome, not as something that would be abnormal.

The Tribunal also considered that the company’s argument would offend against the principal of legal certainty, in that it would be impossible to determine whether the supply was goods or services until the conclusion of the contract.

It is interesting that the company asked for specific findings on 11 questions, and the Tribunal obliged, even though it commented that most of these matters were irrelevant to the eventual decision. Presumably these findings of fact will be pored over by lawyers in the case of an appeal. They were as follows (there appear to be only 10, but one may combine two points raised by the company):

Appellant’s Proposed Finding of Fact	Tribunal’s Comment
The objective purpose of Agility is the hiring of a Mercedes Benz motor vehicle to a customer who wishes to keep his options, regarding ownership of the motor vehicle, open until maturity. This is reflected in the name of the product, implying flexibility, and this is how Agility is advertised/described to customers.	The Tribunal disagrees. In relation to its determination (see paragraph 79 above, and to wider circumstances see paragraph 103 above) Contradictory marketing evidence (see paragraph 101 above)
And Agility is recommended both online and at dealerships to customers who wish to keep their options open; alternative products are recommended to customers who decide at the outset that they do or instead do not wish to own the motor vehicle	HMRC challenged the accuracy of this statement because the Appellant adduced no evidence to substantiate it. The Tribunal ruled that HMRC was not entitled to do this because it was an agreed statement of fact. The Tribunal, however, considers this agreed statement of fact has to be weighed against the commercial rationale (see paragraph 99 above).
The purpose of Agility is reflected in its terms: the customer hires the vehicle for a fixed period in return for monthly payments, and at maturity he has an option	The Tribunal disagrees. See its findings at paragraphs 79 and 80.

to purchase for a fixed price which is calculated at the outset to be equal to the market value of the vehicle at maturity.	
The calculation is genuine and expert estimate of the residual value of the vehicle; it is made partly be reference to external guides e.g. Glass's guide, and partly by reference to Mercedes Benz own knowledge about forthcoming developments which are likely to affect future values, for example, new models	Agreed. The Tribunal, however, questions its relevance for the Appellant's case of flexibility based on the wider circumstances.
The typical period of an Agility contract for a new vehicle is 3-4 years; for a second hand vehicle it is slightly less. For new and second hand vehicles, the period of an Agility contract is always substantially less than the useful life of the Mercedes Benz motor vehicle. This means that the residual value is substantial not a nominal sum.	An agreed statement of fact. The substantial sum has to be weighed against the evidence which showed that the customer's contribution in respect of monthly payments with interest and deposit exceeded the residual value by a significant sum. In the Tribunal's view, the amount already paid was important in relation to the characterisation of the agreement and the customer's decision to exercise the option.
Merely by entering into the Agility agreement, and merely by paying the obligatory monthly payments, the customer is not commercially committing himself to becoming the owner of the vehicle.	The Tribunal does not understand the term commercially committing. The Tribunal accepts that the customer has to exercise an option to purchase before ownership is transferred. The Tribunal, however, considers the monthly payments represent a significant investment in the vehicle by the customer.
Statistics show that the purpose of Agility is in fact achieved; on average around 50 per cent of vehicles are purchased and 50 per cent are returned	Hire purchase have similar high rates of return
The Appellant is neutral as to whether or not an Agility customer decides at maturity to purchase or not to purchase, the motor vehicle.	The Appellant carries no risk if the vehicle is returned.
However, because there is a very real prospect of the customer returning the vehicle, Agility, obliges the customer at maturity to pay for damage to the vehicle, and to pay for excess mileage, and also obliges him to service the vehicle at Mercedes-Benz approved workshops only.	Agreed statement of fact. Relevant to the Tribunal's characterization of Agility as a contract for sale of a vehicle (see paras 79 and 80 above).
Having regard to the terms of Agility there is no expectation at the outset that a typical Agility customer will purchase the vehicle	Tribunal disagrees. Its findings on the agreement and wider circumstances demonstrate that Agility is portrayed as an affordable means to purchase the vehicle.

The decision itself (to dismiss the appeal) was summarised as follows:

(1) The words of Article 14(2)(b) should be read straightforwardly which direct attention to what is provided for in the contract, not on the wider circumstances.

(2) The description of the agreement as hire purchase, the provision for a deposit payment, the specified financial information including the cash price for the vehicle, the substantial capital payment inherent in the contract structure, and the option to purchase are compelling indicators of Agility being a contract of sale of a car

(3) On a proper analysis the sole realistic option under Agility is to purchase the vehicle

(4) In the normal course of events is to be construed as a question of whether the passing of ownership was normal under the terms of the contract, rather than abnormal,

(5) The fact that ownership might not transfer under the Agility contract did not preclude it from being a contract for sale. The passing of title is central to Agility which meant that ownership would normally pass under its terms.

The Tribunal is satisfied on its findings that Agility is a contract for the sale of goods on deferred terms, which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment. Article 14(2)(b) of the VAT Directive, therefore, applied to Agility.

The Upper Tribunal decision

The company appealed to the Upper Tribunal, which decided that the FTT had made errors of law, and overturned its decision.

First, to come within art.14(2)(b) PVD, the acquisition of the goods at the end of the contract had to be *the* normal outcome, not just *a* normal outcome.

Second, the agreement could not be characterised as, in effect, a contract for sale of a vehicle. It was a contract for hire with an option to purchase; that would only be deemed to be a contract for sale of goods if the option was normally exercised. The FTT had reached a conclusion, or a characterisation of the contract, that was not justified by its findings of fact.

A third ground of appeal, that the Tribunal had made findings of fact which had not been contended for by HMRC and had acted unfairly in so doing, was rejected.

The judge noted that there are no CJEU cases directly about art.14(2)(b). The *Eon Aset Menijdmunt* case refers to it, but is not directly relevant to the point at issue here. The judge made the following points of general application:

(1) As recital (1) to the Directive shows, the Directive is intended to harmonise the laws of the Member States relating to turnover taxes and provide for a "uniform basis of assessment".

(2) It is therefore not surprising that the ECJ has said that the notion of supply of goods is not to be determined by national law: the purpose of the Directive might be jeopardised if the requirements for a supply of goods were to differ according to the civil law of the Member State concerned: see Atktiebolaget NN v Skatteverket Case C-111/05 at [32].

(3) The concept of supply of goods is objective in nature. It applies without regard to the purpose or results of the transactions concerned and without its being necessary for the tax authorities to carry out inquiries to determine the subjective intention of the taxable person in question: see Newey v Revenue and Customs Commissioners Case C653/11 ("Newey") at [41]; Dixons Retail plc v Revenue and Customs Commissioners Case C-494/12 ("Dixons") at [21].

(4) Consideration of the economic and commercial realities is a "fundamental criterion" for the application of the common system of VAT. Since the contractual position normally reflects the economic and commercial reality of a transaction, the relevant contractual terms constitute a factor to be taken into consideration; but sometimes contractual terms do not wholly reflect the economic and commercial reality of a transaction, in particular if it becomes apparent that the contractual terms constitute a purely artificial arrangement which does not correspond with the economic and commercial reality of the transaction: Newey at [42]-[45]. This passage has very recently been referred to and relied on by the Supreme Court in Secret Hotels2 Ltd v Revenue and Customs Commissioners [2014] UKSC 16 at [29] per Lord Neuberger.

(5) In a passage cited by Jonathan Parker LJ in Tesco plc v Customs and Excise Commissioners [2003] EWCA Civ 1367 ("Tesco") at [41], the Advocate General (Tizzano) said this in his opinion in Customs and Excise Commissioners v Mirror Group plc Case C-409/98 and Customs and Excise Commissioners v Cantor Fitzgerald International Case C-108/99:

[quotation from judgment]

Jonathan Parker LJ later in his judgment made the point that the "economic purpose" here referred to by the Advocate General is not the same as "economic effect": two transactions may have the same economic effect but that does not necessarily mean that they are to be treated in the same way for VAT purposes: see Tesco at [159].

(6) In MBNA Europe Bank Ltd v HMRC [2006] EWHC 2326 (Ch) ("MBNA"), Briggs J referred to the same passage from Advocate General Tizzano's opinion in saying (at [35]) that the Court is not hidebound by the labels which the parties have chosen to apply to their transactions but must where necessary ascertain the "essential character of the transaction in issue".

The judge noted that it was not possible to decide what would be the "normal" outcome with hindsight: the very first Agility contract was, in principle, either goods or services on the day it was entered into, and that had to be decided on the information available at that time. For the judge, the critical fact was that the option payment was substantial – that distinguished the contract from "standard HP" where at the end of the term the customer had effectively paid the whole price, including interest, and would be foolish not to pay the very small final payment to take up the option to purchase. In the case of Agility, there was a real choice at the point the option could be exercised. It was not, as the FTT had concluded, illusory.

Court of Appeal

HMRC appealed to the Court of Appeal. The judges decided that, in the absence of specific guidance in precedent cases about the meaning of "in the normal course of events" for the purposes of art.14, the Upper Tribunal had been wrong to consider that it could be sure of the correct answer (the matter was "acte clair"). It should have referred questions to the CJEU, which is what the Court of Appeal decided to do.

CJEU

The questions referred were as follows:

(1) What is the meaning of the words "a contract ... which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment" in art.14(2)(b) PVD?

(2) In particular, in the context of the present case, does the phrase "in the normal course of events" require a tax authority to do no more than to identify the existence of an option to purchase which can be exercised no later than upon payment of the final instalment?

(3) Alternatively, does the phrase "in the normal course of events" require the national authority to go further and to determine the economic purpose of the contract?

(4) If the answer to (3) is yes:

(a) Should the interpretation ofart.14(2)(b) PVD be influenced by an analysis of whether the customer is likely to exercise such an option?

(b) Is the size of the price payable on exercise of the option to purchase relevant for the purposes of determining the economic purpose of the contract?

The court commented that, for an agreement to constitute a supply of goods, there had to be an express term relating to the transfer of ownership. Second, it must be clear from the terms of the contract, as objectively assessed at the time when it is signed, that ownership of the goods is intended to be acquired automatically by the lessee if performance of the contract proceeds normally, over the full term of the contract. The only inference to be drawn from the words 'in the normal course of events ownership is to pass at the latest upon payment of the final instalment' is that the final payment of sums to be paid by the lessee under the terms of the contract results by operation of law in the transfer to that lessee of ownership of the goods to which the agreement relates.

The court decided that the proper interpretation of 'in the normal course of events' art.14(2)(b) was as applying to a leasing contract with an option to purchase if it can be inferred from the financial terms of the contract that exercising the option appears to be the only economically rational choice that the lessee will be able to make at the appropriate time if the contract is performed for its full term, which it is for the national court to ascertain. Where the choices available to the lessee appear equally balanced, because the cost of exercising the purchase option would equate to the market value of the car, it appears that the result is a leasing contract.

CJEU (Case C-164/16): *HMRC v Mercedes-Benz Financial Services UK Ltd*

2.12.2 Article

In an article in *Taxation*, Neil Warren highlights the problems of online trading, and notes the possible inconsistencies between the resulting treatment for direct and indirect tax.

Taxation, 14 December 2017

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Clawback charge

Balhousie Holdings Ltd (BH) operated some 25 care homes in the north-east of Scotland and was registered as a VAT group with subsidiaries that carried on related activities. The dispute in the First-Tier Tribunal (TC05131) related to a sale-and-leaseback arrangement in which a care home, constructed under the zero-rating provisions for RRP properties, was transferred to a Real Estate Investment Trust (REIT). HMRC considered that this triggered the self-supply charge on a change of use – described as "potentially business ending" by the company's accountants.

BH argued that it did not fall within the legislation because it had not disposed of its "entire interest" in the property, as required by para.36(2). The sale of the property was inextricably linked to the leaseback. It was clear that BH would continue to use the building for residential purposes after the transactions, so the "mischief" that the legislation was aimed at had not occurred.

HMRC responded that the sale transaction was the "first grant of a major interest" by BH. It could not qualify for zero-rating because the grantee was not going to use it for a RRP; it was going to lease it back to BH. The transaction was therefore exempt, and that triggered the self-supply charge in Sch.10. It was necessary to look at each transaction separately, so it was not permissible to consider the sale and leaseback as part of a single whole.

There were references to numerous precedents from different taxes and legal contexts; to Notice 708, with each side putting a different slant on what the guidance meant and was supposed to mean; and to Hansard, with each side trying to discern the intention of Parliament when Sch.10 was rewritten in its current form.

The FTT considered that the taxpayer's arguments were stronger. The purpose of the legislation appeared to be to prevent tax avoidance where there was a change in the underlying use of the building, not where there was a funding arrangement such as a sale and leaseback. It was appropriate to interpret the legislation according to what appeared to be its purpose: that required the Tribunal to regard the sale-and-leaseback as a single indivisible whole. In that light, the company had not disposed of its entire interest, and the legislation did not bite. The appeal was allowed.

HMRC appealed to the Upper Tribunal. There was no dispute concerning the facts: the only argument was whether the FTT had been correct in law to look at the transactions together. Lady Wolffe rehearsed the legislation and the factual background, then noted that HMRC had changed their position. They now argued that the "disposal of its entire interest" should be interpreted as involving no more than a comparison of the situation before and after the transaction: if the company did not own "its entire interest" after the transaction, it had disposed of it. It did not matter that it had retained some other interest. This meant that arguments about a "scintilla temporis" (a moment of time) were no longer relevant.

HMRC's representative made some general observations about the transactional nature of VAT. Cases such as *Southern Primary Housing* (2003) and *Robert Gordon's College* (1995) showed that it was necessary to consider individual parts of a composite transaction, and not to regard them as part of a single whole unless one was merely ancillary to the other as in *Card Protection Plan*. She also noted that zero-rating, as an exception to the general rules of VAT, had to be interpreted strictly, and made submissions about the proper approach to the interpretation of the VAT Act and the relevance of its purpose.

HMRC argued that there were four errors of law in the FTT's decision:

(i) the reference to an "entire interest" in paragraph 36(2) of Schedule 10 is to the particular interest in land which was the subject of the initial zero-rated supply;

(ii) a sale of land is a transfer of a party's entire interest in land irrespective of whether a separate interest in that land is obtained as the result of a connected transaction;

(iii) BC therefore disposed of its entire interest in the Huntly care home when it sold the same to Target on 8 March 2013; and

(iv) the disposal by BC gave rise to a charge to VAT in terms of paragraph 37 of Schedule 10.

The judge set out HMRC's arguments on these points. The company's representative responded with several sources that supported the FTT's conclusion on the purpose of the legislation, including a statement by the Exchequer Secretary in Hansard of 31 January 2011 and RCB 49/2010. A number of alternative scenarios were suggested in which the clawback would not apply, to illustrate the illogicality of applying it in this case.

The judge agreed with HMRC on the authority of the precedents for the proposition that VAT had to consider individual transactions rather than a composite whole. She also rejected the supposed explanations of the purpose of the provision as "uninformative".

After detailed consideration of all the arguments, the judge concluded that the fundamental question was the meaning of "disposed of its entire interest". The company wanted to compare the situation before and after the transactions, and draw a benefit from the fact that it had similar rights in relation to the property; but this was based on a fallacy. Those similar rights were not connected to the supply that had originally been zero-rated, but from a different supply. The "entire interest" referred to what was derived from the original zero-rated supply, and it was no longer owned; it had been disposed of.

HMRC's appeal was allowed.

Upper Tribunal: *HMRC v Balhousie Holdings Ltd*

3.1.2 Novation of contract

A company, HCL, was incorporated in order to undertake a specific property transaction (yet to be identified at the time the company was incorporated in 2012). A suitable opportunity was identified in 2013 which would involve the conversion of an office block into residential flats. On 27 January 2014 the owner (and one of the occupants) of the property, S, entered into a contract with HCL to sell the property to HCL for £2.8 million (exclusive of VAT). The contract was conditional on S securing that two of the tenants of the office block vacated the property and on the obtaining of satisfactory planning permission by HCL. Both of these conditions could be waived unilaterally by HCL. HCL paid a deposit of 5% (£140,000). S had opted to tax the building.

On 30 April 2014, prior to completion of its contract with S, HCL entered into a contract to sell the property to another company, CCL, for £5.5m. This contract was unconditional; CCL paid a deposit of 5% (£275,000).

HCL registered for VAT on 12 May 2014. On 16 May, various additional agreements were entered into, including variations of the contract between HCL and S that were intended to secure TOGC treatment for that transfer. That would have required HCL to opt to tax, although it never did so. S consented to the assignment of the contract to CCL.

The other variation was made to the contract between HCL and CCL. It removed the obligations of the respective parties to sell and to buy the property, and replaced it with an agreement that HCL and CCL would enter into a novation of the contract with S; CCL would pay HCL a premium of £2.7m less the deposit already paid. The effect of all that was that the property passed directly from S to CCL, which reduced the charge to Stamp Duty Land Tax.

HCL issued VAT invoices to CCL, charging VAT on the £2.7m novation payment and on a separate charge of £25,400 made for "varying the contract". HCL failed to submit a VAT return and so neither accounted for the output tax nor claimed input tax. HMRC became aware of the first invoice showing VAT of £540,000 when this invoice was presented to HMRC by CCL. As a result of this, it made a compliance visit to HCL's place of business in September 2014 but was told that HCL had not started trading. In July 2015, HCL decided that the VAT shown on the two invoices referred to above had been charged in error. HCL therefore issued two credit notes to CCL on 21 August 2015 for the amount of the VAT which had previously been invoiced. It also submitted a nil VAT return to HMRC for the 07/14 VAT period.

HMRC issued an assessment for the output tax shown on the two invoices, confirmed on review, and the company appealed to the FTT. The company argued that it had made an exempt supply of land to CCL. The fact that this was achieved by novation of the contract was irrelevant. The rights under the contract with S were an equitable interest in the land, and this is covered by Group 1 Sch.9.

HMRC responded that the PVD exemptions only applied to leasing or letting of land, and supplies of freehold interests. The supply of an unexercised contractual right to purchase the property from S was not exempt. Their representative argued that this was the effect of Group 1, but if it was not, it would have to be interpreted in that way in order to give it a conforming construction (the *Marleasing* principle).

The judge analysed the law differently: in his view, the taxpayer's representative was correct to say that the contract gave it an equitable interest in the property, and that was capable of being transferred within the exemption. However, in his view the novation did not transfer that interest to CCL; rather, it cancelled HCL's equitable interest, and S made a separate supply to CCL of a new interest. The substance of the transaction was that HCL supplied to CCL the right or opportunity to enter into an agreement with S for the sale and purchase of the property. That was not a supply of goods, and it was not exempt. The assessment was upheld.

HCL had applied for costs. At first sight, it is surprising that the judge even considered this, as HCL lost; however, HMRC had changed their position during the course of the appeal, and there was an argument that their initial stance was "unreasonable". HCL's representative complained that HMRC had consistently failed to explain with sufficient clarity the legal basis on which the appeal was refused. The judge commented: "Whilst I accept that there was some confusion in the arguments put forward by and on behalf of HMRC and that some of the arguments put forward at certain times were hopeless, HMRC's initial statement of case in May 2016 clearly stated that HMRC's view was that HCL's supply was HCL's agreement to step aside and to allow CCL to step into its shoes as far as the Sabre contract was concerned. This was confirmed in the further information in respect of the respondent's case prepared by Mr Singh in July 2016 as well as in Mr Singh's skeleton argument. In my view, HMRC has not therefore acted unreasonably in defending or conducting the proceedings and I cannot therefore make any order as to costs."

First-Tier Tribunal (TC06249): *Hanuman Commercial Ltd*

3.2 Option to tax

3.2.1 Disapplication

A company was formed to carry on a property business in the healthcare sector. It acquired a lease and carried out refurbishment works. It reclaimed the input tax on the basis that it had opted to tax. HMRC ruled that the option would be disapplied under paras.12 – 17 Sch.10 VATA 1994, with the result that input tax totalling £184,630 over the period 02/14 to 11/15 should be disallowed.

Judge Sarah Falk examined the history of the development in exhaustive detail, noting that the evidence presented by at least one of the parties was evasive and unreliable. She concluded that the main conditions for disapplying the option to tax were in place by August 2014:

- an individual had provided finance for the development in the form of loans;
- a company was in occupation of the building not substantially wholly for eligible purposes; and
- the individual was connected with the company by being a controlling shareholder.

The most surprising aspect of the decision appears to be that the property did not fall within the Capital Goods Scheme, because the cost of the refurbishments (as distinct from additional equipment) did not exceed £250,000. Different figures and breakdowns of the expenditure had been provided, which suggested that there might have been an attempt to recategorise some of the expenditure after the event to bring the total below the limit; however, it was clear to the judge that the company had expected the limit to be exceeded, regardless of whether this actually happened, and that was the statutory test.

The only remaining question was whether the grantor of the interest expected this to be the case at an earlier date when the grant of the lease was made. The unreliable party argued that there was no expectation that the works would amount to a capital item, and also that the other conditions above were not foreseen; however, the judge did not accept this version of events. She set out her reasoning in considerable detail, and concluded that the option was disapplied.

She commented on the *Water Property* case, in which the FTT judge held that Member States could only restrict the option to tax within the conditions of art.131 PVD ("ensuring the correct and straightforward application of those exemptions and of preventing any possible evasion, avoidance or abuse"). She noted that the decision was not binding on her; she received no submissions on the principles involved, so she did not comment further and expressed no view on whether the judge was correct or whether the point would make any difference in this case.

First-Tier Tribunal (TC06189): *PGPH Ltd*

3.2.2 Updated Notice

HMRC have updated their Notice *Opting to tax land and buildings* from the March 2017 version. The Notice now includes guidance on the 2% occupation rule at paragraphs 13.8.7 and 13.8.8. This was previously only available in the VAT Land & Property Manual at VATLP 23430. In addition, the address for the OTT unit has been updated, and a 15-day target for acknowledging OTT notifications has been removed.

Notice 742A

3.3 Developers and builders

3.3.1 Zero-rating of construction services

HMRC have issued an Information Sheet to set out a change in policy on the application of zero-rating following the Upper Tribunal decisions in *Astral Construction* (2015), *Boxmoor Construction* (2016), and *J3 Building Solutions* (2017). Each of these cases concerned construction services that created buildings that would on the face of it qualify for zero-rating (either dwellings or RRP buildings), where HMRC sought to deny the relief because there was a previous building on the site that was not completely demolished.

HMRC reiterate that the general rule is that an existing building must be demolished completely to ground level in order for the construction of its replacement to be treated as the construction of a building. Otherwise the works would be seen as the construction of part of a building. The Sheet notes the relaxation for one or two facades retained as a condition of planning consent.

The Sheet goes on to describe the facts and outcome of the three cases. In *Astral*, a complete building (a church) was retained on the site, and two residential wings were constructed on either side of it. The Upper Tribunal found that as a 'question of fact and degree' (and considering the size, shape, function and character of the new work) the completed building (nursing home), was so different from the existing building (a church), that it couldn't be said to constitute an alteration, enlargement of or extension to the church.

Boxmoor was heard by the same judge as *Astral*. In this case, a house had been demolished to ground level apart from the retention of a small part of the facade (not required by planning consent). The judge held that there was a difference between "enlargement or extension", as considered in *Astral*, and "alteration or reconstruction", which was the relevant condition here. The work was clearly not an enlargement or extension, because the new building occupied the same footprint as the old. In that case, it could only be an alteration of an existing building; it could not be construction of a completely new building, because the law defined a new building as one that included nothing of the former structure above ground level. It was not a question of fact and degree, but of statutory definition.

J3 Building Services involved a very significant reconstruction; the FTT had effectively applied the *Astral* decision, but the UT held that it was wrong to do so. The work was not an extension or enlargement, and it could not be new construction.

HMRC then set out their new policy, including the evidence required to show that the relief is due. It is worth reproducing in full.

3.1 Explanation of terms

Demolished to ground level

This means that there must be no part of the former building, such as external and internal walls or any part of its structure, remaining above ground level. The retention of any part of a building, such as a basement or cellar, below ground level wouldn't prevent the replacement building from meeting the conditions for zero-rating.

Following the decision in Boxmoor *HMRC now accepts that a very minor part of a building may be retained above ground level if it's small enough to be ignored as 'de minimis'.*

However, in Boxmoor *the retention of brickwork under a ground floor bay window was held not to be de minimis so the building could not be treated as having been completely demolished to ground level.*

Facade

There is no definition within VAT legislation of the term 'facade' but HMRC's view remains that it's the complete front of a building that usually faces a street, road or some other thoroughfare (including a river or canal) and is the exterior part of a building that's most likely to be seen by passers-by or approaching visitors.

For this reason a facade will usually be designed to a higher standard than the other exterior walls and local authorities may require its retention for aesthetic reasons. Which could include the fact that it's in a conservation area or because it's a particularly fine example of its kind.

A corner site will also look out onto, for example, a street or road, but from 2 sides and as a result, will have 2 facades. The 2 facades that are required to be retained must connect to form a corner.

HMRC doesn't accept that all external walls can be regarded as facades. For example, a wall that forms the back of a property will generally not be treated as a facade unless there's evidence that the local planning authority (LPA) regards it as possessing some aesthetic merit and its retention is required for that purpose.

Party walls

Party walls may be ignored if they're walls that are shared with adjoining buildings such as in semi-detached or terraced houses.

3.2 Evidence needed that facades are being retained as a condition or requirement of SPC

Under UK legislation, for zero-rating to apply, a facade (or 2 facades in the case of a corner site) must be retained as a condition or requirement of an SPC or similar permission.

As it's been the practice of planners to include this requirement as a condition within their planning agreement letter, it's usually been a straightforward matter to demonstrate that the condition had been met. However, HMRC now accepts that it's now more common for owners or developers to meet planners in advance of submitting an application. So submitted plans may already show the retention of a facade when it's known in advance that this will be required within the terms of the planning consent.

In Boxmoor *the UT found that for the purpose of satisfying the demolition test more than mere inference to the requirement to retain facades was necessary as the planning consent must require, rather than merely permit, the retention of the facade. Usually HMRC would expect to see an explicit condition within the SPC to that effect. However, this won't be necessary where the documents make it clear that the work will be carried out in accordance with the plans in which the retention of the facade(s) is clearly shown.*

As that retention must be as consequence of an imposition placed upon the developer, the plans submitted to the LPA must have been endorsed with a statement to the effect that 'the facade(s) has, or have, been retained in accordance with the policy of the LPA' with evidence that they've been seen and approved by the LPA.

3.3 Construction of buildings that incorporate existing buildings

HMRC accepts that in order to establish whether a building is being constructed one needs to take into account the nature of the work. The retention of a minimal amount of an already existing building will be sufficient to disqualify the work from zero-rated relief. However, if the scenario is similar to that which occurred in Astral*, the incorporation of an entire building into a development may qualify if the works are so extensive that they can't be described as works of alteration but are to be as the construction of a building.*

HMRC considers the position in Boxmoor *and* J3BS *will be far more common. In cases such as these, most, if not all, of the work will fall within the footprint of the previously existing building. Only where full demolition cannot take place, because of a condition imposed by the LPA requiring the retention of the facade(s), may the works to replace the original building be treated as the zero-rated construction of a building and not merely the alteration or enlargement of the one that preceded it.*

In an Astral *scenario the situation is different because although an original building isn't demolished, and indeed may be wholly retained with minimal alteration, the nature of the work can still be accepted as the construction of a building. This is because what emerges from the* *completed works is something that's vastly different from that which existed before.*

This will be evident from the nature of the works which will be of such a size in relation to the original building that they can't be characterised as an alteration to the building but must be seen as something much more. Where the size of the addition to the existing building greatly exceeds the original building and the function changes HMRC is prepared to accept that such works are entitled to be zero-rated.

VAT Information Sheet 7/2017

3.4 Input tax claims on land

3.4.1 DIY claim reconsidered

An individual made a claim for £31,833 under the DIY scheme. HMRC refused it on the basis that the planning consent prohibited use as a sole or main residence, restricting use to short-term holiday accommodation. It appeared that the property would be rented out, constituting a business use for VAT, and therefore a DIY claim was not permitted.

The individual asked for a review and subsequently appealed to the FTT (TC05128), arguing that his intention had changed during the course of the project and the conditions had been removed. He now occupied the property as his family home. He had never actually used it for any business.

HMRC argued that the removal of the conditions was retrospective, and precedent cases showed that this was not enough: the consent had to be current at the time the work was done.

The FTT went through the conditions for a DIY claim, and agreed with HMRC. At the time of the claim, the conditions had not been removed, which meant that he could not satisfy the requirements of the law. The appeal was dismissed.

The individual appealed to the Upper Tribunal, where he represented himself. The judges analysed the FTT's reasoning and decisions on the different conditions of Note 2 Group 5 Sch.8. The FTT had appeared to believe that Note 2(c) was not satisfied – however, the restriction did not amount to a prohibition on separate use or disposal, as the FTT had concluded, and the conclusion that retrospective removal of that condition was somehow relevant to Note 2(c) was a mistake.

Turning to Note 2(d), the judges noted that there is a slight difference between Group 5 (which specifically requires construction in accordance with the statutory planning consent) and s.35(1)(b), which requires that carrying out of the works must be lawful. There is an overlap, because non-compliance with the consent would result in unlawful works, but the UT considered that s.35(1)(b) imposed wider conditions.

The FTT did not record any findings of fact in relation to a change of intention by the appellant. It appeared that he had decided to occupy the cottage as a permanent home during the early stages of construction, and that intention was eventually realised. The FTT should have considered whether and when that intention arose, and then consider in the light of that conclusion whether the construction had been carried out in accordance with the statutory planning consent.

Further, the FTT had misunderstood the condition in s.35(1)(b) that the works should not be carried out in the course or furtherance of a business. This issue had been decided in the appellant's favour on the grounds that no business had ever been carried on; however, that was not the requirement. Once again, the FTT ought to have considered the appellant's intentions at the time the construction was carried on, and then decide whether that constituted a business for VAT purposes.

The UT was not in a position to make the necessary findings of fact. The appeal was allowed, but the case would be remitted to a differently constituted FTT for a rehearing.

Upper Tribunal: *Akester v HMRC*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Exchange rates

HMRC have published the usual table of exchange rates to be used by MOSS-registered traders for the quarter to September 2017.

VAT Information Sheet 6/2017

4.2 Where is a supply of services?

4.2.1 Updated Notice

HMRC have updated their Notice *Place of supply of services*, replacing the February 2010 version. The notice has been substantially updated to improve layout and readability. It has also been updated throughout to reflect changes in the law, in particular the November 2017 changes to the use and enjoyment provisions for mobile telecommunications services supplied to UK non-business users when outside the EU.

Notice 741A: Place of supply of services

4.3 International supplies of goods

4.3.1 Valuation rules

A company in Latvia submitted a customs declaration for transit of goods passing through the EU from China to Russia. There was no evidence that the transit had been completed, so the authorities raised an assessment to pay customs duties, anti-dumping duties and VAT on the goods. The company argued that the valuation rule (transaction value) in art.29 of the Customs Code only applied to goods that had been sold for export to the customs territory of the Community; these goods had been sold for export to Russia. It also claimed to have insufficient evidence to apply any of the alternative valuation methods in art.30(2)(a) to (d). Questions were referred to the CJEU.

The court agreed that art.29 could not be used. It went on to rule that a tax authority was required to set out clearly the basis of any valuation used in an assessment so that the recipient could defend its rights under the best possible conditions and decide in full knowledge of the circumstances whether it was worthwhile to bring an action against it, and to enable the courts to review the legality of the decision.

The authorities were not required to ask the producer for information before setting aside the method in art.30(2)(a) (transaction value of identical goods). The authority was, however, required to consult all the information sources and databases available to it. It should also allow the economic operators concerned to provide it with any information which could contribute to determining the customs value of the goods pursuant to that provision.

The authorities were also not required to state reasons why the methods in art.30(2)(c) and (d) were not to be applied, if they determined the customs value in accordance with art.151(3) of the Implementing Regulation (transaction value of similar goods). The methods in art.30(2)(c) and (d) are:

- the value based on the unit price at which the imported goods for identical or similar imported goods are sold within the Community in the greatest aggregate quantity to persons not related to the sellers;
- the computed value, consisting of the sum of the cost of materials, profit and overheads and other items to be included under art.32(1)(e).

CJEU (Case C-46/16): *Valsts ienemumu dienests v 'LS Customs Services'*

4.3.2 Food supplement

An individual appealed against imposition of customs duty at 12.8% and VAT at 20% on an importation of "Cellect", a food supplement. The amounts involved were £39.62 and £69.84 on a value of $340 plus $81 postage. The manufacturer expressly disclaimed any health benefits in the product, but the individual claimed that it helped her (she had a diagnosis of terminal cancer).

The appellant argued that the product should be classified under "pharmaceutical products" which are generally free from customs duty. As the manufacturer did not make any claims for its benefits, and the packaging did not set out recommended doses and therapeutic aims, it could not qualify for this heading. For similar reasons, it could not qualify for zero-rating under Sch.8 Group 12 – it did not fall under any of the headings.

The appellant tried a different argument to qualify for zero-rating under Group 1. There are a number of precedents on the borderline between "food" and "something that is consumed but is not food", and the Tribunal reviewed a range of them. The judge concluded that Cellect was neither a food nor a food ingredient: it was something that the appellant wanted to consume for a particular effect, but it was not within Group 1.

The appeal was dismissed on both issues.

First-Tier Tribunal (TC06244): *Carol Pannett*

4.3.3 Import mistake

A company appealed against a refusal by HMRC to repay to them import VAT which they had paid in error in relation to an import of goods which they were handling. HMRC had repaid them the much smaller amount of customs duty which had been overpaid in relation to the same import, but insisted that the overpaid VAT could only be repaid by being credited as input tax to the importer, not the appellant. The error arose because of a misstatement of the sterling valuation of the goods, which was accepted by HMRC.

The judge examined the facts and recited the law at length, from the Customs Code, the PVD and Notice 702. The Notice contains the following statement about repayment of VAT to shipping or forwarding agents:

What can I do as a shipping or forwarding agent if an importer doesn't pay me the import VAT?

If an importer fails to pay you import VAT you paid on their behalf, your only recourse is to the importer, except where one of the following applies:

- *the importer has gone into liquidation*
- *an administrator or administrative receiver has been appointed, who certifies that in their opinion, ordinary unsecured creditors will receive nothing in the liquidation*

In such cases you may be able to recover amounts paid as tax from HMRC. All of the following conditions must be met:

- *the interval between the date of the import entry for the goods and the date the importer became insolvent is no more than 6 months*
- *you entered the goods in accordance with instructions from the importer*
- *during their stay in the UK the goods were under your control and weren't used*
- *the goods have been re-exported in the same state as they were imported*

To claim repayment you should write to the NDRC at Salford, enclosing:

- *evidence that the import VAT has been paid to HMRC*
- *a certificate from the person in charge, for example, the liquidator, that the VAT hasn't been, and won't be, reclaimed as input tax*
- *within six months of Confirmation from the person in charge that the importer became formally insolvent the date the entry was lodged with HMRC*
- *a declaration that you won't recover the relevant VAT in whole or in part from the insolvency*
- *evidence to satisfy HMRC that you have acted in accordance with the importer's instructions*

The appellant's problem was that the importer, to whom HMRC were prepared to repay the VAT, had "disappeared from sight in the UK" without claiming the credit and without paying the money over to the appellant. The company claimed that HMRC would be unjustly enriched if they refused to repay the money to the only person claiming it.

The appellant had not raised arguments based on the legal doctrine of effectiveness, but the judge (Richard Thomas) considered that it was proper for him to do so for someone who was in effect a litigant in person. He asked a series of 15 questions for HMRC to answer after the hearing in relation to the way they treated claims of this kind and their practices in correcting errors. He attempted to analyse the legal problems arising from Notice 702 para.2.6, which was interpreted differently by HMRC before and after the issue of Customs Information Paper 14/11. He set out the following "simple" example:

100. Suppose (ignoring agency issues)

(1) a fully taxable VAT registered trader imported goods on which import VAT of, say, £10,000 was paid by them on 15 November 2016 in their prescribed accounting period of the three months to 31 December 2016,

(2) on 30 November they realise that because of a mistake the VAT should have been £1,000,

(3) in accordance with VAT 702 paragraph 2.6 (current version) they understand that the £9,000 overpayment cannot be repaid directly and is to be claimed only as input tax,

(4) the VAT return is prepared on 31 January. The certificate (C79) required as evidence of the input tax (regulation 29(2)(c) VAT Regulations) shows VAT of £10,000 so that amount is included in the return, and

(5) the correct tax that should have been shown on the C79 is £1,000, so if they show £10,000 as input tax that is it seems to us incorrect.

101. Is new 2.6 (and pre-CIP 2.6 for that matter) saying that the £9,000 should be included as input tax as part of the £10,000 even though that is incorrect in law? This gives the "right" result in financial terms which is that the trader had a liability to pay £1,000 and to claim £1,000 as input tax but has paid £9,000 too much and reclaimed that £9,000 through its returns as if it were input tax.

102. Or is HMRC saying that the trader is entitled to deduct £10,000 on the basis of the C79 and another £9,000? The absurdity of that result shows that HMRC must have intended the treatment set out in §101. But that still leaves us with an uncomfortable feeling that what HMRC is suggesting be done is not in accordance with the law.

The judge concluded that HMRC had made two fundamental conceptual errors. One was to regard the payment of import VAT as part of the ordinary system of accounting for output tax and input tax – VATA 1994 s.1(4) makes it clear that this is separate. The second error was to confuse a repayment of VAT paid in error with a credit for input tax. Input tax is covered by s.25 and s.26, while repayments of VAT paid in error are covered by s.80. "The two things are wholly separate."

The judge concluded that the proper remedy was to order repayment of the VAT wrongly paid, rather than to allow it as input tax to anyone. He also commented that he thought the current interpretation of para.2.6 in Notice 702 breached the principle of effectiveness, but that was not the basis for his decision. The appeal was allowed.

First-Tier Tribunal (TC06151): *Hemisphere Freight Services Ltd*

4.3.4 Connection to fraud

A company appealed against two decisions of HMRC: the refusal of zero rating on eight supplies of metal to a Belgian registered trader on the grounds that there was insufficient evidence that the goods had left the UK (£160,281 assessed as output tax); and the denial of £2.6m input tax on 655 purchases of various metals from 03/13 to 02/14 on *Kittel* grounds.

The Tribunal judge (John Brooks) commented at the outset "we were disappointed to find that, in addition to factual matters, the witness statements, particularly those of HMRC officers, contained opinions and conclusions to be drawn from the evidence." Such "evidence" is not a matter of fact but a matter of opinion. It is merely a view of a witness on a matter on which the tribunal itself must reach its own conclusion, and as such is of no value as evidence. Such evidence may rightly be excluded on that basis. The Tribunal used its "good sense" to disregard purported evidence that represents conclusions that the Tribunal itself must reach.

The taxpayer was a long-standing family firm that was one of the largest private sector employers in Rotherham, with over 300 workers. The Tribunal started with a review of its history and operations, before considering the despatch assessments. It was not disputed that the goods had not left the UK, so the company had to rely on *Teleos*: it had to show that the documents provided sufficient evidence for it to reasonably rely on them, and that it had acted in good faith and taken every reasonable measure to ensure that the intra-community supply did not lead to its becoming a participant in the fraudulent evasion of VAT.

The despatch documentation did not show all the information required by Notice 725 para.5.2, which has the force of law. The company could therefore not rely on *Teleos*. That was enough to dispose of the output tax appeal, but the Tribunal also found on the balance of probabilities that the company directors were aware of the fraudulent nature of the transactions, and therefore could not plead good faith either.

As regards the *Kittel* appeal, the company's representative argued that *Kittel* only applied to "classic MTIC fraud", and could not be used where HMRC could pursue the defaulters instead. The Tribunal was satisfied that the test was not so restricted, and it was applicable to the present appeal.

The Tribunal was satisfied that there was a loss of tax that arose from fraudulent evasion by various suppliers in the chain. It was not necessary for the appellant to have known exactly how the fraud worked, only to have been aware (or to have had the means of becoming aware) that there would be a loss of tax. Although there were some discrepancies in the descriptions of goods moving through the supply chain, once again on the balance of probabilities the company's inputs were connected to the loss of tax.

The nature of the disputed transactions appeared contrived: there were rapid sequences of transfers between apparently connected parties that had to be, on the balance of probabilities, an orchestrated attempt to defraud the revenue. The Tribunal noted the standing and history of the company in the scrap metal business, and concluded that there were six factors that contributed to a conclusion that the company knew or, at the very least, had the means of knowing:

(1) the lack of any commercial rationale for its position at the end of the chains in which a number of other participants were frequently able to obtain metal at a better price than CFB;

(2) its continued trading with companies controlled by individuals, such as Jonathan France and Mr Cooper, notwithstanding that companies with which they were previously associated had been wound up, irrespective of the risk in doing so:

(3) its failure to act on repeated warnings by HMRC of tax losses in deal chains in which it participated;

(4) its continued trade with businesses notwithstanding being warned of the dangers of doing so by HMRC;

(5) the absence of any critical analysis of due diligence, by staff conducting checks or directors; and

(6) third party payments made outside he UK when identified by HMRC as a risk.

The appeal was dismissed.

First-Tier Tribunal (TC06208): *C F Booth Ltd*

4.3.5 Fulfilment houses

Draft regulations have been published for the fulfilment house due diligence scheme introduced in the Finance (No 2) Bill 2017. Affected businesses were to have to register from 1 April 2018, and the main requirements including penalties will come into force from 1 April 2019.

More information is available in a consultation document. The consultation ran until 15 December 2017.

SI 2018/draft; www.gov.uk/government/consultations/draft-legislation-the-fulfilment-businesses-approval-scheme-regulations-2018

HMRC have published a Guide to their new registration scheme, opening in April 2018, for fulfilment businesses storing goods in the UK for sellers established outside the EU. It appears that the consultation referred to above led to a relaxation: existing fulfilment businesses must register by 30 June 2018; new businesses by 30 September 2018. Record-keeping, due diligence and penalty obligations begin in April 2019.

www.gov.uk/guidance/fulfilment-house-due-diligence-scheme

4.3.6 Joint and several liability

HMRC have issued a guidance note on the proposed extension of joint and several liability for online marketplaces that is to be included in Finance Bill 2017 to 2018. Under the rules, HMRC will be able to hold online marketplaces jointly and severally liable for:

(i) Any future VAT that a UK business selling goods via the online marketplace fails to account for once they have been notified by HMRC;

(ii) Any VAT that an overseas business selling goods via the online marketplace fails to account for where that online marketplace knew or should have known that that business should be registered for VAT in the UK.

Legislation will also be introduced in Finance Bill 2017 to 2018 to require online marketplaces to ensure that VAT numbers displayed on their websites are valid. They will also be required to display a valid VAT number when they are provided with one. This requirement will be supported by a regulatory penalty.

The guidance note provides more details of both proposals.

www.gov.uk/government/publications/vat-extending-joint-and-several-liability-for-online-marketplaces-and-displaying-vat-numbers-online-guidance-note

4.3.7 Customs and Cross-Border Trade Bills

The Taxation (Cross-border Trade) Bill, formerly known as the Customs Bill, was introduced in Parliament in November. The Bill aims to allow the UK to set and collect its own duty on goods coming into the country and will allow the government to implement different outcomes of the EU negotiations, including an implementation period.

The precise nature of the UK's future customs relationship with the EU will be determined by negotiations, and the Bill will allow the government to:

- charge and vary customs duty on goods;
- specify which goods are subject to what duty;
- set preferential or additional duties in certain circumstances, for example:
  - to secure the benefits of global free trade while protecting domestic industries, providing necessary and proportionate safeguards against unfair trade;
  - to support developing countries by offering preferential treatment.
- ensure that VAT and excise legislation function effectively upon EU exit.

The Bill followed on from a White Paper published in October, which followed on from discussion papers published in August and feedback on those papers.

www.gov.uk/government/publications/customs-bill-legislating-for-the-uks-future-customs-vat-and-excise-regimes

4.3.8 Updated Notices

HMRC have updated their Notice *Tools for manufacture of goods for export*, with only minor amendments from the January 2002 version. It explains when supplies of machine tools that remain in the UK can be zero-rated on the grounds that they have been used for manufacturing goods for export or despatch.

Notice 701/22

HMRC have updated their Notice *VAT: Export of goods from the United Kingdom* from the March 2014 version to clarify the evidence required in respect of supplies to the Foreign and Commonwealth Office and Foreign and Commonwealth Office Services for delivery abroad through diplomatic channels. There have also been changes to the classification of territories inside and outside the EC Fiscal VAT area in relation to Cyprus and French overseas territories.

Notice 703

HMRC have updated their Notice *VAT personal export scheme*, which concerns motor vehicle exports, from the January 2014 version to clarify that the scheme requires pre-approval. Vehicles should not be released to customers before HMRC have issued an approval number. The Notice also combines information that was previously in Notices 705 and 705A.

Notice 707

4.4 European rules

4.4.1 Commission proposals

On 4 October, the European Commission launched plans for the biggest reform of EU VAT rules in a quarter of a century. The "reboot" would improve and modernise the system for governments and businesses alike. Overall, over €150 billion of VAT is lost every year. Of this, around €50 billion – or €100 per EU citizen each year – is estimated to be due to cross-border VAT fraud. It is estimated that this sum would be reduced by 80% thanks to the proposed reform.

The proposed VAT reform is also intended to make the system more robust and simpler to use for companies. The Commission wants a VAT system that helps European companies to reap all the benefits of the Single Market and to compete in global markets. Businesses trading cross-border currently suffer from 11% higher compliance costs compared to those trading only domestically. Simplifying and modernising VAT should reduce these costs by an estimated €1 billion.

A definitive VAT system that works for the Single Market has been a long-standing commitment of the European Commission. The 2016 VAT Action Plan explained in detail the need to come to a single European VAT area that is simpler and fraud-proof.

The Commission will seek agreement on four fundamental principles of a new definitive single EU VAT area:

- Tackling fraud: VAT will now be charged on cross-border trade between businesses. Currently, this type of trade is exempt from VAT, providing an easy loophole for unscrupulous companies to collect VAT and then vanish without remitting the money to the government.
- One Stop Shop: It will be simpler for companies that sell cross-border to deal with their VAT obligations thanks to a 'One Stop Shop'. Traders will be able to make declarations and payments using a single online portal in their own language and according to the same rules and administrative templates as in their home country. Member States will then pay the VAT to each other directly, as is already the case for all sales of e-services.
- Greater consistency: A move to the principle of 'destination' whereby the final amount of VAT is always paid to the Member State of the final consumer and charged at the rate of that Member State. This has been a long-standing commitment of the European Commission, supported by Member States. It is already in place for sales of e-services.
- Less red tape: Simplification of invoicing rules, allowing sellers to prepare invoices according to the rules of their own country even when trading across borders. Companies will no longer have to prepare a list of cross-border transactions for their tax authority (the so-called 'recapitulative statement').

The proposal also introduces the notion of a Certified Taxable Person – a category of trusted business that will benefit from simpler rules to save time. Four 'quick fixes' have also been proposed, to come into force by 2019. These short-term measures were explicitly requested by Member

States to improve the day-to-day functioning of the current VAT system until the definitive regime has been fully agreed and implemented.

This legislative proposal will be sent to the Member States in the Council for agreement and to the European Parliament for consultation. The Commission will follow this initiative in 2018 with a detailed legal proposal to amend the VAT Directive so that the "definitive" VAT regime can be implemented.

europa.eu/rapid/press-release_IP-17-3443_en.htm

The European Commission has launched a set of tools to make the EU's VAT system more fraud-proof and close loopholes which can lead to large-scale VAT fraud. The new rules aim to build trust between Member States so that they can exchange more information and boost cooperation between national tax authorities and law enforcement authorities.

The Press Release says that even the most cautious estimates place a figure of over €50bn a year on revenues lost to Member States. The Commission proposals are designed to help Member States to exchange more relevant information and to cooperate more closely in the fight against these activities.

The proposals include:

- the launch of an online system for information sharing within the EU's existing network of anti-fraud experts, Eurofisc;
- opening new lines of communication and data exchange between tax authorities and European law enforcement bodies on cross-border activities suspected of leading to VAT fraud: OLAF, Europol and the newly created European Public Prosecutor Office (EPPO);
- sharing key information on imports from outside the EU between tax and customs authorities to further improve certain customs procedures which are currently open to VAT fraud;
- sourcing car registration data from other Member States.

The legislative proposals will now be submitted to the European Parliament for consultation and to the Council for adoption.

europa.eu/rapid/press-release_IP-17-4946_en.pdf; Implementing Regulation 2017/2454/EU

On 12 October, the Justice and Home Affairs Council of the EU approved a regulation to establish the new European Public Prosecutor's Office (EPPO). The EPPO will have authority to investigate and prosecute EU fraud and other crimes affecting the EU's financial interests. Currently, only national authorities can investigate and prosecute fraud in the EU. Existing bodies such as OLAF, Eurojust and Europol cannot conduct criminal investigations.

A group of 20 member states have so far agreed to participate. The non-participating states are the Netherlands, Sweden, Hungary, the UK, Poland, Ireland, Malta and Denmark. The new office is expected to become operational by 2020, but no earlier than three years after the relevant regulation has entered into force.

The EPPO will mainly rely on national rules of investigation and procedure, which will apply if the regulation does not provide for more specific provisions. In particular, the regulation:

- lists the EPPO's investigative powers with general conditions for their application and also contains provisions defining homogeneous procedural rights of the suspected person; and
- contains rules on the admissibility of evidence, namely, that evidence gathered lawfully in one member state is admissible in the trial courts of all member states, provided the admission does not adversely affect the fairness of the procedure or the rights of defence as enshrined in the Charter of Fundamental Rights.

www.consilium.europa.eu/en/press/press-releases/2017/10/12-eppo-20-ms-confirms

The European Commission has proposed making the minimum standard rate, set at 15% by the PVD, permanent. It has been prolonged several times over the years and the rule is currently in force until 31 December 2017. No country currently operates a standard rate lower than 17%, so the Commission regards the rule as "appropriate".

Although the proposal was published on 19 December 2017, it appears to require member states to implement it in their legislation by 1 January 2018. Given the current minimum rates throughout the EU, this impractical requirement does not appear to make any practical difference.

ec.europa.eu/info/law/better-regulation/initiatives/com-2017-783_en

On 5 December, the Council adopted rules to be incorporated in national law by the end of 2018 and 2020, and to be implemented in 2019 and 2021:

- in 2019, bringing in a threshold of €10,000 below which sellers of digital services to consumers can apply their own country's VAT rules and rates;
- in 2021, extending the Mini-One Stop Shop to distance sales of goods, and also removing the present exemption for small consignments from outside the EU (currently set at €22).

The 2019 measures are already set out in detail. The provisions that will apply from 2021 will be addressed in greater detail in a further Commission proposal under a non-legislative procedure. The Council approved a statement highlighting issues to be considered by the Commission in the implementing phase.

http://www.consilium.europa.eu/en/press/press-releases/2017/12/05/vat-on-electronic-commerce-new-rules-adopted/; Directive 2017/2455/EU

The Implementing Regulation (282/2011/EU) has been amended with effect from 1 January 2019 to simplify the evidence required for the place of supply of telecoms, broadcasting and e-services supplied to consumers, where a supplier supplies no more than €100,000 of such services during a calendar year. Only one piece of evidence will be required to establish the place a customer belongs.

Implementing Regulation 2017/2459/EU

In December, the Commission published three reports making a series of recommendations for improved cooperation between member states on tax and VAT collection. One dealt with VAT collection and control procedures, with key recommendations including:

- investing in digital communication between tax administrations;

- analysis of tax gaps by each member state;
- keeping complete and up-to-date records of registered traders and deregistrations, and making that information available across borders;
- greater assistance for foreign taxpayers in fulfilling their VAT registration obligations.

The full report contains more recommendations and supporting data.

ec.europa.eu/taxation_customs/node/1031_en

4.4.2 OECD guidance on cross-border VAT

The OECD has published guidance on implementing international standards for the VAT treatment of cross-border trade in services and intangibles, as recommended in the BEPS Action 1 report on tax challenges of the digital economy. The guidance focuses on approaches to business-to-consumer sales, along the lines of the EU's "mini one-stop-shop", requiring foreign suppliers to register and collect VAT on cross-border sales.

The guidance includes the comment: "The European Union (EU), which was the first adopter of these collection mechanisms, has identified the total VAT revenue declared via its compliance regime (the Mini One Stop Shop or MOSS) as in excess of EUR 3 billion in its first year of operation. The MOSS has also played an important role in reducing the compliance burden of businesses that use the regime. Approximately 70% of the total cross-border B2C supplies of services and intangibles that are in scope of this regime are captured by this compliance regime."

www.oecd.org/tax/consumption/oecd-delivers-implementation-guidance-for-collection-of-value-added-taxes-on-cross-border-sales.htm

4.4.3 Right to deduct

Romanian law denied a right to deduct where a trader claimed input tax on a supply from a person who had been declared inactive and removed from the register. The declaration of inactivity was accessible on the internet before the date of the supply. Questions were referred to the CJEU to determine whether this was proportionate to the objective of preventing avoidance, evasion and abuse.

The court ruled that obliging taxable persons to carry out a check on the current validity of suppliers' registrations, the national legislation pursued an objective that was legitimate and even imposed by EU law (ensuring the proper collection of VAT and the prevention of VAT evasion). Such a verification could reasonably be required of an economic operator. It was, however, necessary to determine whether that legislation did not go beyond what was necessary to achieve the objective pursued.

The problem with the Romanian rules was that they were absolute: there was no scope for the claimant to demonstrate that the transactions concluded with the trader declared inactive met the conditions laid down by the Directive and, in particular, that the VAT had been paid into the public purse by that trader. This may seem unlikely, given that the trader is "missing", but the CJEU appeared to consider that it should at least be considered a possibility.

The court therefore ruled that the Romanian rules went beyond what was necessary to achieve the legitimate objective, and were therefore not permitted.

CJEU (Case C-101/16): *SC Paper Consult SRL v Directia Regionala a Finantelor Publice Cluj-Napoca and Administratia Judeteana a Finantelor Publice Bistrita Nasaud*

4.4.4 Transport services

The Italian authorities assessed FedEx in relation to "inbound" transport services, receiving international consignments and subsequently delivering them to recipients in Italy. Such services in relation to international trade are generally exempt, but the Italian rules were interpreted as allowing the exemption only if the import itself was subject to VAT. The assessments were in relation to small consignments that were themselves exempt from VAT. Questions were referred to the CJEU.

FedEx also applied to the Commission to take infringement proceedings against Italy, as a result of which the rules were changed. Nevertheless, the Italian authorities defended the original assessments, claiming that they were not contrary to the Directive. The CJEU disagreed – art.144 in conjunction with art.86(1)(b) PVD precluded such legislation.

CJEU (Case C-273/16): *Agenzia delle Entrate v Federal Express Europe Inc*

4.4.5 Access to information

Following a tax inspection, the Romanian authorities formed the view that two individuals were engaged in economic activity as property developers. They raised assessments, which the individuals disputed on the grounds that their rights of defence had not been respected. According to the applicants, the respondent, rather than merely inviting them to a final discussion, ought to have given them access of its own motion to all the relevant information on the basis of which it had adopted the tax inspection report and issued the two tax assessment notices, so that they would subsequently be in a position to challenge them.

The CJEU confirmed that general principle of EU law of respect for the rights of the defence required that, in national administrative procedures of inspection and establishment of the basis for VAT assessment, an individual was to have the opportunity to have communicated to him, at his request, the information and documents in the administrative file and considered by the public authority when it had adopted its decision, unless objectives of public interest warranted restricting access to that information and those documents.

CJEU (Case C-298/16): *Ispas and other v Directia Generala a Finantelor Publice Cluj*

4.4.6 Exemption for land

A dispute arose in Poland about the interpretation of two provisions of the PVD:

- art.12, which permits member states to regard someone as a taxable person if they supply a building before first occupation;
- art.135(1)(j), which excludes from exemption 'the supply referred to in point (a) of art.12(1)' (i.e. the supply of a building before first occupation).

The Polish law required that the 'first occupation' had to arise from a taxable transaction for this purpose. When a company transferred a show home from its fixed assets to its stock and sold it, it regarded it as an 'old property' and eligible for exemption, because it had used it; but the authorities regarded it as 'before first occupation' and therefore taxable.

A further provision of the Polish law ruled out exemption on the sale of a building after an upgrade, unless the cost of the upgrade amounted to less than 30% of the initial value of the building. Art.12(2) PVD refers to the 'conversion' of a building as something that can also be treated as a taxable transaction – effectively once a building has been 'converted', it once again becomes 'before first occupation'.

The court ruled against Poland on the first rule – it could not disregard occupation by the taxpayer itself by making 'first occupation' dependent on a taxable transaction. However, the 30% threshold rule was acceptable, provided that the concept of 'upgrade' was interpreted in line with 'conversion' in art.12(2), namely as meaning that the building concerned had to have been subject to substantial modifications intended to modify the use or alter considerably the conditions of occupation.

CJEU (Case C-308/16): *Kozuba Premium Selection sp. z o.o. v Dyrektor Izby Skarbowej w Warszawie*

4.4.7 Rules for invoices

The German tax authorities refused deduction of input tax where the invoice showed an address where the supplier could be contacted by post, but where he did not carry out any economic activity. The CJEU ruled that this was contrary to the PVD. The right to deduct could not, in principle, be limited. Deduction depended on the substantive conditions, not the formal conditions of art.226.

The court also commented that the purpose underlying art.226 – to enable the authorities to monitor the payment of the tax due and check the supplier – did not require the address to be a place where the supplier carried on its economic activity.

CJEU (Case C-374/16 and C-375/16): *Geissel v Finanzamt Neuss; Finanzamt Bergisch Gladbach v Butin*

4.4.8 Limitation periods

In the case of *Taricco* (Case C-105/14), the CJEU held that Italy had failed to meet its obligations under the European Treaty by providing such a short limitation period for certain VAT offences that they could not be prosecuted in the circumstances of the case. Questions arose in another Italian case: the courts were not sure whether they should disapply the limitation periods and hear the substantive cases against the defendants.

The CJEU ruled that it was appropriate to disapply limitation periods in the case of serious fraud; however, this would only be the case if this did not involve a breach of the principle that offences and penalties had to be defined by law, because of the lack of precision of the applicable law or because of the retroactive application of legislation imposing conditions of criminal liability stricter than those in force at the time the infringement had been committed. It seems likely that disapplying a limitation period would involve such a breach.

CJEU (Case C-42/17): *Re M.A.S. and another*

4.4.9 Cancellation of leases

A finance leasing company entered into agreements in relation to immovable assets which envisaged definite transfer of ownership (i.e. hire purchase). Output tax was accounted for at the time possession of the goods was taken by the lessees. Later the company terminated the agreements for partial non-payment of the amounts due, and recovered the assets concerned. It issued corrected invoices reducing the taxable amounts shown in the original invoices, and reduced its output tax payable on returns for the period in which this was done. The Hungarian tax authorities ruled that this was incorrect, and assessed for penalties and interest. Questions were referred to the CJEU.

The Hungarian authorities argued that art.90(2) allowed member states to set the conditions for reducing the taxable amount in relation to non-payment of consideration. The company argued that it was rather applying the rule in art.90(1) on "refusal" of a supply, and this had direct effect without any discretion.

The CJEU agreed with the company that, in a situation in which the contract had been cancelled so that it was no longer possible for the supplier to claim any further payment from the customer, art.90(1) applied. This was unconditional and sufficiently precise to have direct effect; it overruled any provision of national law that purported to regard such a situation as "non-payment" rather than "cancellation or refusal".

CJEU (Case C-404/16): *Lombard Ingatlan Lízing Zrt. v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatóság*

4.4.10 Lower rates

Polish law applied a VAT rate of 8% to "Pastry goods and cakes, fresh, whose use-by date, fixed pursuant to separate provisions, does not exceed 45 days or, where those goods are marked pursuant to separate provisions solely by a best-before date, that date likewise does not exceed 45 days". A taxpayer sold pastry goods and cakes including croissants with various fillings and sweet rolls that had a longer use-by period. The authorities ruled that they were subject to VAT at the standard rate of 23%. Questions were referred to the CJEU.

The court ruled that the provision, and the criterion on which it was based (use-by date), did not itself breach any principle of EU law. However, it was necessary to comply with the principle of fiscal neutrality, which it was for the referring court to ascertain. It is therefore necessary for the Polish court to consider in detail whether there are products so similar to the taxpayer's products that they are in competition, and yet they are charged at 8%. The lower levels of appeal in Poland had dismissed the company's case on the grounds that it had not produced evidence of such competing products.

CJEU (Case C-499/16): *AZ v Minister Finansow*

4.4.11 Reverse charges

A curious dispute arose in Bulgaria in which it appears the tax authorities disputed the right of a Bulgarian-established trader to deduct the input tax arising on reverse charges; this seems to be related to the fact that the trader made no taxable supplies in Bulgaria, but made supplies that would have been taxable there to customers in other countries. It was below the mandatory registration threshold, but was registered under what was referred to as a "tax deduction scheme".

The CJEU appears also to have been unsure what the problem was. The court noted that the right to deduct was absolute; if the taxpayer was registered under the normal rules, it would have to be allowed the input tax on a reverse charge, if that was used to make the kind of supplies it made, even if it did not charge any output tax in Bulgaria.

However, if the registration was effectively an application of art.289 PVD (exemption for small enterprises), it should not be allowed to deduct input tax. It seems that the Bulgarian law does not deal clearly with a voluntary registration below the registration threshold, but if the effect of the law is to deny a deduction for reverse charge input tax to such businesses, it does not comply with the PVD.

CJEU (Case C-507/16): *Entertainment Bulgaria System EOOD v Direktor na Direktsia 'Obzhalvane i danachno-osiguritelna praktika', Sofia*

4.4.12 Security

Slovakian law provides for a requirement to deposit security as a condition of being VAT registered, as UK law does. A trader who exceeded the registration threshold of €49,790 applied for registration, and was ordered to provide (within 20 days) a guarantee of €500,000 for a period of 12 months. The reason was a VAT debt owing by another company with which a director or associate member of the taxpayer had a personal or proprietorial connection. The taxpayer appealed, arguing that the requirement was disproportionate, and questions were referred to the CJEU.

The first paragraph of art.273 PVD provides that member states can impose other obligations that they deem necessary for the correct collection of VAT and for the prevention of evasion. The court held that the Slovakian rules were within this power in principle. There was a material difference between traders owing tax debts (or connected with other businesses with such debts) and traders owing other kinds of debts, which meant that the principle of equal treatment was not engaged.

It would be for the national court to determine whether the amount of the guarantee in a particular case went further than necessary in order to attain the objectives of art.273.

CJEU (Case C-534/16): *Financné riaditelstvo Slovenskej republiky v BB construct s. r. o.*

4.4.13 Liquidation problem

A Bulgarian company was in financial difficulties, and was put into liquidation by court order. It was removed from the VAT register on the grounds that an entry in the companies register suggested that it had ceased to trade. However, it continued to trade, substantially above the registration threshold, so it applied to be restored to the VAT register. It appeared to be liable to a deregistration charge on the temporary removal. Questions were referred to the CJEU.

The court noted that the deregistration charge was provided by art.18 PVD, and was linked to the right to deduct in art.168 in that it clawed back input tax that was not going to be used for an economic activity. Where a court order resulted in a cessation of economic activity, it was proper for a deregistration charge to apply. However, in this case the economic activity continued, in which case a deregistration charge amounted to an unwarranted restriction on the right to deduct. It therefore did not comply with the PVD.

CJEU (Case C-552/16): *Wind Inovation 1' EOOD (in liquidation) v Direktor na Direktsia 'Obzhalvane i danachno-osiguritelna praktika' – Sofia*

4.5 Foreign refund reclaims

4.5.1 Right of recovery

A German company imported some goods from Turkey into Romania and paid import VAT on them. The goods were intended for use in performance of a contract for an Austrian customer, but the customer was in financial difficulties and suspended the contract. The goods could not be used for anything else. The German company applied to the Romanian tax authorities for repayment of the import VAT, but this was refused on the grounds that the goods had not been used for taxable transactions. The company argued that it intended to export them again, but there was no specific evidence of this. Questions were referred to the CJEU.

The CJEU held that the company had a right to deduct that could not be denied, in the absence of any allegation or suspicion of fraud. The suspended contract was sufficient evidence of economic activity, and it created a right to deduct; that right could not be restricted or removed. The right of refund under the 8^{th} Directive (which was the mechanism for reclaiming at that time) was derived from, and therefore similar to, the right to deduct under the PVD. The Romanian authorities were wrong to refuse the claim.

CJEU (Case C-441/16): *SMS Group GmbH v Directia Generala Regionala a Finantelor Publice Bucuresti*

5. INPUTS

5.1 Economic activity

Nothing to report.

5.2 Who receives the supply?

5.2.1 Legal fees

A company claimed input tax of nearly £80,000 incurred in relation to legal fees incurred in defending civil proceedings brought by another company against one of its directors. HMRC raised an assessment to disallow the VAT (together with a careless inaccuracy penalty, which was suspended). The company appealed to the First-Tier Tribunal (TC05245), arguing that the VAT was incurred by the company in the course of its business.

The director was a former employee of the plaintiff, which sued him for breach of the conditions of his employment. Initially the plaintiff also threatened to sue the company he had set up in competition with it, but the lawsuits that followed only involved the director and three other employees who had left to join his company. If the plaintiff had succeeded, it would probably have joined the company in a further action to account for lost profits. However, the director won in the Court of Appeal, and leave to appeal to the Supreme Court was refused.

The disputed invoices were addressed to the director at his home, but paid by the company. The director stated that he had always considered that the plaintiff was attacking both him and the company, and it was trying to put the company out of business. The very first invoice concerned the initial "letters before action" that were issued to both the director and the company: it was addressed to and paid by the company, and HMRC had not objected to the deduction of the input tax. The judge considered that there was no material difference between that invoice and the subsequent ones, and HMRC could and should accept the invoices as alternative evidence under reg.29. The relationship between the lawyers, the director and the company remained the same. The situation was similar to the *P&O Ferries* case. The link between the company's business and the lawsuit was much more direct and immediate than the general benefit of "keeping the owner out of jail" as in *Becker* or *Rosner*.

The FTT allowed the appeal, and HMRC appealed to the Upper Tribunal. The UT judges summarised the issues as first whether the supplies had been made to the company, and second whether they had been used for the purposes of the company's business. HMRC argued that the economic reality was that the supplies of legal advice were made to the individual director, and the company derived no benefit from them. The company's representative responded that the FTT had been entitled to reach the conclusion it did on the basis of the evidence before it.

The judges agreed with HMRC's representative that the starting point had to be the contracts for services, which were clearly between the individual and the solicitors. The FTT had set out reasons for considering that the supply was made to the company, but it had not at any point made a finding that the company was entitled to legal services or contractually obliged to pay for them. This was an error of law that was sufficiently grave to require the decision to be set aside and potentially lead to the case being remitted to the FTT for reconsideration.

However, the decision on the second issue was more conclusive. The legal action had been for breach of confidentiality and breach of fiduciary duty, and these could only have been personal claims against the individual. There was a possibility that the company could have been joined in the action later, but that would have required different claims and different legal hurdles for the plaintiff. This meant that there was no direct and immediate link between the supplies and the company's business: it was much closer to the *Becker* and *Rosner* cases than the FTT had held. There was undoubtedly a benefit to the business in protecting the shareholder and director from legal action, but the business was not directly engaged in that action. The UT considered that the binding CJEU precedent in *Becker* was directly applicable, and therefore HMRC's appeal had to be allowed.

Upper Tribunal: *HMRC v Praesto Consulting UK Ltd*

5.2.2 Deductions allowed

A partnership operated a seafood takeaway business in Swanage. It operated from premises owned by one of the partners; two connected businesses also operated from the same building, an ice cream parlour run by the freehold owner's son, and a waitress-service restaurant run by his life partner. All three businesses were separately registered for VAT. The building was demolished and rebuilt, and the three businesses continued to share the new premises, including the kitchen.

HMRC disputed the deduction of input tax by the partnership on costs of fitting out the premises and on certain purchases of alcohol. The FTT heard evidence from the freehold owner, who explained that the relationship between the businesses was "laissez faire". He ordered and paid for all the alcohol and shellfish sold by the takeaway and the restaurant, while his partner ordered and paid for all the potatoes and white fish. However, he was adamant that sales were separately recorded, and there was no overlap in the duties of employees.

HMRC argued that the fitting out costs were proper to the owner as landlord, rather than the registered business; and the alcohol was purchased for use in the business of the restaurant, not the partnership that claimed it.

The judge noted that the arrangements for purchasing constituted barter. Output tax appeared to have been accounted for on all sales to consumers; there should also be output tax on sales of alcohol from the takeaway to the restaurant, and sales of fish and chips from the restaurant to the takeaway, but these output tax amounts should then be deductible.

As regards the fit-out costs, there was no recharge from the owner to the other businesses, in barter form or otherwise. The judge was satisfied that the partner had incurred the expenditure not just as landlord but in relation to the partnership business; but that business was only entitled to deduct one-third of it, being its appropriate share of the costs.

First-Tier Tribunal (TC06183): *M G Storer and another*

5.3 Partial exemption

5.3.1 Banking supplies for consideration?

ING has continued to lose its argument with HMRC about the possibility of claiming some input tax on UK advertising costs in relation to its banking business. It lost an appeal in the FTT in late 2014, and in the Upper Tribunal in the second half of 2016; it has now lost in the Court of Appeal as well.

Background

Two Dutch companies were members of a UK VAT group with a UK registered company. The group made voluntary disclosures between 2006 and 2011 claiming back input tax of £6m in total for the periods 10/02 to 03/11.

The company carried on a retail banking business in the UK, taking deposits from private individuals and paying interest. Its profit came from making investments with the deposited money. It was regulated by the Dutch financial authorities, and depositors were protected by the Dutch deposit protection scheme.

The company noted that the costs of attracting deposits were high, and many were VATable (e.g. advertising, construction and operation of call centres, IT services). By contrast, the VAT incurred on the investment side of the business was much less significant. The company charged no fees to depositors, and offered a higher rate of interest than most of its competitors. There were no branches – all interaction with the customers was by telephone or internet. Costs were kept low by offering few facilities – no cheque books, no debit cards, no ability to make payments to third parties.

The group agreed a special method in June 2004 to take effect from 1 April 2003. This noted that the banking operation only generated exempt income, and could therefore not recover any input tax.

The company's claim to recover VAT was based on the fact that some of its investments were made in non-EU interest-bearing bonds. It argued that these constituted "specified supplies" within SI/1999/3121, and therefore justified input tax recovery. HMRC regarded those investments as non-economic activity; the input tax incurred in the UK remained attributable to the exempt supply of banking services to retail customers, rather than to the use of the deposited money for making specified supplies.

First-Tier Tribunal

The FTT judge (Barbara Mosedale, TC04051) noted that there was no real dispute about the law: "*Fundamentally, the dispute between the parties was whether IDUK made supplies for consideration to the depositors. It was assumed (rightly) that if IDUK made a supply of banking services to its depositors, then the costs IDUK incurred on its deposit taking activity had the most immediate and direct link to those banking services. Those banking services, if made, would be exempt and the attributable input tax irrecoverable.*"

The appellant argued that "receiving a loan" (i.e. the deposit) does not constitute a supply, nor is it consideration for a supply. There were references to this in the CJEU *BLP Group plc* decision (Case C-4/94), although it was not part of the basis of the judgment in that case. The funds were being raised to use in the business, so *Kaphag* (Case C-442/01) and *Kretztechnik* (Case C-465/03) were authority for the proposition that the input tax was attributable to all the business activities, rather than to any specific exempt supply.

Judge Mosedale had to consider the proposition that the bank made no supply to its customers, or if it made a supply of services, that supply was not made for a consideration; or, if there was a consideration, it could not be valued in monetary terms. There was authority in the High Court's 2006 decision in *MBNA Europe Bank Ltd* to show that a debtor does not make a supply merely by promising to repay the money lent.

HMRC pointed to a 1995 Tribunal decision, *Bank of Scotland* (VTD 13,854), in which Sir Stephen Oliver held that a bank did supply services to its customers. The appellant argued that this had been wrongly decided. The judge distinguished the situations: in the earlier case, there were other banking facilities (e.g. bill payments, cheque books) that constituted a service.

HMRC also argued that the existence of the exemption for retail banking activities in the Directive ("transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques") implied that they were within the scope of VAT but exempt. The judge agreed with the appellant that this did not logically follow: it was necessary to determine first whether a banking transaction constitutes a supply, and only then to consider whether the exemption applies.

Judge Mosedale also agreed with the appellant that a person who accepts a service provided to them (in this case, the bank accepting the supply of money by the depositor) does not necessarily make a supply of that mere acceptance. However, there could be a barter of services. The judge found that "*depositors could (subject to doing so in the right form) deposit and withdraw money at will; they were provided with an interface to give the bank instructions on withdrawals and deposits and could check their balance when they chose. Statements were provided. I consider that these facilities were valued by depositors.*" This constituted a service provided by the bank to the depositors, as it went well beyond what an ordinary debtor would provide to a lender.

The appellant's representative argued that there could be no consideration, as the bank's contracts emphasised that there were "no fees, no charges, no exceptions". If the judge found that there was consideration, this would amount to saying that the contract was a sham. The judge did not agree: the contract only said that there were no fees or charges, not that there was no consideration at all. The provision of the deposits was non-monetary consideration for the reciprocal supply of banking services.

The appellant's counsel went on to argue that the CJEU decision on *Kuwait Petroleum* (Case C-48/97) meant that the consideration could not be attached to the banking services.

122. The contract in Kuwait can be rendered diagrammatically as:

Cash for A + B

where A = petrol and B = vouchers for free gifts.

123. The contract in this case can be rendered diagrammatically, very similarly, as:

Non-cash (loan) for A + B

where A = interest and B = banking services

124. The judgment in Kuwait makes it clear that it is wrong, says Mr Prosser, to say that because contractually the supplier is bound to provide A + B in return for the consideration (whether cash or non-monetary), the consideration is necessarily 'for' both A + B in the VAT sense.

The judge distinguished the *Kuwait* case on the basis that the customers there only paid cash, rather than being engaged in barter. To her it was obvious that the bank supplied a service, and received consideration for it; the deposits were clearly valuable to the bank, and it was willing to pay interest (as well as incur considerable costs) in order to obtain them. An argument that the subjective value to the bank was "nil" was also rejected. The judge considered how it would be valued, and decided that it was possible (using the principles of *Empire Stores*) but unnecessary.

HMRC's argument that the "specified supplies" were non-economic activity were rejected – the holding of investments was "a direct, permanent and necessary extension" of its business. However, this did not help the appellant, because its inputs were directly linked to making exempt supplies in the UK, rather than being costs of the specified supplies. The appeal was dismissed.

Upper Tribunal

The company appealed to the Upper Tribunal, which considered five separate issues.

The FTT had not made an error of law in concluding that the company made a supply to depositors. The judges set out their reasoning in detail, but broadly agreed with Judge Mosedale.

The FTT also made no error of law in deciding that the customers provided consideration for that supply. Counsel for the taxpayer argued that the situation was similar to *Kuwait*, in which customers paid only for petrol and gift vouchers were provided free; but the UT distinguished the facts, holding that all customers of the bank used the banking services to some extent, if only to deposit and withdraw funds. There was no "optional extra" that could be regarded as provided free. There was a single consideration in "advancing credit", and distinct reciprocal consideration in "interest" and "services".

The UT examined the various possible ways of valuing the consideration and concluded that it would be difficult, but not impossible. It was not necessary to decide exactly how it should be done, only that it could be done. On the basis of these two conclusions – that there was a supply, and it was made for consideration – the appeal had to be dismissed.

The third question was whether, if it was not making supplies for consideration to the depositors, the bank could recover input tax on the account of an economic activity of making investments outside the EU. The UT examined the precedents in some detail, even though it was not necessary in order to determine the appeal, and concluded that it would have required further guidance from the CJEU in this area.

The fourth issue, attribution of inputs to the specified supplies, would have been difficult had the company succeeded on the first three, so the UT did not consider it in any detail.

The fifth issue was whether the company could benefit from reg.109 in respect of inputs that were incurred before the corporate reorganisation and used by one of the new companies afterwards. The UT considered that the regulation did not apply because some use had been made of the inputs before the merger; reg.109 only applies if there is a change of intention before the first use of the input.

The appeal was dismissed again, and the company appealed to the Court of Appeal.

Court of Appeal

Lady Justice Arden gave the judgment, and Kitchin LJ and Floyd LJ agreed. She stated that the three issues for the court were:

1. *Did IDUK in law supply services or do the facilities it provided fall to be treated in law for VAT purposes simply as the receipt of deposits made by the public in return for interest?*
2. *If the answer to Issue 1 is yes, were the services provided for consideration?*
3. *If the answer to Issue 2 [the judgment says 3, but it must be 2] is yes, can that consideration be expressed in a monetary form?*

Before anything else, she stated the decision: the appeal would be dismissed. The Tribunals had been correct to hold against the company on all three issues.

She noted the decision in *BLP Group plc* (Case C-4/94) as authority for the proposition that a person receiving a loan does not make a supply. However, in general, the court must have regard to the terms of the transaction agreed between the parties, including the economic purpose of the parties' arrangements (*Cantor Fitzgerald* Case C-108/99). There must be a direct link between the consideration and the supply in question (*Tolsma* Case C-16/93).

She repeated at some length the decisions of the FTT and UT that the company provided banking services. The company's representative, Kevin Prosser QC, acknowledged that he had to show that these findings were based on an error of law. He relied on the 2006 High Court case of *MBNA Europe Ltd* to support the proposition that the economic purpose in the transaction was the making of the deposit by the individual and the obtaining of funds (receiving a loan) by the bank, and the banking services were incidental to that rather than separate supplies in their own right. In his view, this was the "commercial and economic reality" in line with the *Newey* decision (Case C-653/11).

Arden LJ agreed with the UT that the facts were materially different from *MBNA*, and the answer to the question was rather in the terms and conditions of the agreement between the parties. The following statement is interesting:

"The fact that the terms and conditions use the word 'service' does not of course bind the tribunals to find that there is a supply of services, but the parties' own description of the nature of a transaction is contemporaneous evidence as to what it really was and may sometimes throw light on that matter (see per Lord Neuberger in *Secret Hotels2* at [32]."

The terms and conditions set out what the parties had agreed. They made it clear, as the Upper Tribunal held, that the deposit and the banking services were not interdependent, so the banking services were not ancillary to anything else but a supply in their own right.

The judge also agreed with Judge Mosedale that the transaction involved barter, with the provision of the loan providing consideration for both the payment of interest and the provision of the banking services. The expression “no fee” did not mean “no consideration”. Even if the contract had said that, it would be so clearly at odds with the actual agreement between the parties, that it would have to be disregarded under *Newey* and *SecretHotels2*. The FTT’s finding that there was a direct link between the services and the consideration could not be faulted.

Lastly, the judge agreed that it was possible to put a monetary value on the consideration. It was not necessary actually to do so, so she did not propose to choose between the various methods suggested by the UT. The CJEU had done something similar in *First National Bank of Chicago* (Case C-172/96) and *Naturally Yours Cosmetics* (Case C-230/87).

In her overall conclusion, dismissing the appeal, the judge said: “IDUK was ... free to structure the deposits in the way it thought fit and so it is in principle appropriate for the courts to determine whether there was a supply for VAT purposes by reference to the documentation it chose to use.”

Court of Appeal: *ING Intermediate Holdings Ltd v HMRC*

5.3.2 Article

In an article in *Taxation*, Neil Warren examines the FTT decision on restaurant refurbishment in *Queen’s Club Ltd* (TC06119) and considers the differences between it and similar cases on golf clubs.

Taxation, 17 October 2017

5.4 Cars

Nothing to report.

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

Nothing to report.

5.7 Bad debt relief

Nothing to report.

5.8 Other input tax problems

5.8.1 Runners buying phones

In early 2015, the FTT (TC04249) heard one of a series of cases about the business of employing people to buy iPhones in retail transactions from Apple stores, then selling them on. The trader in this case was substantial – the company employed some 80 people, and purchased 7,000 iPhones in the two months to February 2011. The total amount refused in two decisions relating to the periods January and February 2011 was £590,000.

As in earlier cases on the same issue, the Tribunal decided that the individuals purchased the phones as principal and passed them on to their employer as a non-taxable person (s.47(2A) VATA 1994); even though the individual's VAT cost could be identified from the till receipts obtained, VAT deduction could not flow through such a chain of transactions.

The till receipt did not constitute a valid VAT invoice for the trader, and the FTT did not find that HMRC's refusal to accept it as alternative evidence was an unreasonable decision under reg.29 SI 1995/2518. If it were not for s.47, the FTT would have concluded that there was sufficient evidence to establish the appellant's claim that it had acquired the iPhones from Apple. The FTT concluded that the business model as described "made sense" and, on the balance of probabilities, operated in accordance with the appellant's contentions. However, in relation to reg.29, the question was whether the officer's decision had been unreasonable, not whether the FTT agreed with it. Some of the evidence was unsatisfactory; another company that had been involved in MTIC transactions in 2006 was connected to the trade; many records that might have been expected to exist did not exist. "*When HMRC were considering the adequacy of secondary evidence, and there were all the gaps and uncertainties in the evidence that we have now listed, and no documentary evidence to confirm any audit trail of the goods, we cannot conclude that the case officer's three decisions were in any way unreasonable.*"

The appeal was dismissed, and the company appealed to the UT. It came before Mrs Justice Rose and Judge Charles Hellier in October 2017. The decision starts with a consideration of the jurisdiction of the Tribunal, which is supervisory: although s.83(1)(c) VATA 1994 appears to give an appellate jurisdiction in relation to appeals about input tax claims, because the issue is acceptance of alternative evidence under reg.29, the Tribunal can only consider whether the decision was reasonable, not whether the Tribunal agrees with it. This has been reiterated by the Upper Tribunal in the *Best Buys Supplies Ltd* case (2011).

The grounds of appeal were:

- the FTT had erred in law because it had found that the runners were employees of the appellant, in which case they could not also be agents for the purposes of s.47(2A);
- the FTT should have allowed the appeal under s.83(1)(c) on the basis of its findings of fact, because the Tribunal's exploration of the issues superseded the argument about discretion.

HMRC accepted that s.47(2A) did not apply, because the runners were employees. Nevertheless, they maintained that the runners were the recipients of the supplies from the Apple stores, not the company. They objected to the second ground on the basis that it represented a "complete volte face" by the company: the appeal before the FTT had proceeded on the basis of an agreed approach, as applied in earlier appeals on the same issue. That approach involved the Tribunal considering whether there was in fact a taxable supply, and only if the FTT concluded that there was, then going on to consider whether HMRC had acted reasonably in rejecting alternative evidence. Scandico was now arguing that the first stage was determinative of the appeal whichever way it was decided and not only if the conclusion was that there was no taxable supply.

The UT stated that the role of the FTT was to decide whether the HMRC decision was correct. Although the letters could have been more clearly worded, the decision was properly identified as relating to the lack of evidence; the UT rejected the company's argument that the officer had decided that the company had not actually received a taxable supply. The decision subject to appeal was therefore a decision not to accept alternative evidence within reg.29, rather than a decision of fact.

The UT "firmly disapproved of" the two-stage approach with the parties in this case had encouraged the FTT to adopt and which had been used in other similar cases. The two-stage approach was seriously flawed both in juridical and practical terms.

The taxpayer's counsel argued that the appeal under s.83(1)(c) allowed the Tribunal to consider the broad issue of the amount of input tax that could be credited to the appellant. The UT disagreed. A refusal of input tax could arise from one of two decisions: one about the facts, and one about the evidence. Both types of appeal came through s.83(1)(c), but that did not expand the Tribunal's jurisdiction to consider a decision that HMRC had not made.

The difficulty that the two-stage approach created was that the decision made by the officer was reasonable or not based on the evidence before the officer at the time; if the Tribunal considered the broad issue of whether there was in fact a supply to the company, it would hear much fuller and more up-to-date evidence, but should put that out of its mind when coming to a decision on reasonableness.

The taxpayer's counsel sought to rely on a string of CJEU precedents about the right to deduct input tax, but the UT considered that none of them was relevant to the present decision. They did not affect the principle that, where a taxpayer does not have a valid VAT invoice, the national tax authority has a discretion whether to accept alternative evidence as satisfying it that a taxable supply has taken place entitling the taxpayer to a credit. They did not establish the proposition for which the company contended, that the only circumstance in which a taxable person can be refused the right of deduction is if he knew or ought to have known that he was participating in an evasion of VAT by the supplier.

The most relevant precedent was *Petroma v Belgium* (Case C-271/12), where the taxpayer had submitted VAT invoices which were incomplete and could not be shown to correspond to actual services. The tax authority therefore disallowed the deductions because the company had failed to comply with the domestic statutory requirements. Subsequently additional information was provided by the taxpayer but was not accepted by the authority as a sufficient basis to allow the deduction of the VAT. The court reiterated that:

(i) the right to deduct is a fundamental principle of the common system of VAT which cannot be limited and must be exercised immediately in respect of all the taxes charged on input transactions;

(ii) every taxable person is therefore entitled to deduct the amounts invoiced as VAT for services rendered to him so far as such services are then used for the purposes of his taxable transactions;

(iii) the PVD provides that the taxable person must hold an invoice drawn up in accordance with the provisions of that Directive;

(iv) although Member States are empowered to impose other obligations which they deem necessary, any such requirements must be limited to what is necessary and must not make the exercise of the right to deduct practically impossible or excessively difficult;

(v) any additional requirements imposed by the Member State must not include conditions relating o the content of invoices beyond those expressly laid down in the PVD.

The Court in *Petroma* noted that if incorrect invoices are submitted to the tax authority, they can subsequently be corrected by the taxpayer. If correct invoices are provided before the tax authority concerned has made a decision, the benefit of the right to deduct cannot, in principle, be refused on the ground that the original invoice contained an error. However, if a decision had already been taken, the tax authority was not obliged to revisit it afterwards if further information was provided. The UT considered that this case supported the view that further information provided to a Tribunal was irrelevant to the question of whether HMRC had been entitled to refuse a deduction on the basis that the evidence provided at the time of the decision was insufficient.

Turning briefly to the only part of the FTT's decision that the UT considered strictly relevant, the UT confirmed that it had applied the correct test. The analysis of the situation was "fair and unimpeachable". The UT did not accept that either HMRC or the FTT had imposed additional conditions for the deduction of input tax over and above what the PVD required. Scandico should have realised from the outset of their business that they were not going to receive VAT invoices from Apple because their business model depended on Apple not knowing the ultimate destination of the iPhones. They could have set up and operated their business in a way that enabled them to provide HMRC with clear and unequivocal information supporting their entitlement to a deduction. Instead the case officer was fully entitled to conclude on the basis of the evidence before her that she could not be satisfied that the supply of the phones to Scandico for which a credit was claimed had taken place. She was not setting an impossibly high standard for Scandico to meet in order to claim the deduction.

Accordingly, the appeal was dismissed again.

Upper Tribunal: *Scandico Ltd v HMRC*

5.8.2 Missing traders

A trader appealed against assessments for £10.6m raised on *Kittel* grounds. A dispute arose about whether HMRC should be required to disclose submissions and accompanying letters from the responsible HMRC assurance officers to HMRC's policy unit recommending denial of input tax, and disclosure of the policy unit's response. HMRC refused to give disclosure of those documents. The appellant applied to the Tribunal for a direction that HMRC give disclosure of those documents (the "means of knowledge" submissions) and for a corresponding extension of time for the service of its own evidence. HMRC resisted the application on the grounds that the submissions were irrelevant to the issues before the Tribunal.

The appellants argued that they should be allowed to explore the submissions made at the time for the possibility of inconsistencies between what the officers said then and what they now said under cross-examination. They claimed that this was "fair game". Judge Aleksander concluded that this was no more than a fishing expedition and without merit, and refused to order disclosure. He allowed an extension of time for the appellants to serve their case until 31 December 2017; HMRC had taken a pragmatic approach and had not resisted this part of the application.

First-Tier Tribunal (TC06256): *SVS Securities plc*

A rare FTT success for a MTIC appellant concerned claims for £6.3m in periods 04/06 and 05/06, and £3.5m in relation to 06/06. The initial hearing of the appeal took place in early 2012, but the release of a decision was stayed pending criminal proceedings which took place in the summer of that year.

The company clearly had a genuine trade which had been going on for some years and had been closely monitored by HMRC. The control officer was apparently unaware, when arranging an annual inspection in June 2006, that other HMRC officers were about to raid the premises with a search warrant and remove all the records – some of which appeared then to disappear altogether.

In April 2013, the FTT (TC02667) was split: the judge found the director a convincing witness, an honest businessman whose trading had many of the indications of carousel frauds (including rapid growth and banking with FCIB), but who had co-operated with HMRC throughout and had carried out genuine due diligence. His side member concluded that the *Kittel* tests were satisfied, and that on the balance of probability the company was a willing participant in a fraudulent scheme. The appeal was allowed on the casting vote of the chairman.

HMRC applied for leave to appeal to the Upper Tribunal, putting forward 8 different grounds. The FTT initially granted leave on grounds 3 and 5; following a further application to the Upper Tribunal itself, HMRC were allowed to advance grounds 2, 3, 5 and 8, but not 1, 4, 6 and 7.

Mr Justice Morgan and Judge Herrington heard the appeal in late 2015. The decision criticised the way in which HMRC set out their grounds, as they contained a mixture of claimed errors of law (which would be valid grounds of appeal) together with material that would be used in argument. Given that certain of the grounds had been excluded from the scope of the appeal, it was necessary to analyse carefully exactly what material HMRC were entitled to use, and what were valid grounds of appeal. The decision sets them out as follows:

Ground 2

(1) The F-tT applied the wrong test in deciding not to draw an adverse inference from CCA's failure to adduce evidence in respect of the matters

referred to at paragraphs 22 and 30 above in that it asked itself if the failure was "a deliberate ploy to conceal matters".

(2) It also erred in taking account of the fact that the burden of proof was upon HMRC.

(3) It also took into account irrelevant factors in deciding the issue and it failed to address HMRC's arguments that CCA's evidence on the issue was not credible.

Ground 3

The F-tT erred in law in taking into account an irrelevant consideration relating to connected criminal proceedings against one of CCA's suppliers, Future Communications.

Ground 5

The Ft-T misapplied the test in Kittel in that:

(1) It considered a more onerous test than that prescribed by law;

(2) It applied the burden and standard of proof to individual pieces of evidence as opposed to considering the totality of the evidence;

(3) It adopted an overly sceptical approach to circumstantial evidence;

(4) It paid insufficient regard to the "should have known" limb of the test;

(5) It misinterpreted the case advanced by HMRC as being a case of dishonesty and, in particular, it was wrongly influenced by the opinion of the officers of HMRC as to the nature of the fraud; and

(6) It considered it relevant that the criminal investigation had paid no attention to Mr Trees.

Ground 8

The Judge erred in law in his approach to the banking evidence in that:

(1) His conclusions were inconsistent with the evidence to the extent that they were not conclusions which a reasonable tribunal could have reached;

(2) He wrongly disregarded relevant evidence;

(3) He failed to take into account the detailed submissions made on behalf of HMRC;

(4) His conclusions were based on errors of fact; and

(5) He took account of irrelevant matters;

(6) He failed to give an adequate explanation or reasons for dismissing the banking evidence.

Given the difficulties experienced by the UT in determining the grounds of appeal, the judge made some general comments about how these should be set out, and suggested that a Practice Direction on the matter might be useful.

The UT then went through each of HMRC's grounds in turn. It dismissed Ground 2, finding no error in the way the FTT had approached its task.

In respect of Ground 3, the UT agreed that the FTT had drawn an incorrect inference from the criminal proceedings against the supplier – the FTT judge had concluded that, because he had not been called to give evidence by those prosecuting the supplier, the company's director did not know about the fraud. The state of his knowledge was for the FTT to consider, and this was an unwarranted conclusion.

In respect of Ground 5, the UT examined the conclusions of the FTT on "means of knowledge" and held that they had not been adequately reasoned – they required "much more by way of an intellectual exchange", and HMRC's list of twenty points "did not receive a coherent rebuttal from the judge". This was again an error of law.

There was not time in the hearing of the UT appeal fully to consider all the banking evidence put forward by HMRC in support of Ground 8. The UT had already decided that the case would have to be remitted to a differently constituted FTT for further examination; that part of the case could be considered by the FTT at the same time, being mainly concerned with matters of fact and therefore appropriate for a fact-finding Tribunal.

HMRC's appeal was allowed, and the case was remitted to the FTT. However, the company appealed against this decision to the Court of Appeal. It argued on three grounds:

- the UT should not have interfered with the FTT's conclusion on ground 3 above, that the criminal proceedings indicated that the company did not have actual knowledge of the fraud;
- the UT came to the wrong conclusion on the FTT's approach to the circumstantial evidence (Ground 5 above);
- the UT had erred in its consideration of the evidence regarding banking (ground 8 above).

The CA held for the company on the second of these arguments – it was wrong for the UT to have concluded that the FTT had given insufficient reasons for rejecting HMRC's case on "means of knowledge". However, the UT's decision was upheld on the other two grounds: in relation to the banking evidence, there was insufficient information in the FTT decision to follow the FTT's reasons for rejecting HMRC's case, and in relation to the first ground, the criminal investigation could not logically support the conclusion that the FTT judge drew from it. It was clear that the judge had placed some reliance on it, and it could not be known what his conclusion would have been if he had not. That was an error of law.

Although one of the grounds of appeal was well-founded, overall the decision to remit to the FTT was correct.

Court of Appeal: *CCA Distribution Ltd (in administration) v HMRC*

5.8.3 Allegations of dishonesty

In early 2016, the Upper Tribunal considered a point of principle in relation to two appeals before the FTT (TC04026 and TC04156). The appellants argued that an allegation of involvement in MTIC fraud constituted an allegation of dishonesty or wrongdoing, which if it is to be made must be pleaded with sufficient particularity and in accordance with the pleading rules of civil fraud litigation. HMRC contended that no such allegation of dishonesty was involved: the *Kittel* principle was well-established, and only involved an assertion that the appellant knew or ought to have known that its transactions were connected with fraud.

E Buyer is a large established online retailer which undertook 289 transactions during the period 06/10 to 09/11 that HMRC traced to VAT losses. According to HMRC, these involved both "standard" MTIC frauds and contra-trading. The FTT judge had rejected the company's request for a direction requiring further and better particulars of HMRC's pleaded case.

Citibank was assessed in relation to certain transactions in emissions allowances in 09/09. A similar application for further and better particulars was made, and Judge Mosedale in the FTT agreed with the taxpayer that HMRC's statement of case was seriously flawed. The Upper Tribunal was therefore considering one case as an appeal by HMRC, and the other as an appeal by the taxpayer.

The Upper Tribunal considered the history of case law relating to what might broadly be termed "wrongful" deduction of input tax – ranging from avoidance schemes such as that in *Halifax*, through *Optigen* to *Kittel*. None of these cases refer to "dishonesty". Given that *Kittel* covers those who did not know but should have done, that appeared to be wider than dishonesty as normally understood.

The question was whether a different standard would apply to a case brought by HMRC under the "first limb" of *Kittel* ("actually knew" rather than "should have known"). After considering the UK precedents on MTIC fraud at some length, the UT applied the principles to Judge Mosedale's decision in *Citibank*. Although HMRC's statement of case did not use the word "dishonesty", and appeared only to reflect the CJEU's composite "knew or ought to have known" formulation from *Kittel*, it was nevertheless clear that the case alleged that the appellant knew that its transactions formed part of a contrived scheme designed to defraud HMRC. That was equivalent to an allegation of dishonesty: Judge Mosedale was justified in requiring HMRC either to allege it explicitly or disclaim it explicitly, and HMRC's appeal against her decision was dismissed.

E Buyer's appeal was on two points: a request for disclosure according to the standard in civil fraud cases, where the prosecuting authority would have to disclose not only the evidence on which it sought to rely, but also anything else it had discovered in its enquiries that might undermine its case; and also further and better particulars of its case. The UT set aside the FTT's decision, and ordered that the disclosure application should be granted. It remitted the matter back to the FTT for reconsideration of the "further and better particulars" point in the light of the UT's findings.

HMRC appealed both decisions to the Court of Appeal. The judges set out the following issues:

(1) Whether the UT had been right to hold that there had been no error of law by the FTT in the *Citybank* case;

(2) Whether the UT had been correct to have held that there had been errors of law in the decision of the FTT in the *E buyer* case;

(3) Whether the UT had been wrong to have concluded that an allegation made under the first limb of *Kittel*, that a taxpayer knew that its transactions were part of an orchestrated scheme to defraud the revenue, required a pleading of dishonesty.

In relation to (1), the Court drew a distinction between allegations that were not pleadings of facts but rather inferences from facts. The inference, that the taxpayer had actual knowledge of the fraud, was not an allegation of dishonesty, and it was therefore not necessary for HMRC to have specifically pleaded dishonesty against Citybank in order to be allowed to allege that Citybank knew that its transactions (a) had been contrived, (b) facilitated fraud by others, or (c) were connected to fraud. The UT had been wrong to uphold the FTT's ruling.

Similar principles applied in respect of (2): the UT should not have interfered with the FTT's ruling.

In relation to (3), the key point was that HMRC could allege that a party was dishonest in relation to its transactions, but they did not have to do so in order to deny the right to deduct under *Kittel*. It was therefore inappropriate for the FTT to consider whether the allegations, if proved, would necessarily lead to the conclusion that the taxpayer had been dishonest or fraudulent. It was therefore even more inappropriate to direct HMRC to plead dishonesty when it had expressly informed the FTT that it had not sought to make that allegation.

The *Citybank* case would be remitted to the FTT for reconsideration, and the FTT's order in the *E buyer* case would be reinstated.

Court of Appeal: *HMRC v Citybank NA and another*

5.8.4 Insufficient evidence

A trader appealed to the UT against a FTT decision upholding the refusal of £59,558 input tax claimed on a number of purchases of fuel oil. The evidence before the FTT included a number of invoices dated after the stated supplier had been dissolved, cheques that could not be matched to the amounts on the invoices, and reconciliations of amounts that did not reconcile. The FTT had found against the trader, stating that it was not satisfied on the balance of probabilities that the stated supplier had supplied the oil, or that the claimant had paid for it.

The trader appealed to the UT, arguing that this revealed errors of law. The FTT appeared to have based its decision on a consideration of whether HMRC had come to the correct decision, rather than whether the decision not to exercise discretion had been reasonable. The appellant argued that there was a finding of fact that supplies of fuel oil had been made to him, and that should have been enough for him to succeed.

The UT considered the FTT decision and did not express a view on whether its basis was flawed: even if it was, it would inevitably have dismissed the appeal. There was no evidence that the supplies, if they existed, had been paid for, so VATA 1994 s.26A would have ruled out a deduction. The trader had not been able to provide satisfactory alternative evidence as required by HMRC's statement of practice on deductions without a valid VAT invoice, so there was no basis on which HMRC could properly have exercised its discretion in relation to those supplies.

The appeal was dismissed.

Upper Tribunal: *Robinson v HMRC*

5.8.5 Article

In an article in *Taxation*, Neil Warren comments on the difficulties that clients can create for themselves by not following advice and communicating with HMRC without understanding what they are saying. The article deals with errors in the statistical boxes on a VAT return and how to correct them, and the importance of the word "and" in the requirements for a business splitting direction.

Taxation, 23 November 2017

5.8.6 Updated Notice

HMRC have issued a new version of their Notice *VAT refund scheme for museums and galleries*. It includes an updated list of qualifying museums and galleries.

Notice 998

5.8.7 Addition to s.33 bodies

The *Value Added Tax (Refund of Tax to the Cambridgeshire and Peterborough Combined Authority) Order 2017* specifies a new local authority as entitled to recover VAT incurred in relation to its non-business activities under s.33 VATA 1994.

SI 2017/1203

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

6.2.1 Farmers' flat rate scheme

It is rare for any appeal to feature the agricultural flat-rate scheme (AFRS). HMRC decided to cancel a farmer's AFRS registration for the protection of the revenue. The trader appealed, arguing that HMRC had no power to do that.

In the FTT (TC04057), HMRC put forward figures showing that the trader was enjoying a large and increasing benefit under the AFRS. In the year to 30/6/2012, HMRC calculated that it had benefited by nearly £137,000. It had lost out because of capital works on the farm in the years to 06/07 and 06/08, but overall it was making a great deal of money, and the amount was increasing year by year.

The FTT held that the ability of HMRC to exclude a trader from the AFRS was clearly in accordance with the PVD, which gave Member States leeway to design their own schemes but required them to restrict the benefit to the amount of input tax that would otherwise be claimed. The size and nature of this appellant's business was such that it obtained a financial benefit that could not be reconciled with fiscal neutrality.

The FTT declined to refer a question to the CJEU because, in the opinion of the judge, the answer was obvious.

The trader appealed to the Upper Tribunal, where Mr Justice Nugee was less confident about the answer. He decided that it was appropriate to refer questions. After lengthy consideration and quotation of the law and the FTT decision, the judge summarised the contentions of the taxpayer as:

- The "exclusivity issue": whether Article 296.2, which permits a Member State to exclude from the scheme "certain categories of farmers", provides an exclusive regime as to when persons can be excluded from the common flat rate scheme.
- The "categories issue": whether the exclusion of Shields from the scheme can be said to be, or result from, the exclusion of a category within the meaning of Article 296.2.

The taxpayer's counsel cited *Zita Modes* as an example of the exclusivity issue: member states had discretion on whether to introduce a TOGC rule, but if they introduced one, they could only do so within the parameters set down by the PVD. He identified four different "tools" set down by the PVD for the regulation of the AFRS, which he argued were comprehensive. Member states did not have a general discretion to exclude particular farmers from the scheme for reasons other than those given.

HMRC responded that the PVD required the scheme to be operated in accordance with the principle of fiscal neutrality, and the UK's rules were in line with that.

On the "categories" issue, the taxpayer's counsel argued that the law allowed for the exclusion of "groups" of farmers, but not individual farmers as in this case. HMRC responded that the "group" was "farmers who are found to be recovering substantially more as a member of the Flat Rate Scheme than they would if they were registered for VAT in the usual way", and this individual farmer was a member of that group.

The judge decided that there was insufficient precedent to answer either question with certainty, so the following questions were referred to the CJEU:

1. With regard to the common flat-rate scheme for farmers which is established by Chapter 2 of Title XIIPVD, is art.296(2) to be interpreted as providing an exhaustive regime as to when a Member State is able to exclude a farmer from the flat-rate scheme? In particular:

> *1.1 Is a Member State only able to exclude farmers from the flat-rate scheme pursuant to art.296(2) PVD?*
>
> *1.2 Is a Member State also able to exclude a farmer from the flat-rate scheme using art.299 PVD?*
>
> *1.3 Does the principle of fiscal neutrality give a Member State a right to exclude a farmer from the flat-rate scheme?*
>
> *1.4 Do Member States have an entitlement to exclude farmers from the flat-rate scheme on any other grounds?*

2. How is the term "categories of farmers" in art.296(2) PVD to be interpreted? In particular:

> *2.1 Must a relevant category of farmers be capable of being identified by reference to objective characteristics?*
>
> *2.2 Can a relevant category of farmers be capable of being identified by reference to economic considerations?*
>
> *2.3 What level of precision is required in identifying a category of farmers which a Member State has purported to exclude?*
>
> *2.4 Does it entitle a Member State to treat as a relevant category "farmers who are found to be recovering substantially more as members of the flat-rate scheme than they would if they were registered for VAT?*

In relation to the first question, the CJEU considered that the main objective of the FRS was to simplify the administration of the farmers who joined it, which objective had to be reconciled with the need to compensate them for the loss of input tax. The PVD allowed member states to exclude farmers whose administration would not be simplified by the FRS, in accordance with its objectives. Neither the objectives of the FRS nor the context of art.296(2) suggested that the legislature intended member states to have a wider discretion to exclude farmers. Although this would lead to a breach of fiscal neutrality, that was inevitable in a simplification measure such as the FRS: fiscal neutrality on its own could not justify any widening of the terms of art.296(2).

In relation to the second question, the CJEU observed that the law has to be sufficiently clear and certain to make it possible for someone to carry out an analysis to see if they fall within an excluded category. The court did not consider that the concept of one amount being "substantially more" than another amount satisfied this rule.

In effect, the partnership won on both arguments: art.296(2) was exhaustive, and "farmers who benefit substantially" could not constitute an excluded category.

CJEU (Case C-262/16): *Shields & Son v HMRC*

Following the CJEU decision announced in October, the Upper Tribunal formally allowed the partnership's appeal, with costs, in December.

Upper Tribunal: *Shields & Son v HMRC*

6.2.2 Article

In an article in *Taxation*, Andrew Hubbard questions the assumption of the Office of Tax Simplification that the VAT registration threshold causes fiscal distortions.

Taxation, 16 November 2017

6.3 Payments and returns

6.3.1 Payments on account

HMRC have updated their Notice *VAT payments on account* with new contact addresses.

Notice 700/60

6.4 Repayment claims

6.4.1 Compound interest

The Supreme Court has decided against the taxpayer in the *Littlewoods* case on compound interest. The case itself involved a claim for £1.25 billion, but the judges noted that there were a further 5,000 claims stood over behind it with a total sum at stake of about £17 billion. The judgment overturns the decisions of the High Court and Court of Appeal, and the judges considered that no further reference to the CJEU was appropriate or necessary.

The judgment starts with a reminder of the technical issue underlying the case. Littlewoods sold goods on mail order. It paid commission to its agents in cash (10% of the value of goods they sold) or in kind (a 12.5% discount on the catalogue selling price of goods they bought using their commission account). Between 1973 and 2004, Littlewoods accounted for VAT on such commission sales treating the 2.5% as a price discount, but it was then decided that the whole 12.5% should have been a discount. Claims for repayment were submitted, and after the *Fleming* window allowed claims going back to 1973, the total output tax repaid to the company was £205m.

HMRC added interest under s.78 VATA 1994, calculated on a "simple" rather than a "compound" basis, amounting to £268m. The company argued that it was entitled to compound interest, either as a matter of UK law or as a matter of EU law, and claimed a further £1.25 billion.

The claims were based on the common law principle of restitution: HMRC had been unjustly enriched by having the company's money for a period, and ought to compensate the company for the loss of the use of the money. Although s.78 provided for interest, a claim under the common law would be separate and not subject to the conditions or the required calculation of s.78. A claim in restitution could be established where the unjust enrichment had arisen as a result of a mistake of law (a "*Kleinwort Benson*" claim, with a time limit of six years from when the mistake could reasonably have been discovered), or simply as a result of overpaying tax (a "*Woolwich*" claim, combined with *Sempra Metals*, with a time limit of six years from the payment of the tax to the making of the claim).

HMRC argued that s.78 excluded the possibility of any other claim for interest on a repayment of VAT. At the first hearing in 2010, Vos J in the High Court agreed with HMRC on this point, but decided that questions had to be referred to the CJEU to determine whether a provision restricting interest in this way was compatible with EU legal principles, in particular the principle of effectiveness of rights.

The CJEU (Case C-591/10) gave its ruling in 2012. A-G Trstenjak had clearly considered that the payment of £268m of interest was a more than derisory remedy, and was sufficient; she appeared to compare it to the principal sum, rather than the huge extra amount that the company claimed. The full court gave an unclear judgment that the Supreme Court had to interpret.

The case returned to the High Court where Henderson J found for the taxpayer. He disagreed with the taxpayer's construction of s.78, but he decided that only compound interest would provide "an adequate indemnity", as required by the CJEU. The exclusion of claims by the UK legislation therefore had to be disapplied in order to reflect EU legal rights.

Both parties appealed to the Court of Appeal, which agreed with Henderson J on all points. Both parties therefore appealed again to the Supreme Court.

Construction of s.78

Lord Reed and Lord Hodge set out the leading judgment, with which Lords Neuberger, Clarke and Carnwath agreed. They first noted the restrictions and history of s.80, the basis of the claim for the VAT itself. There is an explicit exclusion of claims for overpaid VAT other than under s.80 in s.80(7), as applied by the Supreme Court recently in the *Investment Trust Companies* case. By contrast, s.78(1) obliges HMRC to pay interest on a VAT repayment "if and to the extent that they would not be liable to do so apart from this section". The company argued that this recognised the possibility of alternative claims such as claims in the common law of restitution; if it did not contemplate the possibility of other claims, it was meaningless.

The judges considered the history of this argument, which has been examined by the courts a number of times. They noted in particular that, at the time the legislation was first enacted, there was no clear principle of law that entitled a taxpayer to interest on a repayment of tax separately from the repayment of the tax itself. That was established later in *Sempra*

Metals. The "apart from this section" in s.78 could refer to the very restricted circumstances under which interest could otherwise be paid – on a judgment debt and awarded by a Tribunal after a successful appeal under s.85A.

The judges were particularly convinced by the argument that, if Littlewoods were right, s.78 would hardly have any application. If it did not exclude and take precedence over a compound interest claim under the common law, such a claim would surely always be more favourable. It was necessary to construe the legislation in accordance with what appeared most likely to be the will of Parliament when it was drafted; the imposition of conditions in the section that would not apply to common law claims (e.g. the requirement for an "official error") surely meant that it was intended to be the exclusive route to an entitlement for interest.

EU legal right

The answer given by the CJEU to the questions referred was:

European Union law must be interpreted as requiring that a taxable person who has overpaid value added tax which was collected by the Member State contrary to the requirements of European Union legislation on value added tax has a right to reimbursement of the tax collected in breach of European Union law and to the payment of interest on the amount of the latter. It is for national law to determine, in compliance with the principles of effectiveness and equivalence, whether the principal sum must bear 'simple interest', 'compound interest' or another type of interest.

This could be read either way: HMRC argued that "it is for the national law to determine" meant that s.78 was an appropriate and legal measure, ruling out compound interest; Henderson J and the Court of Appeal paid more attention to "in compliance with the principles of effectiveness and equivalence". At para.29, the CJEU had stated, "*In this case, that principle [effectiveness] requires that the national rules referring in particular to the calculation of interest which may be due should not lead to depriving the taxpayer of an adequate indemnity for the loss occasioned through the undue payment of VAT.*" Henderson J considered that simple interest was simply not adequate as a measure of the loss to the taxpayer for being deprived of the money over such a long period. The Supreme Court described his judgment as "impressive", but went on to disagree with it and overturn it.

The judges considered a number of other cases in which the CJ has considered the requirement to pay interest on repayments, not just of VAT but other duties and obligations. If the CJ intended a general right to compound interest in such situations, it would surely have said so more clearly by now. The phrase "an adequate indemnity" should be interpreted in the context of the wider judgment: in the following paragraph, the CJ states "*It is for the referring court to determine whether that is so in the case at issue in the main proceedings, having regard to all the circumstances of the case. In that regard it should be noted that it is apparent from the order for reference that, under the provisions of s.78 VATA 1994, the Commissioners paid Littlewoods interest on the VAT levied in breach of EU law. Pursuant to those provisions, Littlewoods received payment of simple interest, in accordance with the said provisions, in an amount of £268,159,135, corresponding to interest due over about 30 years, which amount exceeds by more than 23% that of the* *principal sum, which amounts to £204,774,763.*" Henderson J had confessed that he could not understand what this statement was supposed to signify; the Supreme Court decided that it was effectively approval of the A-G's opinion that a payment of interest that exceeded the principal sum by a substantial margin was *capable* of being "an adequate indemnity", but it was for the national courts to come to a final conclusion on the matter.

The judges noted that the UK government had submitted evidence to the CJ that of 13 member states whose rules the government had examined, only one provided for compound interest (Sweden), and all the others provided for simple interest. Once again, if such a widespread practice was contrary to EU law, the judges would have expected the CJ to have said so much more clearly.

The final conclusion of the Supreme Court reflects the difficult position of the government in responding to VAT case law: "*Littlewoods have already recovered overpaid tax, and interest on that amount, going back several decades. The size of that recovery reflects a combination of circumstances which could not have occurred in most of the other EU member states; the retroactive nature of a major development in the common law by the courts, so as to allow for the first time recovery of money paid under a mistake in law, and the inability of the legislature to respond to that development, under EU law, by retroactively altering the law of limitation so as to protect public finances. The resultant payment of interest cannot realistically be regarded as having deprived Littlewoods of an adequate indemnity, in the sense in which that expression should be interpreted.*"

HMRC's appeal was allowed, and Littlewoods' cross-appeal was dismissed.

Supreme Court: *Littlewoods Ltd and others v HMRC*

HMRC have issued a Brief to confirm that they will not pay anything other than simple interest at statutory rates on overpaid VAT and will invite taxpayers to withdraw any outstanding claims for compound interest. Some claims to the underlying tax have apparently been held over pending the outcome of the *Littlewoods* claim, and these will now proceed to consider the outstanding issues.

Revenue & Customs Brief 5/2017

The decision is discussed in an article in *Taxation* by Sarah Black, who speculates that HMRC may seek to apply the principles to direct tax claims as well.

Taxation, 16 November 2017

6.4.2 Time bar

A motor manufacturer made a *Fleming*-type claim in November 2011 for £78.68m in relation to manufacturers' rebates paid to buyers of commercial vehicles between 1 January 1978 and 31 December 1989. Following the CJEU's decision in *Grattan* (Case C-310/11), it dropped that part of its claim relating to the period up to 31 December 1977, i.e. before the implementation of the 6th Directive in the UK. This reduced the amount to £73.36m. HMRC resisted the claim on the basis of the time limits for making claims, and also on the question of whether this appellant (registered only from 31 December 1992) was entitled to make the claims, when different taxpayers had paid the VAT in the past.

In TC03141, the Tribunal considered the time limits and its jurisdiction as a preliminary issue.

The judge agreed with the taxpayer that the right on which the taxpayer relied, to adjust the consideration under Art.11C(1) 6^{th} Directive, had not been properly implemented in the UK before 1990. As a result, there was nothing to determine how or when any adjustment to its VAT account should be made under UK law; until it made a claim for its directly effective EU rights, there was no "accounting for VAT that was not due". That meant that the claim was not made under s.80 VATA 1994, and the time limit in s.80(4) could not apply.

In order to give effect to the claim, the judge ruled that SI 1995/2518 reg.38 should be read as if reg.38(5) did not apply. This would be a "conforming construction" that allowed the company its EU rights. As the underlying Directive did not contain a time limit, an adjustment to the VAT account should be allowed at any time, without time limit.

HMRC argued that, if the claim was not made under s.80(4), the Tribunal did not have jurisdiction to hear an appeal. The part of s.83 most obviously applicable to repayment claims is s.83(1)(t): "a claim for the crediting or repayment of an amount under section 80." The conclusion on the time limit ruled that out. However, s.83(1)(b) allowed appeals to be heard in respect of "the VAT chargeable on the supply of any goods or services." The judge concluded that this was wide enough to encompass a dispute about the direct application of a VAT Directive in determining the chargeability of a taxable person to VAT in relation to a supply that had been made.

The preliminary issues were therefore decided in favour of the taxpayer.

The remaining issue was HMRC's argument that, as a matter of EU law, a directly-effective right under the 6^{th} Directive had to be exercised within a reasonable time after the relevant price reduction leading to an overpayment. As a similar argument had been rejected by the Upper Tribunal in *GMAC UK v HMRC; British Telecommunications plc v HMRC* and was the subject of an appeal to the Court of Appeal, that issue was stood over to be considered after the CA had given its judgment.

Although BT lost in the CA, the FTT judge concluded that the CA agreed with the UT on this point: there is no principle of EU law that requires a claim based on adjustment of consideration to be brought within a particular time-frame.

As this was the only remaining issue, and the CA judgment was binding on the FTT, the judge allowed the taxpayer's appeal in TC03578.

HMRC appealed to the Upper Tribunal, which agreed with both parties to defer consideration of the question of whether EU law required a claim to be brought in a reasonable time until the CA has decided the *GMAC* appeal. HMRC had several other grounds, arguing that the FTT had erred:

- in holding that s.80 did not apply to the claim, or that if it did, the claim was made within the time limit;
- in seeking to interpret reg.38 to give effect to art.11C1(1);
- in concluding that it had jurisdiction to consider the preliminary issue.

The Upper Tribunal started with an interesting discussion about the interaction of reg.38 and s.80, commenting that the apparently mandatory corrective mechanism of reg.38 requires an adjustment through the VAT account of the current period. It is then not entirely clear from the legislation what should happen if the result is a negative entry in Box 1. There has not been an "overpayment" in the s.80 sense: when the original return was made, showing the original price charged, the VAT was properly due.

The company argued that this counted in its favour. There was no "overpayment" until it made a claim to adjust its VAT account using the directly effective rights under the PVD, so the time limits in s.80 could not apply. HMRC argued that the overpayment arose when the company made the adjustment to the price and could or should have adjusted its VAT account.

The Tribunal commented that it might be necessary to "mould" the legislation in order to interpret it in a manner compliant with the PVD, but it was not clear whether it would be reg.32, reg.38 or s.80 that had to be so "moulded". The UT's understanding of the *Marleasing* principle led it to the view that the company's claim should have been made under s.80: it had directly effective rights at the time the adjustment to consideration was made, and that would have led to a *Fleming* claim. It had missed the *Fleming* window, and it was now too late to claim.

The Tribunal also considered the law on restitutionary claims, and concluded that the company's claims based on price reductions occurring before the beginning of 1984 were time barred by 1 January 1990. This was because there was no UK regulation implementing art.11C(1) 6th Directive before reg.38 came into force on 1 January 1990; the time limit for making restitutionary claims, which would have been required to give direct effect to the company's EU rights, was six years.

The UT did agree with Judge Berner that the FTT had jurisdiction to consider a claim under a "moulded" reg.38. However, the claim should have fallen under s.80, and the FTT had therefore come to the wrong conclusion. HMRC's appeal was allowed: "S.80 applies on the basis that the reduction in the taxable amount and the consequent overpayment of VAT arose on the occasion of each price reduction. If that is wrong, all of Iveco's claims in relation to price reductions occurring before 1 January 1984 were time-barred prior to 1 January 1990. S.80 does not apply in relation to such claims and does not revive them."

The company appealed to the Court of Appeal, where Newey LJ gave the lead judgment, dismissing the appeal; Henderson LJ and Sharp LJ agreed with him. He set out the grounds of appeal as arguments that the UT had been wrong:

i) In concluding that, notwithstanding that it had not yet been implemented, art.11C(1) reduced the "taxable amount" when a rebate was paid;

ii) In concluding that s.80 (or a moulded s.80) provided the means for Iveco to enforce the directly effective rights conferred by art.11C(1) and that reg.38 could not, or should not, instead be moulded for that purpose; and

iii) In concluding that "all of Iveco's claims based on price reductions occurring before the beginning of 1984 (six years before s.24 FA 1989 came into force) were time barred by 1 January 1990".

He named these, respectively, "The When Issue", "The How Issue" and "The Restitution Issue".

As regards "when", the judge did not agree that a taxpayer should have a free choice of when to exercise directly effective rights. The rights arose when, or shortly after, Iveco had paid rebates between 1978 and 1989. This did not represent the member state claiming direct effect of a provision that it had not properly implemented. HMRC were, instead, entitled to dispute the company's contentions on the results of the failure to implement the Directive.

As regards "how", the judge held that s.80 was the correct mechanism for giving a remedy to someone who had overpaid tax. It followed that the claim should have been made no later than the end of the *Fleming* window, and it was time-barred in its entirety.

Similarly, any possibility of a restitutionary claim for such ancient claims must have expired by now. The judge did not consider it necessary to examine the merits of the issue in any detail.

The appeal was dismissed.

Court of Appeal: *Iveco Ltd v HMRC*

6.4.3 Direct claims

Two pension fund trustees made direct claims against HMRC for VAT paid on investment management services to various investment managers. The funds were "defined benefit" schemes, and the managers included both authorised insurers and others. Pension fund management services had been regarded as exempt when provided by authorised insurers but taxable when provided by others.

Until 1 January 2005, the different treatment of supplies by insurers, on the one hand, and by non-insurers, on the other hand, had been in accordance with UK statute. Following amendment of the UK legislation with effect from that date, the difference in treatment was no longer in accordance with UK statute, but continued to be applied by HMRC. The trustees' case was that the supplies made by non-insurers had been insurance transactions for the purposes of the 6^{th} Directive and the PVD, and had attracted mandatory exemption from VAT. However, UK legislation at all material times had failed to provide for the exemption required by the Directives. The trustees and their predecessors had paid VAT to their suppliers which should not properly have been payable. The trustees claimed that they had a directly effective right to exemption with a consequential right to recover from HMRC the VAT which they should never have been obliged to pay.

The High Court considered that pension fund management did not constitute an "insurance transaction". As a matter of UK law, it was not exempt. The principle of fiscal neutrality did not assist the claimants: to achieve consistency, the preferable course would be to deny exemption to the insurance supplies, rather than allow exemption for the non-insurers.

Even if the answer to the first question had been "yes", the court did not consider that it would have been "impossible or excessively difficult" to make a claim for repayment using the normal route (via the supplier, who would have to make a s.80 claim to HMRC).

Even if the claim was still alive after those two defeats, the judge held that a restitutionary claim would depend on disapplying s.80(7) VATA 1994, and would in any case be time-barred after four years in accordance with s.80(4).

The judge considered that the matter was "acte clair", and there was no need for a reference to the CJEU. The claim was dismissed.

High Court: *United Biscuits (Pension Trustees) Ltd and another v HMRC*

6.4.4 Date of claim

A golf club claimed to have sent a Fleming claim for green fees to HMRC, via its accountants, on 30 March 2009. HMRC said they had no record of having received it, and had not acknowledged it; there was no record of any further action in relation to the matter until the accountants sent a letter dated 16 February 2016. The club appealed to the Tribunal on the preliminary question of whether it had made a claim in time.

HMRC argued that they had no record of receiving the claim; the accountants had no proof of posting; and the fact that no query about HMRC's lack of response had arisen until 2016 suggested that the claim had not been made.

The Tribunal heard from the accountant who dealt with the club's affairs throughout the period. She was found to be an obviously honest, straightforward and highly credible witness. The burden of proof lay upon the club to prove, on the balance of probabilities, that the claim was valid; the witness recalled specifically seeing the particular letter handed to the postman on 30 March 2009. Her evidence convinced the Tribunal that the claim had been made; the Tribunal accepted her explanation that such cases were not followed up because there were a number of them.

The Tribunal found as a fact that the letter had been handed to the postman, properly addressed, in time for it to arrive by the deadline. It must therefore be assumed to have arrived, in accordance with s.7 Interpretation Act 1978. The reasonableness or otherwise of the accountants in failing to follow up the lack of response was not relevant to the basic issue. HMRC's application to strike out the appeal was dismissed, and the substantive appeal was stayed for six months to give the parties time to resolve the issues.

First-Tier Tribunal (TC06250): *Knott End Golf Club Ltd*

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Updated Notice

HMRC have updated their Notice *Self billing* with clarification around self-billing agreements (paragraph 3.1) and the responsibility of the self-billee to account for output tax (paragraph 6.4).

Notice 700/62

6.7 Assessments

6.7.1 Onus of proof

A hotel business appealed against assessments totalling £25,876 covering the periods from 08/12 to 05/16. The problem was that the company did not account for VAT on deposits for wedding receptions as they were received, but rather operated a "catch-up" from time to time. There had been no "catch-up" since 05/12; in quarter 05/16, the gross value of deposits on which VAT had not been accounted for totalled £145,000, with unpaid VAT of £24,245.

The judge commented that "The appellant's system, if it can be called that, was very odd, and inappropriate. It did not comply with the requirements of the legislation." The appellant did nothing to satisfy the onus of proof required to displace the assessments; the judge suggested that the assessments were in fact lower than they ought to have been. The appeal was dismissed.

First-Tier Tribunal (TC06153): *Lifestyle Hotels Ltd*

6.8 Penalties and appeals

6.8.1 Default surcharge

A company appealed against a 5% surcharge of £1,540 imposed for its 03/16 period. The company had fallen into the surcharge regime because of late payments in 09/15 and 12/15 while its finance manager was on maternity leave and agency cover workers proved unreliable. The 2% surcharge in 12/15 was below £400, so the 5% charge for 03/16 was the first the company would have been required to pay. By this time the company had an appropriately qualified temporary employee who appeared to be competent; unbeknown to the directors, she was caring for a sick relative. On the due date for the 03/16 payment she did not attend the office, made no contact with the directors, and did not alert them to the fact that a payment was due.

The Tribunal considered that this was "on the margins" but did constitute a reasonable excuse. Even with careful management, "events can sometimes take over". The appeal was allowed.

First-Tier Tribunal (TC06128): *Rux Burton Associates Ltd*

A commercial lettings business appealed against a 2% surcharge of £499.11 for its 11/16 period. The return had been filed on 22 December 2016, but the payment was not made until 9 January, 2 days late. The trader argued that its offices were closed during the Christmas period and only reopened on 9 January. The Tribunal did not consider this a reasonable excuse, and dismissed an argument that the penalty was disproportionate.

First-Tier Tribunal (TC06133): *SBS Partnership*

A company appealed against a 10% surcharge of £383.06 for its 12/16 period. Returns for the previous 3 periods had all been lodged late on 29 November 2016, and the final payments of tax for those periods was also late. SLNs had been issued. The tax due for 12/16 was also paid late, and no explanation was given. The only ground of appeal was that the previous accountant had been responsible for filing the returns and it was unfair to penalise the appellant for someone else's failing. This could not be a reasonable excuse because of s.71 VATA 1994, and the appeal was dismissed.

First-Tier Tribunal (TC06138): *M F Social Work Services Ltd*

A company appealed against a 10% surcharge of £2,967.28 for its 01/17 period. The return had been submitted on 9 February, but the VAT was only paid on 29 March. The business was a small independent retailer where the owner "did everything", except for accounting, because he was not good at that. The person he hired to do that work proved unsatisfactory, and the company fell into the surcharge regime. The director realised that he needed to replace the accountant with a more reliable firm, but there was a delay before they took on the work; for one period, he had to complete the VAT return himself. He tried to follow the instructions in the accounting software but failed to appreciate how the payment needed to be made.

The judge agreed with HMRC that reliance on an accountant is not a reasonable excuse, but viewed this situation "in the round": in all the circumstances, the trader had been taking steps to rectify the problem, and should not be penalised for an error committed while doing that. The appeal was allowed.

First-Tier Tribunal (TC06164): *Furniture Interior Ltd*

A company appealed against a 5% surcharge of £6,514.80 for its 12/16 period. It had defaulted in 12/15, but had agreed TTP before the due date; it defaulted again in 06/16, when an initial 2% surcharge was reduced to a non-financial SLN because of the TTP agreement in 12/15. The payment for 12/16 was made by electronic transfer on 8 February 2017, 1 day late. The explanation was that the return gave rise to a larger liability than usual; the company had discovered too late that the bank would not process a "same day transfer" of that amount. An attempt to split the payment into two instalments did not solve the problem – the payments went through the banking system at 3 minutes past midnight.

HMRC argued that the company should have foreseen unforeseeable difficulties, given that it was in the surcharge regime; but the judge held that the fact that this was a larger payment than the company had ever made before, combined with the efforts the company had made to make the payment on the due date, constituted a reasonable excuse. The appeal was allowed.

First-Tier Tribunal (TC06214): *Stylographics Ltd*

A company appealed against 15% surcharges of £9,354 for its 01/16 period and £7,201 for its 04/16 period. Its argument was that it was waiting for in-year repayments from HMRC under the Construction Industry Scheme. The company had expanded very rapidly and had serious cash flow issues; the debt of £248,310 due from HMRC had a significant impact on its ability to pay its VAT. The directors accepted that their previous accountant should have advised them to apply for TTP but had "let them down".

The judge did not consider this to be a reasonable excuse. The CIS and VAT systems were quite separate and there was no provision for any offset. The cash flow shortage did not arise from any unforeseeable or unexpected event. The appeal was dismissed.

First-Tier Tribunal (TC06216): *Deep Soil Mixing Ltd*

A company brought a late appeal against a surcharge of £555 for its 08/15 period. It had an earlier appeal against surcharges for 08/14 and 11/14 dismissed. The company argued that it had intended to include the third surcharge in the first appeal, but HMRC pointed out that the first decision had clearly indicated which surcharges it covered. The company had taken no action for a year after the first decision, claiming only to have realised that the third surcharge was due when HMRC applied for payment. The judge concluded from the documents that the director could not genuinely have believed that the first appeal had dealt with the third surcharge; however, it was also clear that the company must have been aware of its existence.

The judge noted that HMRC asked her to consider the Data Select criteria for allowing late appeals. She pointed out that more recent cases, including *BPP Holdings*, have placed a greater emphasis on compliance with rules and procedures. The judge applied the three stage review from the *Denton* case:

- the delay in this case was serious and significant, being, even based on the latest possible date for SSBML becoming aware of the appealable decision shortly;
- the reasons given for failing to comply with the time limit, being a lack of awareness of the surcharge or that the surcharge had already been dealt with in the first appeal, were not credible;
- taking everything into account, given that there would be some prejudice to HMRC in allowing an appeal to proceed in a case where they would have good reason to have supposed that the company did not intend to appeal, the application should be refused.

First-Tier Tribunal (TC06218): *Single Source Binding Machines Ltd*

A company appealed against a 15% surcharge of £432 for its 11/16 period. The company's director did not attend the hearing; this was not a "paper appeal", but it proceeded without his attendance. The trader had submitted the return on 2 December, determined to avoid a surcharge, but as he paid by direct debit, HMRC called for the money only on 11 January. On that date, there was insufficient money in the bank account to meet the payment, and the bank refused the DD, even though the company had enough money in another account.

The trader argued in correspondence that this was unfair, given that he had filed the return so early when there was sufficient money to pay the tax; however, the judge concluded that he had been aware of the rules and the due date, and none of this constituted a reasonable excuse.

First-Tier Tribunal (TC06221): *Peter Cowsill Ltd*

A company appealed against a 10% surcharge of £2,022 for its 12/16 period. The late payment had arisen because the directors wrongly believed that a DD was in place; when they realised it was not, they further discovered that the bank would only make online payments of £10,000 on any day. The company paid half the liability on 8 February and half the following day, so all of it was late. The funds were available.

The judge did not accept that any of this was a reasonable excuse. There were no unforeseeable or unexpected events outside the proprietor's control. An argument about the "excessive" nature of the penalty was routinely rejected.

First-Tier Tribunal (TC06228): *Xen Jewellery Design Ltd*

A company appealed against a 15% surcharge of £2,396 for its 09/16 period. Although the appeal had been submitted by a firm of accountants, the company was not represented either by them or by an employee at the hearing. The judge noted that the reason put forward as an excuse changed several times during the course of correspondence, but boiled down to the absence of the proprietor from the business premises, either on holiday or while working, and an inability to access the internet to make a payment on the due date. The director claimed to have given instructions to a bookkeeper to make the payment, but this had not been done. The company had sufficient funds available to pay the VAT, and had done so as soon as the director realised that it had not been settled.

The judge pointed out that none of this could be a reasonable excuse, and also that the company had not provided any evidence to back up the facts. If the bookkeeper was an employee, the default belonged to the company; if the bookkeeper was an independent contractor, reliance on them was ruled out by s.71. A separate argument about disproportionality was also rejected.

First-Tier Tribunal (TC06231): *Galaxy Decorators Ltd*

A company appealed against a 15% surcharge of £6,039 for its 11/16 period. A director attended the hearing to explain the circumstances: a large invoice (£60,000) was expected to be received on Friday 6 January under a factoring arrangement, but the accounts clerk did not work on Fridays. He himself telephoned HMRC to explain the position. He told the Tribunal he was told 'not to worry, just ensure payment is made as soon as you can'. He said that he told the person he spoke to that the VAT was due on Saturday 7 January (even though it would have to arrive in HMRC's account by the Friday). He was not corrected and was only asked to give the Company name but no further details (e.g. the Company's VAT Number). He was (mistakenly) 'very aware' that the VAT fell due for payment on 7 January but explained that he was not asking for time to pay. Had his clerk been working that day, payment would have been made on 6 January subject to the company receiving the £60,000. He felt as if he had been inadvertently misled by HMRC.

The judge accepted that the director would have asked for time to pay, which given the circumstances would have in all probability been agreed, had he not been inadvertently misled by the person he spoke to at HMRC on Friday 6 January 2017. He did not know that the VAT had to be paid on 6 January and that was not explained to him by the person he spoke to. Had he known that payment had to be made that day, and that otherwise a VAT default surcharge would arise, which was never mentioned, he would have asked for time to pay. The judge considered that constituted a reasonable excuse, and allowed the appeal.

First-Tier Tribunal (TC06235): *Mezzanine Floors (Hull) Ltd*

A company appealed against a 5% surcharge of £3,768 for its 03/17 period. The surcharge rate had been reduced from 10% on review on the grounds that one earlier default had related to a late return on which there was no VAT liability, so the rate should not have increased. The judge noted the reason for this: a surcharge notice had been issued because the return was late, and it only became apparent that the return was a repayment return when the late return was actually submitted. The judge commented that it was unsatisfactory that HMRC's system did not appear to recognise and correct this situation automatically.

The trader complained that it had agreed a TTP arrangement with HMRC some time earlier under which it was paying off debts at £11,000 per month. The 12/16 period gave rise to a large VAT repayment (£31,000) which HMRC set off against the outstanding debts under the TTP, reducing the direct debits for later months. The company said that it had been expecting the amount to be repaid in cash, and if this had happened, it would have been able to pay the 03/17 liability (or at least part of it) earlier.

The judge noted that there was no evidence to support the company's assertion that it had attempted to query the treatment of the 12/16 repayment several weeks before the due date for 03/17. The director who was said to have made the call did not attend the hearing and could not be cross-examined. It was not therefore possible to find, on the balance of probabilities, that the company had made a specific request for the VAT credit to be treated in any particular way. In the absence of such a specific request, HMRC were entitled to allocate it against VAT due for earlier periods.

The company claimed that it had not been able to make a payment until 22 May because it was not sure how much it owed, but the judge said that this "is not a reflection of the reality of the situation". In any case, the liability on the return was substantially greater than that, and it could at least have paid the excess. None of this constituted a reasonable excuse, and the appeal was dismissed.

First-Tier Tribunal (TC06246): *Reciprocal Ltd*

A company within the payments on account regime appealed against a surcharge of £297,845 for late payment of its final POA for the period 09/16. The company had made late payments in 2012 and 2013 and had therefore entered the surcharge regime; although it had not made any late payments since, it had filed some returns late, which meant that it was still in a surcharge liability period with an applicable rate of 10%. The payment of £2,978,459.24 was made on 1 November 2016 rather than 31 October 2016. The VAT liability itself was not out of the ordinary for the company as a final instalment for a VAT period.

The company appealed on two grounds. It put forward a reasonable excuse for its default in 12/13. If that default was struck out, the rate of surcharge applicable in 09/16 would fall to 2%, because it would be the first late payment in a new surcharge period (triggered by late returns in 09/14 and 09/15). The company appeared to believe that the percentage would fall to 0% for a first late payment, but the judge commented that this could not be correct under the law. The second ground of appeal was that the penalty for its single day delay was disproportionate to the gravity of the infringement.

The 12/13 late payment was a very small one. It arose because the company had been audited by HMRC in 2012, as a result of which it received and paid an assessment of £1,583. Given that the turnover of the group of which it was a representative member was £110 million, this was an insignificant amount of money. However, due to an accounting error, this was recorded in its VAT control account as a payment without a corresponding entry for the assessment. So, later in the year, when a VAT payment had to be made, £1,583 less was paid than was owing, because the accounting system treated this amount as a credit. That was enough to constitute a late payment and to increase the percentage for the next default, even though the surcharge applicable to that late payment (at 5%) would have not been collected.

The company argued that its honest mistake in paying too small an amount should be regarded as a reasonable excuse, in the context of the balancing payment for the period 12/13 (£2,377,763). HMRC responded:

(a) at the time of its default, the company knew that it was in the default surcharge regime and should have been taking particular care to ensure that it complied with its VAT obligations;

(b) a company of that size should have had sufficient financial controls in place to identify errors such as the one which was made; and

(c) the assessment was issued on 12 March 2013 and paid on 28 March 2013, some nine months before the reconciliation process in relation to the VAT Control Account was effected. If the company had conducted that exercise earlier, it might have discovered the problem and prevented the default.

The judge noted that there were relatively few entries in the VAT Control Account; a balance of £1,583 could not have represented an instalment payment in the ordinary course of the company's business, so it should have triggered an investigation. The genuine mistake did not, in the circumstances, constitute a reasonable excuse.

The Tribunal considered, as usual, the principles derived from the precedent cases of *Total Technology* and *Trinity Mirror*. It noted the comments of the Upper Tribunal that it was possible for an individual surcharge to be disproportionate when the system was not disproportionate, but the UT could not give an example of when that might apply. The Tribunal also noted from the CJEU precedent of *Louloudakis* (Case C-262/99) that (i) penalties must not go beyond what is strictly necessary for the objectives pursued, and (ii) a penalty must not be so disproportionate to the gravity of the infringement that it becomes an obstacle to the underlying aims of the applicable directive.

The company's representative argued that the underlying aims of the PVD included the company's accounting for VAT in its internal systems, but not the timely submission of returns to HMRC. He had to sustain this difficult position to try to make the late returns in 09/14 and 09/15 less relevant to the punishment that the system imposed on the company. The Tribunal did not accept this: "In our view, it is apparent from the context that 'accounted for' means submitted to HMRC in the form of the VAT returns and not some accounting procedure which is internal to the relevant taxpayer. The reason why the submission of VAT returns on a timely basis is an important part of the collection process is that that is how HMRC is informed of the amount of VAT which is due."

As a result, the late submission of two VAT returns could not be ignored. Even though it was on a 10% surcharge rate only because of a late payment of £1,583, and even though it had made 32 VAT payments on time between the late payment for 12/13 and the late payment for 09/16, and even though it was just one day late, the penalty of £297,845 was not disproportionate. The appeal was dismissed.

First-Tier Tribunal (TC06252): *Global Switch Ltd*

6.8.2 Consultation

In December HMRC launched a consultation, to run to 2 March 2018, on interest and sanctions for late payment under making tax digital. The consultation examines options for aligning late payment interest and penalties across VAT, income tax self-assessment and corporation tax. It takes account of responses to the earlier consultation on sanctions for late submission under the MTD regime. HMRC propose a hybrid model for late payment penalties, to include a charge at 5% of the tax due, plus an additional element charged in an 'interest' type calculation.

Oddly, the consultation does not appear to take account of the fact that MTD has been indefinitely postponed for income tax.

www.gov.uk/government/consultations/making-tax-digital-interest-harmonisation-and-sanctions-for-late-payment

6.8.3 Other penalties

A company appealed against inaccuracy penalties totalling £156,163 for its return periods 12/09 to 09/13. The penalty related to an earlier assessment for £258,495 on sales that had been zero-rated as despatches to customers in Ireland, but on which HMRC concluded that the appellant had not followed correct procedures, and had not kept the required evidence to show that the goods had been sold to a customer VAT registered in another EU Member State, and thus had not been entitled to sell the goods free of UK VAT.

The company did not appeal the assessment, so the Tribunal proceeded on the basis that it was correct. The only issue was whether the conduct had been "deliberate" or merely "careless". If it was deliberate, the directors could also be made personally liable. HMRC had issued personal liability notices to the married couple who owned the company.

The company had traded in furniture. On a VAT visit in 2009, the requirements for cross-border sales had been explained to the director, but on a further visit in 2013, it appeared that they were not being met. Contact with the Irish authorities revealed that customers whose VAT numbers were being used did not buy anything from this company, and other customers had been deregistered. The director claimed that records had been destroyed in a flood. In the absence of evidence that goods were sold to the customers whose RoI numbers were quoted, HMRC issued a penalty at 56% of the PLR, giving 40% mitigation of the difference between 35% and 70%.

The Tribunal recorded the evidence of facts presented by a number of HMRC officers, a witness statement from a RoI officer, and the appellant. The judge started his findings with the following interesting statements:

Curiously, neither party identified any case law dealing with the legal test for distinguishing between a "deliberate" and a "careless" inaccuracy for purposes of Schedule 24.

An inaccuracy will obviously be "careless" rather than "deliberate" in circumstances where the trader knows the correct figure and intends to include that correct figure in the VAT return, but through inadvertence or oversight puts a different figure in the return.

An inaccuracy will obviously be "deliberate" in cases where the trader includes in a VAT return the figure that the trader intends to put, and knows that the figure is wrong.

A more difficult question is how to classify an inaccuracy in circumstances where the trader includes the figure that the trader intends to put, but the trader does not know whether the figure is correct or not. An example would be where the trader has some information suggesting that the figure is correct, but where the trader does not have the time or inclination to check whether this is so, and simply uses that figure hoping that it is correct. Another example might be where a trader has no information as to the correct figure, but just uses a good faith estimate, which turns out to be inaccurate.

The judge went on to comment on the difficulty where the trader acted in ignorance of the law. As ignorance is no defence, including a figure that is wrong could be regarded as "deliberate"; or it could only be "deliberate" if the trader actually knew that it was wrong. Similar issues might arise if the trader failed to carry out appropriate checks and as a result did not know the true facts.

None of these issues were addressed in the submissions of the parties, so the Tribunal made no detailed findings of law in respect of them. HMRC accepted that they had the burden of proof to show that the penalties had been correctly levied. However, the judge made inferences from various factors: the lack of records for a business that had sales of £100,000 per quarter; the timing of the claimed flood that destroyed the records; the claim that the company made no money in spite of the substantial sales; and a number of inherently implausible assertions. The judge decided that, on the balance of probabilities, the sales had not been made in the manner claimed, and that the director was not disclosing the true facts. That satisfied the judge that the inaccuracy was deliberate, and the appeal was dismissed.

First-Tier Tribunal (TC06194): *Mehaffey Ltd*

A trader appealed against a penalty for failure to notify liability to register amounting to £6,908. HMRC had enquired into the appellant's tax affairs after discovering that she was selling significant quantities of goods on eBay. She denied doing so and denied having a PayPal account, but HMRC identified 20,574 feedback postings and analysed 3,983 of them in order to extrapolate to a total. They estimated her turnover between June 2010 and July 2011 as £278,000, with a registration liability arising no later than 1 December 2010. She appeared to have ceased trading on 17 July 2011. A VAT assessment was raised for £27,632; a penalty of £14,507 was reduced on review to £6,908 on the basis that the failure was not deliberate. The minimum for such a delay would be 20% and the maximum 30%; HMRC had allowed mitigation of 10% for telling, 30% for helping and 10% for giving access, so the mitigation amounted to half the difference between the minimum and maximum penalties.

The Tribunal noted that there could be no appeal against the VAT assessment – that could only be challenged by filing a VAT return. In those circumstances, the penalty had to stand as assessed. The Tribunal was satisfied that the assessment was to HMRC's best judgement, and the various factors that had gone into the calculation of the penalty were all in order. The appellant had raised a number of objections to HMRC's calculations, but she had produced no records and no evidence that could even start to justify her claim. The appeal was dismissed.

First-Tier Tribunal (TC06210): *Parminder Kaur*

6.8.4 Appealing out of time

An individual appealed against personal liability notices amounting to £490,000 issued to him as director of a company that had traded in metals. The trader had put his affairs in the hands of someone who claimed to be competent in such matters, but the representative had not filed an appeal. He appeared to have a number of outlandish views on how the law could be manipulated to avoid the liability, including declaring that the appellant was dead.

The trader changed adviser in July 2016. His new representatives addressed the outstanding notices of appeal by September 2016. He now applied for leave to appeal out of time. His representative argued that he had been totally reliant on the previous adviser, and although the delay (somewhere between 13.5 and 24 months) was admittedly serious, his reliance was understandable.

HMRC contested the application. They considered that the appellant should suffer the consequences of the actions of his adviser. They considered they would suffer prejudice as the officer involved in the case had left the service.

The judge considered that, on balance, the prejudice to the appellant from refusing the application outweighed the possible prejudice to HMRC and the seriousness of the delay. He would inevitably lose his home if he could not challenge the penalty notices. His first representative's actions were so far outside any reasonable brief that the appellant could have given, that he should be regarded as "on a frolic of his own".

The application was allowed. The case, and the peculiar beliefs of the first adviser, are reviewed by Andrew Hubbard in his editorial comment in *Taxation*, 7 December 2017.

First-Tier Tribunal (TC06149): *Muhammed Hafeez Katib*

An individual submitted appeals against a number of determinations for income tax and VAT, together with penalties, totalling £56,167. The notice was submitted on 23 September 2016, but it turned out that it was an attempt to resist a statutory demand from HMRC based on a statement of liabilities dated 19 February 2016. The various assessments in fact dated back to periods between 2007 and 2012.

The judge reviewed the history of the disputed tax and a large number of assertions made by the appellant. However, she concluded that there was no reasonable excuse for such a substantial delay in appealing. The application was refused.

First-Tier Tribunal (TC06145): *Koysar Khan*

Another individual applied to appeal late against various assessments to income tax, NIC and VAT, together with penalties, for periods from 2011 to 2015. It appeared that HMRC had issued decisions without making clear the rights of appeal and the time limits; they had confirmed those decisions on review but then continued to enter into correspondence about the liabilities without emphasising that it would now be necessary to appeal to the Tribunal.

The judge did not accept that "continuing to correspond with HMRC in the hope of avoiding a Tribunal hearing" was a reasonable explanation for the delay in appealing. The explanation did not extend to all the income tax assessments or a VAT penalty, where the proper course of action had been made clear to the appellant at the time. Some of the correspondence about the decision to register the trader for VAT had not been as clear as it might have been, but it appeared that the trader had not been misled, and the officer had been clear that the proper course was to make an appeal to the Tribunal.

The Tribunal decided that, on balance, the delay was significant and the appellant and his agent had not been sufficiently active in contesting several different liabilities. The potentially serious consequences for the appellant did not outweigh the other factors. The application was dismissed.

First-Tier Tribunal (TC06226): *Adam Akhtar*

6.8.5 Application to stay

A college applied to have the hearing of its appeal stayed until the release of the Court of Appeal decision in *SAE Education Ltd*. HMRC did not dispute that the CA decision would be significant, but argued that there were findings of fact specific to the appellant that would require determination and, given the early stages of the appeal, the parties could usefully progress matters. HMRC reckoned that the case would not in any event actually reach a hearing before the CA judgment was handed down (which it now has been: *SAE* lost).

The judge decided that the delay would be minimal, and there would possibly be a significant saving in time and effort if the CA judgment clarified and narrowed the areas of dispute. She granted the application to stay the appeal.

First-Tier Tribunal (TC06129): *London School of Marketing Ltd*

6.8.6 Costs

A company appealed against a decision of HMRC that certain of its supplies did not qualify for exemption under item 5 Group 5 Sch.9 VATA 1994. The appeal was made on 5 September 2016 and allocated to the standard category. The company amended its grounds of appeal on 9 November; HMRC issued a statement of case on 23 December; case management directions were issued on 13 January 2017, and on 25 April the case was listed for hearing on 8 June; the company withdrew its appeal on 23 May.

HMRC applied for costs of £10,815 on the grounds that the appellant had acted unreasonably in bringing, defending or conducting the proceedings. The company contested this, and applied for £1,350 in costs of the costs hearing, on the grounds that HMRC were acting unreasonably in applying for costs.

HMRC recognised that the appeal itself had not been vexatious, but argued that withdrawing it at such a late stage had been unreasonable. The company explained that it had been withdrawn because of significant time pressures on the finance staff within the appellant, meaning that it was not possible properly to prepare for the appeal. There had been three different unexpected commercial events that brought about the withdrawal. HMRC should not be allowed costs on principle, but even if they succeeded in their application, the amount should be significantly reduced to the "standard" basis of assessment.

The Tribunal reviewed a number of precedents on what constituted unreasonable behaviour, particularly in the context of a late withdrawal from an appeal. The judge decided that, on balance, the trader's actions had not been unreasonable; but HMRC had also acted reasonably, given that the trader's explanation for the late withdrawal had not been provided at the time the application for costs was made.

Both applications were refused.

First-Tier Tribunal (TC06232): *Housesimple Ltd*

6.8.7 Procedure

A company appealed against four "*Kittel*" decisions and a decision to deregister it on the grounds that its registration had been used and would be used for fraud. Three of the *Kittel* appeals had been consolidated; HMRC applied for the other two to be consolidated as well. The appellant applied instead for the deregistration appeal to be heard first and quickly, because the decision made it extremely difficult to trade. It argued that it would be insolvent before the Tribunal could make its ruling on the matter, unless the hearing came very quickly.

Judge Mosedale considered that the facts and evidence that would have to be considered in the two types of case were virtually identical, which weighed very heavily in favour of consolidation. She was not convinced that there was a great prejudice to the appellant, in that it appeared to have ceased trading. She ordered that the appeals be consolidated, but also directed that HMRC should proceed to a hearing as quickly as possible.

First-Tier Tribunal (TC06257): *Manhattan Systems Ltd*

6.8.8 Strike-out

A Subway franchisee appealed against an assessment for £141,422 in July 2013. The appellant was granted hardship. The appeal was stayed behind the litigation in *Sub One Ltd*, which became final in 2015. The appellant nevertheless notified the Tribunal that it wished to pursue its appeal, without giving its grounds. Pressed by the Tribunal, the appellant indicated that it considered the assessment was not to best judgement, for unspecified reasons.

After various failures to comply with directions, the case came before a judge (Barbara Mosedale) who had first to consider whether to strike out the appeal. The judge criticised the conduct of the taxpayer's representative, who appeared to have ignored e-mails from HMRC and the Tribunal. The conduct of the representative would not necessarily be visited on the appellant, but in this case, the appellant had no acceptable excuse for its breach of an unless order.

Having decided that the appeal should be struck out, Judge Mosedale went on to consider the merits of the appeal, and said it also stood no reasonable prospect of success. So it would have been struck out on that ground as well.

First-Tier Tribunal (TC06141): *Greenish Ltd*

In 2012 a company claimed a repayment of output tax accounted for on gaming machines between December 2005 and January 2007. HMRC refused it as subject to capping; HMRC had paid an earlier claim for an earlier period during the *Rank* litigation. The company appealed against the refusal of the claim; its representatives asked for the case to be stood over behind *Rank (no.2),* where judgment is awaited on the final resolution of that litigation. HMRC objected on the grounds that the only issue in the company's case was the lawfulness of capping after 1996, and that had been upheld in cases including *Leeds City Council*. HMRC applied to have the company's appeal struck out as having no reasonable prospect of success.

The judge agreed with HMRC: the *Rank* litigation would not decide any issue that was relevant to its appeal. The case was struck out.

First-Tier Tribunal (TC06176): *Clyde Leisure Ltd*

A firm of opticians was involved in a dispute with HMRC about the calculation of output tax on the sale of spectacles and dispensing services. HMRC's approach was set out in Information Sheet 08/99, which consolidated guidance on the apportionment of charges for supplies of spectacles and dispensing. The Information Sheet sets out the two methods of apportionment open to opticians, namely Full Cost Apportionment ("FCA") and Separately Disclosed Charges ("SDC"). If the requirements for SDC are not met then FCA is the only other alternative.

Judge Anne Scott considered the history of the dispute and the way in which it had been conducted, and concluded by striking out six appeals. It appears to be a case that turns on its own particular facts.

First-Tier Tribunal (TC06192): *DCM (Optical Holdings) Ltd*

6.9 Other administration issues

6.9.1 Autumn Budget 2017

The Autumn Budget included the following announcements on VAT:

- the registration and deregistration thresholds will not change for two years from 1 April 2018 (they will remain £85,000 and £83,000);
- new legislation will be introduced to extend joint and several liability to online marketplaces who know or should know that overseas traders are selling goods through their websites and not properly accounting for UK VAT on those sales;
- the Government will publish a response to the "call for evidence" about the "split payment model" whereby online sales are charged to VAT automatically at the point of sale, with the tax going directly to HMRC;
- there will be consultation on making the VAT charge on the use of vouchers consistent with the VAT charged when consumers use other means of payment;
- there will be consultation on draft legislation for a reverse charge on labour in the construction industry to prevent missing trader fraud;
- a summary of responses to the consultation on grouping will be published in December – the Government will consider further the scope of VAT grouping, the issues raised and the impact of any potential changes (it is available here: *www.gov.uk/government/uploads/system/uploads/attachment_data/file/663933/Scope_of_VAT_Grouping_-_summary_of_responses.pdf*).

www.gov.uk/government/publications/autumn-budget-2017-overview-of-tax-legislation-and-rates-ootlar

6.9.2 Vouchers consultation

Further to the announcement in the Budget, HMRC published the vouchers consultation on 1 December, to run to 23 February 2018. It considers transposing the new EU vouchers directive into UK law from January 2019. The new rules aim to ensure that when customers pay with gift cards and vouchers, businesses account for the same amount of VAT as when other means of payment are used. The changes do not extend to discount vouchers or money-off tokens. Draft legislation will be published in Summer 2018 and introduced in a subsequent Finance Bill.

www.gov.uk/government/consultations/vat-and-vouchers

6.9.3 Updated leaflets

HMRC have issued updated versions of the compliance check leaflets they issue in relation to enquiries. The following have all been amended from the March 2017 version to explain that penalty reductions for 'telling, helping and giving' will be restricted by 10% above the minimum where taxpayers take 3 years or more to correct or disclose inaccuracies.

- CC/FS1a: *General information about compliance checks*
- CC/FS1b: *General information about checks by campaigns and projects*

- CC/FS1c: *Compliance checks into certain large and complex businesses*
- CC/FS7a: *Penalties for inaccuracies in returns and documents*
- CC/FS7b: *Penalties for not telling HMRC about an under-assessment*
- CC/FS11: *Penalties for failure to notify*
- CC/FS1c *Compliance checks into certain large and complex businesses* has also been updated to include apprenticeship levy for tax years starting on or after 6 April 2017.

The following have been updated from the April 2017 versions with a new section on penalties and possible criminal investigation for concealing, destroying or otherwise disposing of documents.

- CC/FS3: *Compliance visits by agreement or with advance notice*
- CC/FS4: *Unannounced visits for HMRC inspections*
- CC/FS5: *Unannounced visits for inspections approved by the tribunal*

6.9.4 Disclosure of avoidance schemes

The *Indirect Taxes (Disclosure of Avoidance Schemes) Regulations 2017* came into effect on 1 January 2018. They set out:

- the requirements on promoters and users of, and others party to, indirect tax avoidance schemes;
- the time limits within which those requirements should be met;
- the circumstances when persons who would otherwise be treated as promoters of indirect tax proposals and arrangements are excluded from that definition.

SI 2017/1215

The *Indirect Taxes (Notifiable Arrangements) Regulations 2017* also apply from 1 January 2018. They set out the features which, together with the provisions in Schedule 17 to the Finance (No 2) Act 2017, lead to the requirement to disclose indirect tax avoidance schemes.

SI 2017/1216

6.9.5 Making tax digital for VAT

HMRC are consulting on draft regulations for MTD for VAT until 9 February 2018.

www.gov.uk/government/consultations/draft-legislation-the-value-added-tax-amendment-regulations-2018

HMRC have also published an explanation of the impact of the revised timetable for mandatory implementation of Making Tax Digital. It reiterates that the Government will not widen the scope of Making Tax Digital beyond VAT before the system has been shown to work, and not before April 2020 at the earliest.

The statement makes the following comment, which is questionable:

"It should be noted that those now mandated to join Making Tax Digital from April 2019 for their VAT obligations are businesses that are likely to be more digitally ready and capable of making an earlier transition, with the majority already reporting VAT quarterly. Where they have alternative reporting arrangements, these will be maintained. Because a significant proportion of the mandated population already uses software and has less need of new or upgraded hardware to operate Making Tax Digital these transitional costs are lower than previously estimated."

www.gov.uk/government/publications/making-tax-digital-changing-the-scope-and-pace-technical-note

6.9.6 Finance (No 2) Bill 2017

The *Finance (No.2) Bill 2017* passed through Parliament without amendment to the following items on VAT:

- clauses 48 – 59 and Schedule 13: fulfilment businesses.
- clauses 60 – 62 and Schedule 14: digital reporting and record-keeping for VAT.

services.parliament.uk/bills/2017-19/finance.html

6.9.7 Tax disputes

HMRC have published the latest version of their *Code of Governance for resolving tax disputes*, which was last updated in July 2014. It covers the following subjects:

1. How we aim to resolve tax disputes

2. Governance of decisions on resolving tax disputes

3. How we decide our position on disputed points affecting more than one taxpayer

4. Specific arrangements that apply in the specialist areas of transfer pricing and diverted profits

5. Reviewing processes used in settled cases

6. High Risk Corporates Programme

7. Alternative Dispute Resolution

It sets out the principles that HMRC are supposed to follow in tax disputes; it is a relevant document if a taxpayer is engaged in a dispute and believes that HMRC are not following their own internal guidance. In particular, heading (2) embodies the following principles:

- *Our tax professionals have the technical and collaborative working skills to make decisions in routine cases, supported by their line managers.*
- *Each HMRC business group has processes for referring larger, more complex cases and sensitive cases to decision-making bodies, made up of senior tax and other professionals from across HMRC.*
- *Our approach to resolving a major disputed point arising in several cases is decided by cross-HMRC panels, to ensure consistency.*
- *Our governance processes should have no adverse impact on customer experience.*
- *Our review programme of settled cases checks that processes are being adhered to in practice.*

www.gov.uk/government/publications/resolving-tax-disputes

Related to the above, HMRC have also updated their guidance on the Litigation and Settlement Strategy that was introduced in 2007. They say "*LSS is the framework within which HMRC resolves tax disputes through civil law processes and procedures in accordance with the law. It applies irrespective of whether the dispute is resolved by agreement with the customer or through litigation.*" The following sections are particularly interesting:

Minimising the scope for disputes

A key part of HMRC's overall customer strategy is to help reduce the likelihood of situations arising which may give rise to a dispute.

Disputes are costly for both HMRC and its customers and therefore HMRC is committed to supporting its customers to get their tax right without the need for a dispute.

There are many strands of existing HMRC activity which play a significant part in helping to minimise disputes, for example well-framed legislation, guidance, rulings and clearances processes, HMRC's risk based approach to compliance work, relationship management for large and complex customers.

Engaging in disputes

HMRC seeks to secure the best practicable return for the Exchequer. To do this it must apply the law fairly and consistently. Entering into, taking forward and resolving disputes contribute to securing the best practicable return for the Exchequer.

The objective of securing the best practicable return for the Exchequer requires consideration of not only the tax at stake in the dispute itself but also – in circumstances where a precedent may be set, or where HMRC is seeking to influence customer behaviour – potential tax liabilities of the same or other customers.

In general, HMRC will not take up a tax dispute unless it is likely to secure the best practicable return for the Exchequer.

HMRC's programme of random enquiries is used to validate the risk-based approach to compliance work and consequently helps to inform choices to secure the best practicable return.

Once again, the whole document is worth reading if engaged in a dispute with HMRC, particularly if litigation seems likely to ensue.

www.gov.uk/government/publications/litigation-and-settlement-strategy-lss

6.9.8 Tax gaps

HMRC's calculation of the "tax gap" – the difference between the tax considered to be due and the tax actually collected – is an important factor in the government's setting of strategy for maximising revenue collection. The latest briefing on the subject, entitled "Calculating the 2015 to 2016 tax gap", found that the gap had shrunk to the lowest on record at 6% (down from 7.9% in 2005/06 when it was first measured). HMRC said the tax gap reduction was due to the introduction of additional measures to reduce tax avoidance, evasion and non-compliance, including an £800m investment in compliance operations.

The VAT gap is at its lowest historical level of 9.8% (£12.6 billion) in 2015 to 2016, compared to 10% (£12.4 billion) the year before, and has fallen from 13.6% in 2005 to 2006.

HMRC analyse the gap by "behavioural components". They consider that "failure to take reasonable care" is the largest component, estimated at 18% of the overall tax gap (£6.1 billion). It is this that they hope to reduce by the introduction of Making Tax Digital.

www.gov.uk/government/publications/issue-briefing-calculating-the-2015-to-2016-tax-gap

6.9.9 Warrants

HMRC applied for search and seizure warrants, under the Police and Criminal Evidence Act 1984 (PACE), in connection with a criminal investigation of suspected evasion of VAT, income tax and national insurance contributions by companies involved in the activities of Newcastle United Football Club (NUFC) in relation to payments made to and via football agents. The companies sought judicial review of the HMRC decisions to apply for the warrants, and of the court decisions to approve them.

The High Court reviewed a number of criticisms of the actions of HMRC and the court, and concluded that none of them was enough to undermine the legality of the warrants. The application was refused.

High Court: *R (Newcastle United Football Club Ltd and others) v HMRC*

6.9.10 Directors' liability

The liquidator of a company sued the directors for losses arising from a failure to charge and collect VAT on VATable supplies. The company was intended to be a not-for-profit community project to monitor the production of Halal meat. When it went into insolvent liquidation it had 14 directors.

The High Court considered that the directors had the inescapable duty to acquire and maintain sufficient knowledge and understanding of the company's business to enable them to discharge their duties as directors. On the evidence, the liquidator's claim was made out: the company had failed to register for VAT and failed to charge VAT to customers, and had suffered loss as a result. This was the directors' fault.

High Court: *Raithatha (as liquidator of Halal Monitoring Committee Ltd) v Baig and others*

6.9.11 Clearance

HMRC have updated their guidance on non-statutory clearances. Annex D deals with VAT clearances. The update advises that it is currently taking approximately 8 weeks to respond to clearance requests, rather than the target response time of 28 days.

www.gov.uk/non-statutory-clearance-service-guidance

6.9.12 Office of Tax Simplification

The first report on VAT from the OTS contains 23 recommendations for simplifying the tax, including the following 8 core recommendations:

- the government should examine the current approach to the level and design of the VAT registration threshold, with a view to setting out a future direction of travel for the threshold, including consideration of the potential benefits of a smoothing mechanism;
- HMRC should maintain a programme for further improving the clarity of its guidance and its responsiveness to requests for rulings in areas of uncertainty;
- HMRC should consider ways of reducing the uncertainty and administrative costs for business relating to potential penalties when inaccuracies are voluntarily disclosed;
- HM Treasury and HMRC should undertake a comprehensive review of the reduced rate, zero-rate and exemption schedules, working with the support of the OTS;
- The government should consider increasing the partial exemption de minimis limits in line with inflation, and explore alternative ways of removing the need for businesses incurring insignificant amounts of input tax to carry out partial exemption calculations;
- HMRC should consider further ways to simplify partial exemption calculations and to improve the process of making and agreeing special method applications;
- the government should consider whether capital goods scheme categories other than for land and property are needed, and review the land and property threshold;
- HMRC should review the current requirements for record keeping and the audit trail for options to tax, and the extent to which this might be handled on-line.

The Budget included an announcement that the first recommendation will not be implemented.

www.gov.uk/government/news/otss-first-review-of-vat-triggers-debate

The OTS has published a review of its work programme over the next 12 months. It will continue to progress the report on VAT with the aim of publishing it in October or November.

www.gov.uk/government/publications/ots-publishes-outline-of-its-future-work-programme

The OTS VAT proposals are reviewed in an article by Richard Curtis in *Taxation*.

Taxation, 9 November 2017

6.9.13 Online VAT fraud

The Public Accounts Committee has published a report criticising HMRC for being too cautious in their approach to tackling online fraud, including a failure so far to “name and shame” any supplier under the rules introduced in the FA 2016. The PAC described a “mystery shopping exercise” that revealed how easy it was to buy something delivered from a

UK base without paying VAT. The report described how repeated requests for a VAT invoice led to an offer of a partial refund.

The PAC's recommendations to HMRC in the report include:

- producing an updated estimate by March 2018 of the scale and impact of the online VAT fraud tax gap (the latest estimate is between £1bn and £1.5bn in 2015/16);
- speeding up the introduction of new measures, such as the 'split payment' method of collecting VAT;
- exploring new measures to make platforms liable for VAT evasion, such as requiring online marketplaces to withhold VAT when a sale is made and pass it directly to HMRC;
- putting in place by March 2018 an agreement setting out collaborative working arrangements between HMRC and all online marketplaces, which should include a requirement to show a valid VAT number for any non-EU trader selling goods to customers in the UK, where those goods are already in the UK;
- reporting to the committee by March 2018 with targets for reducing the amount of VAT lost through non-compliant online sales, with details of how much HMRC has collected from newly-registered traders; and
- undertaking a definitive assessment of the scale of the fulfilment house industry (HMRC currently estimates the number to be somewhere between 500 and 3,000), setting out how HMRC intends to enforce the process of registration for the new scheme.

www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news-parliament-2017/tackling-online-vat-fraud-error-report-published-17-19/