VAT UPDATE
JULY 2017

Covering material from April – June 2017

Notes prepared by Mike Thexton MA FCA CTA

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VAT Update July 2017

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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

The HMRC website section which reports the progress of appeals reappeared on 21 January 2011 after lying dormant for some time. It says that it will be updated monthly, but it appears to be less frequent or regular than that. The latest update appeared on 17 April 2017 after a gap since 16 December 2016.

Several of the "appeal will be dropped" 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

1.1.1 UK appeals awaiting hearing or decision

- *Associated Newspapers*: HMRC are seeking leave to appeal to the Supreme Court against the Court of Appeal's ruling in relation to the deductibility of input tax on promotional vouchers and the non-applicability of SI 1993/1507.
- *BPP Holdings*: HMRC have been granted permission to appeal to the Supreme Court against the CA's ruling that the FTT was correct to bar HMRC from further participation in the proceedings.
- *British Film Institute*: CA will consider the CJEU judgment from the April 2017 update, which favoured HMRC.
- *CCA Distribution Ltd*: the UT remitted matters in dispute back to the FTT; an oral permission hearing for an appeal to the CA is listed for 11/12 July 2017.
- *DPAS Ltd*: HMRC appealing points from FTT decision to Upper Tribunal, which decided to refer questions to CJEU after considering the judgments in *Bookit* and *NEC*.
- *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.

- *E Buyer Ltd and Citibank NA*: HMRC are appealing to the CA against UT's confirmation of FTT ruling that HMRC's statements of case were inadequate – they have to explicitly plead fraud or not suggest it at all. Hearing listed for 18 July 2017.
- *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).
- *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.
- *Iveco Ltd*: company has appealed UT's decision in favour of HMRC in case about repayment claim based on alleged "adjustment of consideration" (hearing date November 2017).
- *KE Entertainments Ltd*: HMRC have appealed FTT's decision in favour of taxpayer in case about adjustment of consideration in bingo (hearing April 2017).
- *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*: HMRC have been granted leave to appeal to the Supreme Court against the CA's decision in favour of the company on the question of compound interest on long-term repayments. HMRC are appealing on both liability and amount, hearing listed for 3 – 6 July 2017.
- *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 (CJEU hearing 19 January 2017).
- *Metropolitan International Schools*: HMRC appealed to the UT against the FTT's decision that the taxpayer supplied predominantly printed matter with incidental services (hearing February 2017).
- *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 to be confirmed.
- *Pacific Computers Ltd*: MTIC case remitted by the UT to differently constituted FTT for rehearing.
- *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 have appealed to the UT (hearing June 2017).
- *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.

- *SAE Education Ltd*: the company will appeal to the CA in June 2017 against the UT's ruling that the FTT was wrong to allow exemption to the taxpayer as a "college of a university" (listed for 27/28 June 2017).
- *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.
- *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.
- *Temple Finance Ltd and Temple Retail Ltd*: HMRC have been granted leave to appeal against the FTT's ruling that, in the main, Sch.6 para.1 directions were not possible and the standard method override did not apply (UT hearing listed 5/7 June 2017).
- *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).
- *Wakefield College v HMRC*: the college has applied for leave to appeal 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 (leave hearing listed for 27 April 2017).
- *Wetheralds Construction Ltd*: HMRC are seeking leave to appeal against the FTT's decision that certain works qualified for the lower rate as relating to insulation for roofs, not "insulated roofs".

1.1.2 Unresolved cases not on the list

The following cases have disappeared from the HMRC website list, but do not appear to be resolved yet:

- *HMRC v Bratt Auto Contracts Ltd and another*: taxpayer has been granted permission to appeal to the CA against the UT's ruling that its *Fleming* claims did not meet the statutory requirements for claims to be recognised, and therefore missed the 31 March 2009 deadline (hearing to commence 28 or 29 June 2017).
- *Copthorn Holdings Ltd*: HMRC were refused (by the FTT) leave to appeal against the FTT's decision that they should reconsider their refusal to allow retrospective grouping. They have decided not to apply to the UT for permission; it remains to be seen what will happen next, because the decision of the FTT required HMRC to consider again their original decision.
- *John Wilkins Ltd and others*: Supreme Court refused HMRC permission to appeal one aspect of the case, in which the Court of Appeal decided that motor dealers were entitled in principle to claim compound interest on VAT repayments. Substantive issue stayed pending the *Littlewoods* decision (now awaiting a Supreme Court

ruling after the HC and CA both applied the CJEU's judgment in Case C-591/10 in favour of the taxpayer).

- *United Grand Lodge of England v HMRC*: taxpayer will apply for leave to appeal to the CA (commencing 9 November 2016) against the UT's confirmation of the FTT's decision that it did not qualify as a body with philosophical, philanthropic or civic aims.
- *Victor Dunlop*: HMRC have been granted leave to appeal to the Upper Tribunal against the FTT's decision that part of a garage conversion qualified for a DIY claim. In January 2017 the list said "Upper Tribunal hearing vacated", and the case has now disappeared altogether, so presumably the case has been abandoned.

1.1.3 Cases in the current update

The current update includes the latest developments in the following cases from HMRC's list or previous outstanding lists in this update:

- *Brockenhurst College*: CA has referred questions to CJEU about application of education exemption to meals supplied to third parties in order to train students in waiting and cooking (judgment in this update, favouring the taxpayer, contradicting the A-G's opinion in January).
- *Coinstar Ltd*: HMRC unsuccessfully appealed to the Upper Tribunal against the FTT's decision that machines which exchanged loose change for vouchers made an exempt financial supply.
- *James Edwin Boyce (t/a Glenwood)*: HMRC successfully appealed FTT's decision in favour of taxpayer in case about evidence of export of vehicles.
- *Colaingrove Ltd*: HMRC's list used to contain four separate appeals, but this has been reduced to just TC02534 (fuel – UT decision in favour of HMRC that the lower rate did not apply because there was a compound supply of "caravan with electricity"); the company has been given permission to appeal to the CA, hearing set for February 2017. The cases about removable contents/definition, removable contents/apportionment and verandas are now resolved.
- *Investment Trust Companies (in Liquidation) v HMRC*: after the CA effectively reversed the High Court's decision in relation to the companies' direct claims for overpaid VAT, both parties appealed to the Supreme Court, which agreed with the CA.
- *C Jenkin & Son Ltd*: both sides appealed a FTT decision in which HMRC assessed to disallow input tax on the basis that the company made exempt supplies, but the FTT held that the assessment was invalid because it should have charged output tax. The UT held that the supplies should have been zero-rated.
- *Volkswagen Financial Services Ltd*: the Supreme Court has dismissed HMRC's appeal in relation to one matter, and has referred questions to the CJEU.

1.1.4 Cases dismissed

HMRC's list contains the following case as outstanding, but it has been determined:

- *ETB (2014) Ltd v HMRC*: company applied for leave to appeal to the CA against the UT's decision on its default surcharge of £972. The UT held that the FTT had not properly dealt with facts relied on by the taxpayer, but in remaking the decision also dismissed the appeal. Leave to appeal was refused on 26 April 2017.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 "Overpayments"

NCP reclaimed VAT on alleged "voluntary payments" made by customers in its car parks between June 2009 and December 2012. The total amount claimed was £488,000. The basis of the claim was the fact that customers without the correct change would pay more than the amount required to obtain a "pay and display" ticket for a given period. As the machines did not give change, the company made an extra profit. It argued that this was not subject to VAT, as the displayed prices set the consideration for parking and the balance was "ex gratia". This argument had succeeded in *Borough Council of King's Lynn and West Norfolk* (TC02342).

The company's representative in the FTT (TC04784) cited cases such as the "Dutch potato case" (*Staatssecretaris van Financien v Cooperatieve Aardappelenbewaarplaats GA* Case C-154/80), *Apple & Pear Development Council, Tolsma*, *Commission v Finland* and *Societe Thermale d'Eugenie-les-Bains* on what constitutes consideration and the requirement for a direct and immediate link to the supply. She argued that the customer did not enjoy any additional consumption for the additional payment. Customers were not obliged to pay an extra amount: they could park elsewhere, go and find change, or pay by an alternative method. The payment of an additional amount was similar to giving a tip in a restaurant – it was not part of the consideration for the main supply.

HMRC's counsel responded that the correct starting point was the contract made between the parties. The obligation on the customer was to pay not less than the amount displayed on the tariff board: paying an extra amount was a contractual offer which was accepted by the company through the medium of its machine, or an offer by the company of parking at a minimum price which was accepted by the customer paying a greater amount.

HMRC did not appeal the *King's Lynn* decision. It was specific to its facts, because the local authority had statutory restrictions on the amount it could charge for parking. HMRC did not claim that the decision had been wrong, but that it was not applicable to a commercial company.

The FTT noted that the approaches of the taxpayer and HMRC were quite different: the taxpayer started with EU concepts of consideration, while HMRC relied on domestic concepts of contract law. As EU law had to be paramount, it was regrettable that there was no EU legal definition of consideration.

The FTT did not agree that the extra payments were arbitrary, uncertain or voluntary. A customer was faced with a "binary choice": pay the available change for the right to park, or park somewhere else. Unlike in the *Finland* case, the payment arose from a commercial decision by the customer, and not from "the ability to pay" in the sense of an external judgement about the person's income.

The FTT was not convinced that the *King's Lynn* decision was justified on the basis of the statutory order. In any case, that decision was not binding

on the FTT, and the circumstances were certainly different; many of the arguments about contracts had not been put to the earlier Tribunal.

The company had also argued that the earlier decision created the potential for a fiscal distortion if local authorities were able to keep the "VAT" in their overcharges but commercial companies were not. The present Tribunal did not agree. While two customers might be receiving similar supplies, and the statutory regime might be an "artificial distinction based on insignificant differences", the FTT was not persuaded that it should follow a decision that it was not bound by and was not convinced by.

The FTT concluded that the full amount paid by the customer was all consideration for the supply of parking, and the appeal was dismissed.

The company appealed to the Upper Tribunal (Mrs Justice Rose and Judge Greg Sinfield). They considered the precedent case law again, and came to a very brief decision: *King's Lynn* was wrongly decided, and the overpayments were consideration for a supply for VAT purposes. They noted that "consideration" for VAT purposes is not the same as consideration in English contract law:

"*It is the value actually given by the customer (or a third party) in return for the service supplied and actually received by the supplier and not a value assessed according to objective criteria. The service and the value given or to be given in return for it may be ascertained from the legal relationship between the supplier and the customer. Under the contract between NCP and the customer which is formed when the customer inserts money into the ticket machine at the car park and receives a ticket, NCP grants the customer the right to park his or her car for one hour in return for inserting not less than £1.40. If the customer wishes to park for up to three hours then he or she must pay not less than £2.10. It follows that NCP agrees to grant a customer the right to park for up to one hour in return for paying an amount between £1.40 and £2.09. If a customer pays £1.50, that amount is the value given by the customer and received by the supplier in return for the right to park for up to one hour. Accordingly, that is the taxable amount for VAT purposes.*"

The appeal was dismissed again.

Upper Tribunal: *National Car Parks Ltd v HMRC*

2.2 Disbursements

2.2.1 MOT fees

It is some time since there was a case on the treatment of MOT fees as disbursements. HMRC will accept that VAT does not need to be added where it is made clear to the customer that the work is subcontracted to a different testing station, the exact cost is charged on, and no profit is made by the servicing garage. An officer concluded that these conditions were not met and raised an assessment for £3,847 covering the periods 04/14 to 07/15. The garage accepted suspension of a penalty, but asked for that to be taken into account as well as it depended on the treatment of the MOT fees.

The garage had lost its MOT testing status following a change of ownership but wanted to retain the business while it reapplied. All customers were informed that the tests would be carried out elsewhere. The garage made a flat rate charge for MOT tests, sometimes making a profit and sometimes making a loss on the amounts charged by the authorised testers. The charge actually paid to the testers was not separately itemised on the invoices as a disbursement.

The garage accepted that it was reasonable for VAT to be charged on any "profit" that it made, but disputed the charge on the underlying cost of the MOT test itself. A director had only discovered material about MOT test fees in Notice 700 part-way through the period concerned, and would have arranged the transactions differently had he known about it throughout.

The FTT judge (Anne Scott) noted that until the hearing, HMRC had made no attempt to put forward any legal argument about agency, relying solely on Notice 700 and their internal guidance. Their representative accepted that these did not have the force of law. The judge also described herself as "somewhat startled" that the bundle of cases only included one of four recent cases on the issue: *Graeme Duncan t/a G Duncan Motor Services*. She took the time to consider in addition *Jamieson t/a Martin Jamieson Motor Repairs, Lower and another* and *Denton t/a Denton Auto Repairs*. All of these cases were decided in favour of the taxpayer for broadly similar reasons. Although each case had to be decided on its particular facts, the judge considered the cases relevant for her discussion.

The judge said "the three cases to which I was not referred made it very clear, occasionally in excoriating terms, that VAT Notice [700] and HMRC guidance were less than a model of clarity or a good exposition of the law". HMRC's guidance had been updated on 26 July 2016, but referred to the "simplified" treatment to be adopted from 1 November 1996 and two cases from 1999, rather than the more recent and surely more relevant decisions. The judge wholeheartedly agreed with Dr Avery Jones' suggestion that HMRC should review their guidance, and found for the taxpayer.

First-Tier Tribunal (TC05813): *Ellon Car Clinic Ltd*

2.3 Exemptions

2.3.1 Counting money

A company owned and operated kiosks in supermarkets that would accept loose change from customers, count it, and return to them a cash voucher that could be used for shopping. It charged a 9.9% commission for the service, which it shared with the supermarket. HMRC originally ruled in 2000 that the commission was exempt where a voucher was issued to the customer, but an alternative involving arranging a donation to charity (with Gift Aid) was taxable. The transaction was considered to fall within Sch.9 Group 5 item 1: "The issue, transfer or receipt of, or any dealing with, money, any security for money or any note or order for the payment of money."

In 2015, following an inspection, the HMRC issued a new ruling that the commission was taxable. They cited case decisions as the reason for the change in ruling. The FTT (TC05346) noted that 31 decisions were included in the bundle. HMRC argued that the appellant was making an overarching taxable supply comprising two elements:

(1) Sorting and counting the coins accurately

(2) Issuing the customer with a voucher which can be redeemed for cash or goods in the supermarket in which the machine is located.

HMRC accepted that the voucher could be a security for money, but argued that that was insufficient in itself for the overall supply to come within the finance exemption in art.135 PVD and Sch.9 Group 5. The counting and sorting elements predominated.

The appellant argued that the service provided was one of exchanging coins for a more convenient, more usable means of exchange. The coin counting was a necessary prerequisite, but it was not the predominant element of the service.

The FTT agreed with the appellant on this point: the 9.9% commission seemed too high for a mere coin-counting service. The customer wanted a more convenient means of paying for goods in the supermarket. The Tribunal went on to consider whether this was exempt.

HMRC considered that the decision in *Wilton Park Ltd and others v HMRC* (about "Secrets money") supported their view. The vouchers in that case were agreed to be "securities for money" but dealings in them were not exempt. The Tribunal considered that the facts of that case were different, and this one was nearer the *Kingfisher* case, where such vouchers had been held to be exempt.

The Tribunal considered that the transaction was analogous to a foreign exchange conversion. Although the coins were in the same currency as the voucher, there was nothing in the PVD to restrict such transactions to those effected in different currencies. The various decisions cited by HMRC differed in that the underlying service was not a financial one. In *Wilton Park*, it had been held that the commission charged to the dancer for redeeming vouchers was part of the consideration for giving her access to the customers. It was not truly for dealing in vouchers. In *Ladbroke*, *Bookit* and *NEC*, there was an underlying non-financial service, such as bookmaking or acting as an agent for an entertainment venue.

The FTT was satisfied that the company's supplies fell within Item 1, and allowed the appeal. HMRC appealed to the Upper Tribunal. The parties agreed with the FTT that there was a single overarching supply, but HMRC contended that the FTT had erred in deciding that it fell within item 1. They put forward two reasons for this:

- *First, HMRC contended that the FTT erred in law by ignoring the contractual position between the customer and Coinstar, along with other objective evidence of the typical customer's economic reason or purpose for using Coinstar's services.*
- *Secondly, having correctly found that there was a single overarching supply comprised of a number of elements, the FTT erred in law by mis-characterising that supply as a supply of exempt financial services.*

HMRC pointed out that the machine displayed the offer of a "coin-counting service", and that the FTT had been wrong to construe the agreement between Coinstar and its customers as something different from that. The UT did not agree. There was a prior question before the statement on screen about the coin counting fee: the customer was asked if he/she wanted a voucher or to make a charitable donation. This was every bit as much part of the contract as the offer of coin counting on the next screen. The FTT had considered the economic reality of the transaction between the customer and the company, and was entitled to conclude – even with supporting evidence – that a customer would not have paid 9.9% just to have the coins counted and returned.

HMRC's second argument was that the voucher was only a receipt, a necessary but incidental part of a complex interwoven transaction of which the main element remained coin-counting. Their representative made a number of detailed criticisms of the FTT's interpretation of the facts, the relationships between the parties, the nature of the transaction, and the application of the law. The UT judges rejected them all. HMRC's appeal was dismissed.

Upper Tribunal: *HMRC v Coinstar Ltd*

2.3.2 Payment processing

Two companies provided services to utility companies and others enabling customers to make credit top-ups or prepayments ("pre-payment services") or pay invoices or bills ("post-payment services") over the counter at shops and other retail outlets. HMRC issued decisions that:

- pre-payment services were standard rated;
- services provided by one of the companies constituted debt collection and were therefore standard rated;
- post-payment services supplied by the other company were exempt as transactions concerning payment.

The companies' representative disputed the reasoning underlying the decision, but agreed with the conclusion about the standard rated services. The companies appealed against the part of the decision that held that some of their supplies were exempt. Presumably they wanted 100% input

tax deduction on infrastructure, and most of their customers would be fully taxable utilities.

The judge summarised how the business operated. It was agreed that, as the arrangements between the parties were described in detail in contracts, those contracts should be the basis for the VAT treatment unless there was a good reason to depart from them. It appeared from the contracts and the description of the business that the company collected and transmitted information, which enabled its clients to transfer funds. It did not itself transfer the funds.

The judge examined a number of precedents at some length, including *SKD*, *Nordea*, *NEC* and *Bookit*. He concluded that the mere transmission of information, without being involved in the actual transfer of money, was not enough to be exempt. The appeal was therefore allowed. The question of the liability of the "debt collection" supplies was not considered in detail, because the argument was academic: even though the taxpayer did not agree with the reason, it was happy with HMRC's conclusion, so no further action was required in the FTT.

First-Tier Tribunal (TC05888): *Paypoint Collections Ltd and another*

2.3.3 Updated Notices

HMRC have updated their Notice *Betting, gaming and lotteries* to reflect their acceptance of the CA judgment that spot the ball competitions are games of chance and exempt from VAT as a form of pool betting. There are a number of minor changes throughout the Notice, which was last updated in May 2016.

Notice 701/29

HMRC have updated their Notice *Finance* from the January 2013 version. The main change is to incorporate the new treatment of prompt payment discounts that was introduced from April 2015.

Notice 701/49

2.3.4 Closely related to education

The *Brockenhurst College* case is about restaurant meals and public performances that are received by members of the public in return for payment, but are provided as an essential part of training courses in catering and performing arts by a college. In HMRC's view, they cannot be exempt as "education" or "services closely connected with education" because they are supplied to someone other than the recipient of the education. The UK FTT and UT decided that the benefit to the direct recipient was incidental to the educational aim of the supply, and the services fell within the exemption. The UT considered that it was not necessary to rule on whether the UK legislation was consistent with the Directive in requiring "direct use" by the recipient of "closely related services": a conforming construction could interpret the direct benefit of the student's education as "direct use".

Advocate-General's opinion

The Court of Appeal decided to refer questions to the CJEU, where Advocate-General Kokott gave an opinion that favoured HMRC's view. She noted the difficulty in defining the borderline between supplies that were "closely related" and those that were "no longer closely related". In trying to define that borderline, she made the following points.

The Court has held that "closely related" means "ancillary to the principal supply". That would suggest that the recipients would have to be identical, because different recipients would necessarily imply distinct supplies. However, she did not consider that art.132(1)(i) and art.134 implied that "closely related" had to mean "ancillary" in this context. If it did, there would be no need for the explicit mention in the PVD, because they would enjoy exemption under *CPP* principles in any case.

The "closely related" supply referred to must therefore be an independent or principal supply in its own right, but is exceptionally accorded exemption because of its close relationship to the educational supply. Art.134 then imposes the extra requirement that it must be essential to the educational supply.

Under this analysis, it would be possible for a supply to a third party to be "closely related"; but the purpose and objectives of the tax exemption should be considered. These are to prevent an increase in the cost of education arising from VAT. This is a benefit for the consumer, not for the business. In this context, an exemption of supplies that are consumed directly by third parties and are 'produced' only on the occasion of training is difficult to justify.

In addition, the principle of fiscal neutrality militated against allowing exemption to supplies made to those who were not themselves receiving training, because there would be a disadvantage for directly competing suppliers. The UK government argued that the potentially higher error rate in a training restaurant was allowed for in the lower consideration (payment of 80% of the meal cost), and it did not change the nature of the service itself.

The limitation of recipients to people registered in advance (e.g. friends and relations of students) did not change the nature of the supply. On fiscal neutrality grounds, the training restaurant would still be competing with VATable establishments, and it should charge VAT just as a Members' Club has to on catering supplies.

The strict interpretation of exemptions required the word "essential" to be given its proper meaning. The CJEU held in the case involving Germany that carrying out research projects for third parties was helpful for university education, but it was not essential to it, so it could not be exempt.

In the A-G's view, charging VAT on the supplies to third parties would not increase the cost to the recipients of the education, so the purpose of the exemption did not require those supplies to benefit from it. The taxation of the supplies in the present case 'merely' makes access to the restaurant and theatre services more expensive for the restaurant and theatregoers. It followed that there was no service closely related to the exempt provision of education.

Full court's decision

It is relatively unusual for the full court to take a radically different view from the Advocate-General, but that is what has happened in this case. The full court noted the following background facts:

- the customers of the restaurant and the theatre were a restricted class of people who had registered to receive newsletters;
- they were told that the purpose of the supplies was to provide part of the students' education;
- the charges represented 80% of the cost of the food, and if fewer than 30 places were booked, the meal was cancelled;
- obtaining additional income was not the basic purpose of the transactions;
- practical training was a fundamental part of the course, and the students knew this when they enrolled.

The court also noted the legal principles to be applied:

- exemptions are to be interpreted strictly, but not so strictly as to deprive them of their intended effect;
- a service may be regarded as ancillary to a principal supply if it is not an end in itself, but rather a means of better enjoying that principal supply;
- the conditions for exempting a supply as closely related to education are threefold – it must be supplied by an eligible body, it must be essential to the educational supply, and the purpose must not be to generate additional income by carrying out transactions which are in direct competition with commercial enterprises.

The first of these three conditions was agreed to be satisfied. The court agreed with the UK courts and the Commission's submission that the second condition was satisfied – without the practical experience, the education would be incomplete.

The remaining question was whether the "fiscal neutrality" condition was satisfied. The court differed from the A-G in holding that the circumstances of the training restaurant and theatre were sufficiently different from commercial supplies for there to be no infringement – the restrictions on the recipients, the possibility of the meals being cancelled, the fact that all the "workers" were students supervised by their teachers, and the level of charges all distinguished these supplies from commercial activities.

It was left to the referring court to confirm whether these conditions actually subsisted, but if they did, the exemption could apply.

CJEU (Case C-699/15): *HMRC v Brockenhurst College*

2.3.5 Updated Notice

HMRC have updated their Notice *Education and vocational training* to include apprenticeship training paid for using the new apprenticeship service account from 1 May 2017. The Notice, which was last updated in February 2014, is a complex document covering all forms of education supply, and extending to other related matters such as school photographs.

Notice 701/30

2.3.6 Welfare

Judge Barbara Mosedale had to consider an appeal by a company that provided day-care to vulnerable adults. The company had applied in August 2014 to be deregistered with retrospective effect from 1 September 2009 on the grounds that its supplies were exempt. The application was refused, ostensibly because the company was not below the deregistration threshold. This clearly ignored the point of the application, and is described as "inept" by the judge. However, the appeal was about the underlying liability issue, rather than the inadequacy of the decision.

HMRC accepted that the company provided "welfare services", but not that it was a state-regulated entity. It therefore failed to qualify for exemption under Sch.9 Group 7 item 9 and note 6. The company argued that the requirement that all its staff should have a disclosure and barring service check ('DBS' check) (perhaps better known by its old title of the Criminal Records Bureau or CRB check) constituted the requisite state regulation. It also had to comply with a number of other health and safety and employment law requirements.

Judge Mosedale considered the nature of these various requirements and what appeared to be required by note 6. She concluded that the company was not state-regulated within item 9. However, she went on to consider whether it was exempt within art.132(1)(g) PVD, which covers "the supply of services....by bodies governed by public law or by other bodies recognised by the Member State concerned as being devoted to social wellbeing". She summarised the taxpayer's representative's arguments in this regard as follows:

(a) EU law gave exemption to bodies 'recognised' and not merely 'regulated' by the UK;

(b) There was (said Mr McNicholas) a major widening of the scope of the exemption in the PVD from the 6VD and UK law had failed to recognise this as Group 7 Item 9 had not been amended when the PVD came into effect;

(c) The UK exercised its discretion improperly when implementing Art 132(1)(g) in not recognising TLC as TLC was largely state-funded;

(d) The appellant was in direct competition with LB Havering whose supplies were exempt and that meant the UK had breached fiscal neutrality in its implementation of Art 132(1)(g);

(e) Bodies located in Scotland and Northern Ireland making identical supplies to the appellant were granted exemption so there was a further breach of fiscal neutrality by the UK in its implementation of Art 132(1)(g);

(f) There was also a breach of fiscal neutrality for the reason stated in Life Services Ltd in relation to the exemption for charities.

As regards (a), Judge Mosedale did not agree that "recognised" was as wide in its meaning as the taxpayer contended. It appeared to her to afford some discretion to the Member State. She also rejected the argument (b) that the change of wording in the PVD required the UK to change the wording of item 9. She further rejected argument (c) that effectively all state-funded welfare should be treated as "recognised" for the purposes of the exemption. As regards (d), she noted that the CJEU had recognised that there were inherent differences between private welfare institutions and public authorities, so although possibly the UK should have considered the question of fiscal neutrality in exempting local authority welfare supplies and not those of bodies like the appellant, it was not incompatible with the Directive.

However, when she turned to (e), Judge Mosedale found for the company. She examined the proposition in considerable detail, including attempted refutation of the argument by HMRC's representative. In her view, a Member State has some discretion on which bodies it recognises for the purposes of the welfare exemption, but it cannot directly or indirectly recognise a body in one part of the State and not recognise an identical body in another region. That was the effect of devolution: the devolved powers in Scotland and Northern Ireland required companies such as the appellant to be regulated, so their supplies would be exempt. HMRC argued that the law was the same throughout the UK – regulated bodies were exempt and unregulated bodies were not – but Judge Mosedale ruled that the indirect effect of the combination of devolution and the VAT law was incompatible with the PVD. She considered this to be clear in the law and in the CJEU precedent of *Zimmerman* (Case C-174/11), so she declined to make a reference to the CJEU.

Having decided in favour of the appellant in respect of (e), the judge did not need to rule on (f) as well. However, she did consider the argument, and concluded that it would also succeed – if all charities qualified for exemption whether or not they were state regulated, but commercial entities had to be state regulated, the principle of fiscal neutrality was breached. The appellant would not need to show that failing to regulate charities actually put it at a competitive disadvantage: it would be a question of principle.

The appeal only concerned whether the supplies were exempt. The judge was not addressed on the date from which exemption should apply, the date from which the company should be deregistered (presumably from the date that it was first registered) or the amount of VAT that should be repaid to it. If the parties could not agree on these questions, they would have to return to the Tribunal for a further hearing.

Finally, the judge commented that, had the supplies been properly standard rated, there would have been a further question about the recipient of that supply – where the funding came from the local authority, it might claim VAT back under s.33. However, she was not addressed on this issue, and she made no ruling on it.

First-Tier Tribunal (TC05946): *The Learning Centre (Romford) Ltd*

2.3.7 Not for profit body

A company limited by guarantee ("Leisure") operated a golf club as the tenant of a commercial business ("Club"). HMRC ruled that Leisure was not an eligible body for the purposes of the sporting services exemption, because it was either not a not-for-profit body or because it was subject to commercial influence. The company appealed, arguing that the decision was incorrect; it also argued that the 1999 Sports Order, which introduced the "commercial influence" test, was ultra vires. Although the formalities of the appeals process had not been followed, it appeared that the hearing covered assessments for VAT from 1 January 2009 onwards and also a late registration penalty.

Club operated a hotel and gym on the site. HMRC enquired into the arrangements between the two companies in 2011 and concluded that this was "a longstanding tax avoidance scheme that has remained unchallenged [since 1996/97]".

Judge Anne Redston considered the CJEU precedent on "not-for-profit bodies" in *Kennemer Golf & Country Club v Staatssecretaris van Financiën* (Case C-174/00). The key points from that decision were that it is the aims of the body that count: it is possible for a non-profit body to make a surplus, which is then used to improve the facilities; it is also possible for a non-eligible body to not make a profit.

HMRC argued that Leisure was an integral part of Club's commercial operation, and had been set up with the intention of exploiting the VAT exemption. Its board was not independent of Club, whose finance director was in effect a "shadow director" of Leisure exerting commercial influence.

HMRC had provided draft minutes of an August 2012 meeting with the owner of Club which included the sentence "the family had received advice from Deloitte & Touche, the Club's auditors, who advised [the owner] to set up a non-profit making company". The owner had an employee also taking notes, and HMRC's draft minutes had been returned to them with this sentence deleted and replaced with "the family did not receive advice from Deloitte & Touche". There was no record of the correction being commented on by HMRC. Under cross-examination at the hearing, the owner denied having taken advice on the VAT position – she gave a number of other explanations for the way in which the golf club was structured, which mainly related to removing a time-consuming distraction from the running of her commercial enterprise. In her view, the VAT treatment followed from the non-profit constitution, rather than the other way around.

The judge considered the arguments and the evidence of the witnesses, and concluded that the taxpayer's version was more likely to be correct. It appeared that HMRC's officers had concluded in advance that this was the same as many other VAT avoidance structures they had seen, when in fact there were substantial differences.

The judge went on to examine the reasons for the appointment of Leisure's directors, the way in which the licence fee was set, an agreement in 2009 by which visitors' green fees were transferred from Club to Leisure in return for an increase in the annual licence fee, market valuations of the licence fee carried out at various times, and the basis for

a number of cross-charges between Club and Leisure. She concluded that HMRC's main contentions were not correct:

- Leisure's affairs were not managed so that its financial surpluses were applied for the benefit of Club;
- it was not operated as an integral part of a single commercial enterprise.

HMRC's final argument, that Leisure could not satisfy art.133's requirement to spend any surpluses on improvement of the facilities because it did not own them, was also rejected. That is a subsidiary requirement to the main condition that the body must not systematically aim to make surpluses. That was satisfied, in line with the *Kennemer* decision.

The judge also commented briefly on two cases that had been cited, *Messenger Leisure Developments* and *Massey t/a Hilden Park*. She explained the significant differences in the underlying facts that, in her opinion, distinguished those cases (where the taxpayers lost) from the present situation.

Lastly, the judge commented on the arguments about the Sports Order. She considered that the UK's application of a "commercial influence" test based on the existence of a shadow director was justified by condition (b) of art.133 PVD, which allows the imposition of a "managed on an essentially voluntary basis by persons who have no direct or indirect influence" test. She therefore concluded that the Sports Order was not incompatible with the PVD, even though this was not a necessary part of the decision because she had already allowed the appeal on the main issue.

First-Tier Tribunal (TC05726): *Stoke by Nayland Golf and Leisure Ltd*

2.4 Zero-rating

Nothing to report.

2.5 Lower rate

2.5.1 Energy supplies

In TC02534, a company supplied holiday accommodation in chalets, static caravans and caravan pitches to customers. It made a separate charge for the provision of electricity, but this was not metered or specifically related to the amount of electricity consumed by the particular customer paying it. It was accepted that the pitch hire was standard rated; HMRC ruled that there was no separate supply of electricity that could be lower-rated, or else that the supply of electricity was incidental to the SR supply.

The company had made reclaims in relation to supplies to mobile caravans in the early 1990s, and HMRC had agreed and settled these. It

subsequently made another claim in relation to the supplies currently in dispute, which was also settled by HMRC. For a time it made manual adjustments to its VAT returns to reflect lower-rating of the electricity charges, but then decided instead to account for everything at the standard rate and make periodic voluntary disclosures. The current dispute started when one of these disclosures was refused in 2002.

HMRC's representative argued that it would be artificial to give different VAT liabilities to the two parts of the supply when the charge for electricity was simply a flat rate amount unrelated to actual consumption. In effect, there was a single supply of "fully serviced accommodation" for a single charge, and it was standard rated. He submitted that to give separate liabilities would make a nonsense of the *CPP* precedents and would "open the floodgates" to many similar claims.

The FTT did not accept this. The UK's legislation appeared specifically to provide for the application of the lower rate to supplies of electricity for consumption in a caravan. That was a specific and distinct circumstance in which the law provided for the relief to apply; allowing this appeal would not have a wide effect beyond that limited circumstance. Although there might be scope for abusive value-shifting between the two types of supply, the FTT found no evidence that this had occurred.

On that basis – that the UK legislation specifically provided for the lower rate to apply in this situation – the appeal was allowed. However, the FTT went on to make other findings in case its decision on this point was appealed and overturned. As a matter of general principle, it agreed with HMRC that there would be a single supply within *CPP*, because the customer was interested in buying a package from the company of "accommodation with electricity". That single supply would, if considered without the benefit of Sch.7A, be standard rated.

HMRC appealed to the Upper Tribunal. Their grounds of appeal (all on questions of law) were:

(1) First, HMRC contend that the FTT was wrong to conclude that this was a case to which the CPP line did not apply, and had misunderstood the French Undertakers case. More particularly, HMRC contend that the FTT failed to distinguish between (a) the court determining which elements within a category of supply (such as burial and cremation services) may properly be treated by Member States as attracting a reduced rate, thus giving an express differential rating to different elements of a category of taxable supply (the issue in the French Undertakers case) and (b) whether or not, on a case-by-case basis, an element of an economically indivisible transaction should be artificially split into constituent parts with different rates of VAT being applied to different parts (the approach prohibited by the CPP line).

(2) Secondly, HMRC contend that the FTT erred in construing the UK's national legislation in question as enabling the application of a reduced rate to goods or services regardless of whether such goods were provided separately or as part of a single complex supply. HMRC submit that there is no provision of UK national legislation which could sensibly be interpreted as having that effect.

(3) Thirdly, HMRC contend that the FTT erred in concluding that the principle of fiscal neutrality would still be observed by 'carving out' a

reduced rate for elements of a single complex supply, and failed in the process to take into account that if the French Undertakers case 'trumped' the CPP line, then in every case where some element of a single complex supply could conceivably attract the reduced rate, it would be argued that that element should be taxed at a different rate, and the CPP line (which is founded on the principle of fiscal neutrality) would seldom if ever fall to be applied at all. HMRC also submit that if the FTT was right, cases such as the decision of the House of Lords in College of Estate Management applying the CPP line would have to be considered to have been wrongly decided, given that in that case the supply of written materials and education was held to be a single supply of education services and the supply of books (which as a separate supply would be zero-rated) as an element of that single complex supply was not regarded as benefiting from the zero rate.

Shortly after HMRC had submitted their grounds of appeal in this case, Vos J issued the UT decision in *William Morrison*. That decision explicitly criticised the FTT decision in this case, and suggested that HMRC's grounds – in particular, that "*CPP* trumped s.29A", was correct. Colaingrove initially applied to have its appeal "leap-frogged" to the Court of Appeal, on the basis that the UT was likely to follow Vos J's decision and it would therefore be a waste of time to have the intermediate hearing when it would be necessary to go higher. The procedure for such a leap-frog was unclear, so the UT hearing proceeded. Meanwhile, the *Morrison* decision has not been appealed.

In the UT (2015), Hildyard J examined the competing arguments and declared that the situation was more difficult than that in *Morrisons*. The taxpayer's representative argued strongly that Parliament had intended to provide for fuel in caravans to be lower-rated even when part of a single supply, and his examples highlighted the fiscal distortions that arose if such supplies were not lower-rated. However, the judge's analysis of the precedents accorded with HMRC's. The *CPP* approach was the starting point. Once something had been identified as a single supply, it must have a single rate of VAT applied to it; unless the domestic legislation explicitly carved out a discrete and concrete element of the supply that would be taxed differently, as in *French Undertakers* and *Talacre*. There was no explicit provision of UK law that stated "fuel in caravans is lower-rated even when part of a single complex supply". As a result, it had to be taxed as part of that single supply, at a single rate. HMRC's appeal was allowed.

The company appealed to the Court of Appeal. It argued "that EU law permits a member state to apply a reduced rate to an individual element of a composite supply, that this is also permitted by Group 1 on its true interpretation, and that this interpretation is consistent with fiscal neutrality and fulfils the intention of Parliament in enacting the fuel charge." Arden LJ summarised Roderick Cordara QC's exposition of these arguments, which included the contention that the word "supply" should be interpreted differently in different parts of the VATA.

For HMRC, Jeremy Hyam QC argued that the UT had taken the correct approach. It was possible for the law to apply different rates to parts of a "*CPP* compound supply", but that would require clear words in the legislation. Sch.7A did not contain those clear words. "The plain meaning of section 29A is that VAT shall be charged at the reduced rate

on any supply that is *of a description* specified in Schedule 7A. In this case, the supply was of serviced holiday accommodation, which is not in the Schedule. For the appellant's interpretation to be correct, VATA would on Mr Hyam's submission have to provide in terms that when fuel is supplied as part of a composite supply, it attracts the lower rate."

Arden LJ agreed with HMRC and Vos J in *William Morrison*. The emphasis in s.29A is on the description of the supply, not on "use". The supplies made to the holidaymakers were composite "serviced accommodation", which was not a description included in Sch.7A. Fiscal neutrality was not infringed, because the situation of holidaymakers in caravans was not sufficiently similar to the domestic use of fuel towards which Sch.7A was directed; the separate supply of fuel to the owner of a caravan parked on a pitch was also a different situation.

The appeal was dismissed.

Court of Appeal: *Colaingrove Ltd v HMRC*

2.6 Computational matters

Nothing to report.

2.7 Discounts, rebates and gifts

2.7.1 Brewers' discounts

A company negotiated discounts with two brewers on behalf of a number of publicans, obtaining better prices because of their combined purchasing power. In respect of hotels and pubs owned by the company, it retained all the discount received from the brewers, and the VAT treatment of those amounts was not in dispute. In respect of pubs which were owned and tenanted, pubs where the company held an investment interest, and two specific pubs that did not fall into either category, the company received the discount from the brewers and paid a share of it to the managers of the pub. HMRC ruled that the retained discount represented consideration for a supply of services by the company to the publicans, and it was liable to output tax. The company was assessed for over £180,000 covering a four-year period.

There were two main ways in which the discount operated. Under Method 1, the publican paid the undiscounted price to the brewers for purchases; the brewers paid the total discount to the company; and the company paid a share to the publican. An illustrative example was given using gross price £500, total discount £200, discount paid over £150, retained discount £50. Under Method 2, the discount was shown on the invoice and the publican paid the discounted amount to the brewer; the brewer then paid an extra discount based on volume to the company.

The company argued that Method 1 represented a supply by the publicans to the company for £150. In Method 2, there was a supply by the company to the brewers for the discount paid by the brewers. The company argued that it made no supply to the publicans under either method, so the retained discount was not subject to output tax. It was necessary to "follow the money", or consider the commercial reality of the relationships and transactions, as in the case of *Newey*. The company sought to distinguish the present situation from the Tribunal decision in *Landmark Cash & Carry Group Ltd*, on which HMRC relied for the principle that a buying consortium supplied services to its members in return for a share of the discounts they achieved on their purchases.

Judge Ruthven Gemmell preferred HMRC's analysis. Even though there were no formal contracts and no invoices raised, so that the publicans could not know how much of "their" discount the company had retained, it was supplying a service of organising and facilitating the aggregation of their purchases in order to obtain better terms. The consideration for that service was in the form of some discount forgone, even if the publicans did not know exactly how much that was.

The company was therefore liable for output tax and its appeal was dismissed. Presumably it ought to have issued VAT invoices to the publicans, who would in the great majority of cases have been able to deduct the VAT charged as input tax. The discounts allowed by the brewers would also have reduced their output tax in accordance with the principles of *Elida Gibbs*. This seems to be the correct decision, but gives rise to an unnecessary tax cost that will have arisen because the parties did not understand the nature of a triangular transaction.

First-Tier Tribunal (TC05722): *Redwood Birkhill Ltd*

2.8 Compound and multiple

Nothing to report.

2.9 Agency

2.9.1 TOMS

Two related companies appealed against decisions made by HMRC in 2010 and assessments raised in October of that year covering the period from 1 November 2005 to 31 January 2011. The issue was whether the companies provided holiday accommodation to travellers as principal and therefore fell within TOMS, or whether it acted solely as an intermediary or agent.

The judge noted that a number of other similar cases were to be referred to the CJEU. The present hearing would be restricted to the issue of whether, as a matter of English law, the appellant was acting as a principal or an agent, in accordance with the principles set out in *SecretHotels2*.

Lord Neuberger's judgment from that case was quoted at length for identification of the important principles, in particular:

"*One starts with the written contract between Med and the customer, as it is the customer to whom the ultimate supply is made. However, one must also consider the written contract between Med and the hotelier, as there would be a strong case for saying that, even if Med was the hotelier's agent as between it and the customer, Med should nonetheless be treated as the supplier as principal (in English law) or 'in its own name' (in EU law) if, as between the hotelier and Med, the hotel room was supplied to Med.*"

The judge went on to examine the way in which the appellants carried on their business, including the details of its contracts with customers (on its website) and with suppliers. One interesting detail is that the company made 8th Directive claims to Spain, Portugal and Greece in 2007; HMRC argued that this indicated that they regarded themselves as a principal, buying and selling accommodation. The claims were rejected because the authorities in the other countries ruled that they would have been within the local TOMS rules. The companies argued that they had simply been advised by their tax advisers that they were entitled to make the claims, and had always been clear in their submissions that they were making those claims as agents. The judge accepted this explanation and held that making the claims did not contradict any of the other evidence.

The Tribunal concluded that the contracts with the customers were clearly similar to those in the *SecretHotels2* case. The judge noted that some of the contracts with suppliers were subject to foreign law, on which no evidence had been presented. In *Hotels4U.com*, the judge had declined to make any findings on such contracts. The judge in this case considered this unsatisfactory, and proposed to use English law to interpret the contracts unless there was a good reason not to do so. All the evidence, the pattern of the companies' business, and the similarity to various features of the earlier case, all suggested that these were also agency contracts.

After detailed examination of many different features of the business, the judge concluded that the companies were clearly acting as agents under English law, and were not subject to TOMS in respect of the transactions at issue (although they had accounted for some packaged holidays under TOMS). Although this was enough to conclude the appeal in the taxpayers' favour at this point, it is subject to the reference to the CJEU on the meaning of "acting solely as an intermediary" under EU law.

First-Tier Tribunal (TC05926): *Lowcost Holidays Ltd t/a Lowcost Beds*

2.10 Second hand goods

2.10.1 Puppies

A company received a ruling that it should not use the margin scheme for sales of puppies. It was connected with another company that had been investigated by HMRC in relation to the same treatment; it had been incorporated while the other company was arguing the point, and it started to trade after the other company received a formal ruling in October 2014. Appeals against rulings were filed by both companies, but the predecessor went into liquidation and the liquidators decided not to pursue the appeal. The second company proceeded to a hearing.

The appellant accepted that it should account for output tax on the whole selling price of home-bred puppies, and also bought-in puppies that were bought from a VAT-registered supplier. It argued that puppies bought in from unregistered suppliers were eligible for margin scheme treatment as second-hand goods.

The judge noted that "goods" or "tangible moveable property" was not a description that would commonly be applied to animals, particularly family pets. However, it was a possible description. The key question was rather whether the puppies were "second-hand". The legislation required margin scheme goods to be "suitable for further use as it is or after repair". That implied that there had already been "use". Puppies purchased from the unregistered breeder were up to 8 weeks old.

There was also implied authority from a CJEU decision (*Forvaltnings AB Stenholmen v Riksskatteverket* Case C-320/02) that horses bought from a breeder could not be "second-hand". The CJ had held that purchases from a private individual ("other than the breeder") could fall within the margin scheme. HMRC sought to rely on the exclusion in the CJ decision; the appellant argued that it was not explained and not an essential part of the judgment. The Tribunal noted that the Advocate-General's opinion in the case did explain the distinction, commenting that newborn animals would not be covered by the scheme, which was supposed to apply to goods that had been first sold to a non-taxable person and then sold to a dealer.

The judge considered the economic rationale for the second-hand scheme, and concluded that it should apply on the re-entry to circulation of something that had already been sold once subject to VAT. There was some argument about the irrecoverable VAT incurred by the unregistered breeder, but the judge was satisfied that there was no fiscal distortion by requiring the full value of these puppies to be charged to VAT.

There was an interesting further point about the use of "global accounting". HMRC argued that, if the margin scheme was available, the puppies could not be brought within it, either because their value was over £500, or because they were excluded by the list in article 13 of the Special Provisions Order. This includes item (e) "horses and ponies", which HMRC wanted to extend to "dogs". The judge rejected this: the words could not be stretched that far. In addition, the £500 limit related to the purchase price, not the sale value, and the puppies were all bought for less than that. However, the point was academic, as the margin scheme was not available at all.

First-Tier Tribunal (TC05811): *Little Rascals Pets Ltd*

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Articles

In an article entitled *VAT Landscape*, Steve McIntyre provides some points on VAT issues that ought to be considered when preparing year-end accounts for a client. These include registration, partial exemption and dealings in land and property. The article includes a useful questionnaire to help in identification of risk areas.

Taxation, 20 April 2017

In an article entitled *Big Four*, Neil Warren comments on the issues that have brought in the most work to his VAT consultancy in the last year. These were, in reverse order, partial exemption, international services, the option to tax, and the flat rate scheme. He suspected that the FRS would, after the changes introduced on 1 April 2017, revert to being much less important; Brexit-related queries are likely to become most significant.

Taxation, 4 May 2017

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 More than bare land?

A hotel had a room that was licensed for carrying out civil wedding ceremonies. Customers could hire the room separately from the other facilities for wedding receptions supplied by the hotel. The hotel treated the hire of the ceremony room as exempt, while the rest of any services supplied were treated as standard rated catering. HMRC ruled that the whole supply was standard rated and assessed the hotel for £54,610 for periods from 09/09 to 12/12.

HMRC put forward two arguments in the FTT (TC05078): either the supply of the room was part of a single “wedding package”, and it could not be given a separate liability; or else it was part of a composite supply of which the principal supply was the catering. They accepted that the hire of the ceremony room on its own was exempt, but wherever it was supplied to someone who also used the hotel for a wedding reception (which appears to be on most occasions), it would be standard rated.

The company argued that the facts differed from earlier cases on the subject of wedding facility hire. The room for the ceremony was supplied without any other facilities; it was not artificial to regard it as a separate supply. It was a genuine exempt licence to occupy land. If it was part of a composite supply, it was the predominant element: if there was no ceremony, there was no wedding.

The FTT considered that the elements of the package were closely linked to each other geographically, temporally, economically and from a marketing perspective. On the other hand, the wedding room was a legally separate supply, and people did buy the elements separately, or decide to buy them at different times. Separate prices were effectively charged, even though the total would be paid by the same people on the same invoice. The Tribunal did not consider that it would be artificial to treat the elements of the supply as separate, so they were not a single supply within *Levob*.

The FTT also considered the arguments about which was the principal supply. The significant differences in character between the supplies supported the conclusion that they were separate and distinct.

However, it was still necessary to consider whether the separate hire of the wedding room was an exempt supply. The FTT noted that HMRC had accepted this in situations where there was no supply of catering in addition, and seemed to doubt whether that was correct. Confining itself to the supplies which were under appeal, the FTT noted that the wedding regulations required that the public could not be excluded from a place where a legal wedding ceremony was being performed. That raised the question of whether it was truly a licence to occupy land. However, the key point was that the room was provided with the licence to carry out a lawful wedding: it was a facility or opportunity that went beyond the passive letting of land, similar to the opportunity to participate in a fair in *International Antiques & Collectors Fairs* (TC04538).

The appeal was dismissed, and the company appealed to the Upper Tribunal (Judge Roger Berner and Judge Greg Sinfield). The point at issue was whether the nature of the room and the circumstances of its hire meant that it could not be regarded as the passive letting of land. The main cases considered by the judges were *Temco* (Case C-284/03), *MacDonald Resorts Ltd* (Case C-270/09) and *Stade Luc Varenne* (Case C-55/14). They derived the following principles:

In order to be a supply of the leasing or letting of immovable property, a transaction between an owner of an interest in a property ('the landlord') and another person ('the tenant') must:

(1) confer on the tenant the right to occupy the property as if the tenant were the owner;

(2) allow the tenant to exclude from enjoyment of such a right persons who are not permitted by law or by the contract to exercise a right over the property;

(3) be for an agreed period which may be restricted but must not be occasional and temporary ; and

(4) be in return for payment.

How the transaction is classified by the parties is not determinative and regard must be had to the objective character of the transaction.

The UT decided that the Approved Premises Regulations, which required that members of the public had to be allowed to attend a wedding ceremony, did not prevent the hirer from enjoying the rights of an owner for the duration of the letting. It was in the nature of the room that no one – not even the outright owner – could exclude the public from a wedding ceremony. The possibility of external legal rights overriding the right of exclusive occupation was recognised by the CJEU in *Temco*; the FTT's failure to appreciate that constituted an error of law.

However, the second point was decided in favour of HMRC: the UT agreed with the FTT's conclusion that the hiring went beyond passive letting. The UT described its reasoning differently, not agreeing with the FTT's comparison with *International Antiques & Collectors Fairs*. Rather, it was the fact that the Approved Premises licence required the provision of a responsible person, and the provision of a "seemly and dignified venue", that made it a more complicated and active service in line with the CJ decision in *Stade Luc Varenne*. By its active exploitation of the room, the hotel added significant value, and this took it outside the exemption. The appeal was dismissed again.

Upper Tribunal: *Blue Chip Hotels Ltd v HMRC*

3.1.2 Caravans

A company treated rental of caravans as zero-rated. HMRC raised an assessment for £481,068, covering periods from 12/09 and 04/13, disallowing input tax claimed on that basis; HMRC ruled that the supplies should have been treated as exempt.

The taxpayer supplies caravans, used as mobile homes, to members of what is known as the "travelling community" eligible for housing benefit

for use as their homes and to be sited on pitches provided, in general, by local authorities.

The FTT judge (TC04434) noted that one of the taxpayer's complaints was that HMRC had carried out three visits on which they had effectively approved the practice, before raising the issue only on the fourth visit. The judge pointed out that the FTT could not give a remedy on the basis of this argument: that could only be taken to the Revenue Adjudicator, or by applying for judicial review.

The technical argument was also based on Notice 710/20, which gives the following explanations:

You are supplying a caravan if you do any of the following:

- *sell it*
- *lease it under a long term leasing agreement under which the lessee is free to transport it to a park or other place of their own choosing*
- *loan it without making a charge*
- *divert it to your own personal use*

If you provide accommodation in a caravan that is:

- *on a site designated by the local authority as for permanent residential use, and*
- *let to a person as residential accommodation*

your supply will be exempt.

It was common ground that the caravans exceeded the size limits in Sch.8 Group 9 and were capable of being zero-rated if they were supplied in accordance with the conditions of that legislation. The tenants paid the local authority for the right to place a caravan on the site, and rented the caravan itself from the taxpayer.

The taxpayer's counsel characterised the transactions as follows:

(i) the supply of a sited mobile home is a composite supply of both a home and a pitch, whereas the taxpayer's only supply is that of the mobile home;

(ii) the mobile home cannot be an exempt supply in the absence of the supply of the pitch or some other right over land, since the supply of the pitch itself is not by the taxpayer but by a third party site owner, usually a local authority;

(iii) the mobile home lessees are free to move their home to a park or other place of their own choosing.

HMRC responded that Note (b) of Group 9 Sch.8 excludes from zero-rating "the supply of accommodation in a caravan or house boat". In spite of attempts by the taxpayer's representative to differentiate that provision from the situation in which travellers were using a caravan as their residence, HMRC argued that it applied. The supply of land was indeed exempt, and was also separate from the supply of the caravan because they were made by different people; but the only possible conclusion was that the supply of the caravan ought to be standard rated.

This possibility had not been raised before the hearing, in correspondence, in the review of the decision or in HMRC's skeleton argument. The judge adjourned the hearing for the taxpayer's representative to consider whether he needed to prepare a response; after taking instructions, he decided to carry on without a further delay.

This led to a bizarre result. The judge concluded that HMRC's arguments at the hearing were correct – the taxpayer's supplies could not be exempt and they could not be zero-rated, so they must be standard rated. However, that was not the basis for the assessments: they had been raised on the basis that the input tax was not deductible. That was incorrect, so the appeal had to be allowed.

Both the company and HMRC appealed to the Upper Tribunal (Mr Justice Norris and Judge Greg Sinfield). The company argued that the FTT had erred in concluding that its supplies were "accommodation in caravans" rather than simply "caravans". HMRC responded that the FTT had erred in failing to make a specific finding that the supplies were standard rated. HMRC further argued that the FTT's conclusion that the assessments were invalid was also an error of law.

The judges considered that there is a fine distinction between "accommodation in a caravan" and "a caravan". However, they resolved it by considering that "accommodation" must be something more than the caravan on its own: it must enable the caravan to be occupied as a residence. That involved the provision of the site and connection to utilities. Those matters were supplied by someone else: the appellant supplied nothing more than the caravan. If there was an abuse, the two supplies by different people might be compounded, but that was not the case here. Accordingly, the appellant's supply was zero-rated and its appeal was allowed.

The UT commented that the FTT's conclusion on the invalidity of the assessment could not stand. The Tribunal is supposed to determine the correct amount of tax; the fact that the reasons for the assessment have changed do not invalidate it except in the circumstances described in *Rahman (t/a Khayam Restaurant)* (2003). However, the point was not important as the appeal succeeded.

HMRC had also argued that the FTT should have had (and exercised) a power to increase the assessments to reflect undercharged output tax – a greater amount than the input tax they had sought to disallow. Again, it was not important because of the technical decision, but the UT rejected this argument. The Tribunal should not increase or impose liabilities of its own motion: it would be incumbent on HMRC to raise new or amended assessments in a higher amount, if they were still in time to do so.

Upper Tribunal: *HMRC v Jenkin and Son Ltd*

3.2 Option to tax

3.2.1 Article

In an article entitled *It was 50 years ago...* (referring to the anniversary of *Sergeant Pepper's Lonely Hearts Club Band*), Richard Curtis examines a number of Beatles-related tax issues. "It was 20 years ago" suggests the rules on the revocation of the option to tax, where the writer notes that cancelling an option is subject to conditions and procedures rather than automatic.

Taxation, 1 June 2017

3.3 Developers and builders

3.3.1 Construction of dwelling

HMRC refused zero-rating on some construction work. The VAT at issue was £40,069. The FTT (TC05087) noted that the planning consent was not included in the appellant's bundle of evidence, and this might have counted against them; however, they were not tax experts, so they were directed to produce the documents after the hearing, which they did.

The project involved the demolition of a coach house. Two walls were retained as required by the council; the company argued that extra walls had been constructed inside these outer walls, so they ceased to be part of the building but rather were part of the perimeter. If they were part of the building, they were two facades required to be retained by planning consent.

The FTT judge noted that no precedents were cited by either side. He said he had carried out his own researches and discovered the 2015 UT decision in *Astral Construction Ltd*, which he regarded as a relevant and binding precedent. He was surprised that HMRC's representative did not mention that there was such a relevant case. He also referred to the discussion of the purpose of Group 5 as discussed in *TGH (Commercial) Ltd* (TC04581). This would provide a useful "cross-check" of the decision.

The judge identified the key issue as whether there had been an "enlargement, extension or reconstruction" within Note 16, and if so, whether it fell within the "facade" rule of Note 18. HMRC did not argue for enlargement or extension, but considered that there had been a reconstruction. After examining the precedents of *Wimpey*, *Marchday*, *Penwith* and *Astral* in detail, and regarding the question as one of fact and degree, the Tribunal concluded that this was the construction of a new dwelling, not the reconstruction of an existing building.

The Tribunal went on to consider Note 18 in great detail, even though it was not strictly necessary as Note 16 was satisfied. The judge considered the history and purpose of the provision, and commented that the drafting was poor – if applied literally, it was hard to see how it could ever apply to a construction project. In this case, the judge accepted that what was retained constituted "facades" and the house was "a corner site", even

though the side wall did not face a street (disagreeing with the recent Tribunal in TC04980 *Reeves*). However, the mere fact that the walls were shown as retained on the approved plans was not enough to make them required as a condition of planning consent (following *Boxmoor*).

The appeal was allowed by the FTT on the basis of *Astral Construction* and Note 16. HMRC appealed to the Upper Tribunal, where the case came before Mr Justice Mann and Judge Colin Bishopp. The legal issues were summarised as follows:

- both sides agreed that the works would fall within item 2 of Group 5 if it were not for Note 16;
- HMRC argued that the works fell within "alteration" in Note 16;
- the taxpayer argued that the works fell within none of the descriptions in Note 16;
- if they did fall within Note 16, it was agreed that Note 18 did not "rescue" the project, on the basis of the unchallenged findings of the FTT that too much was retained and not required by planning consent.

The FTT had relied substantially on the case of *Marchday Holdings*, in which the Court of Appeal upheld a VAT Tribunal decision to the effect that the works were so significant that the previous building on the site had ceased to exist. The problem with applying that decision was that Note 18 had been introduced into the law since then. It took effect from 1 March 1995 and defined when a building ceased to exist. If Note 18 was not satisfied, even the most substantial works would not have caused the building to cease to exist, which would mean that those works could only constitute an alteration rather than new construction.

The Upper Tribunal explained how the decision in *Astral Construction* could still be correct, given that it related to facts after 1 March 1995. That case concerned the "enlargement or extension" part of Note 16, rather than the "conversion, reconstruction or alteration" part. In the view of the Upper Tribunal, these were very different situations. It was possible to consider an "ordinary language" meaning of "enlargement or extension", even though it was determined that the original building persisted; it was not possible to consider an "ordinary language" meaning of "reconstruction or alteration", because that question was predetermined by Note 18. The works in *Astral* constituted new construction, rather than enlargement or extension of the existing structure, because they were so much bigger than the existing structure.

In applying for leave to appeal, HMRC had sought to argue that *Astral* was wrongly decided. The judges preferred to distinguish the case, and expressed no view on whether that decision was correct or not, simply noting that HMRC had not appealed it to the Court of Appeal. HMRC's appeal in the present case succeeded.

Upper Tribunal: *HMRC v J3 Building Solutions Ltd*

3.3.2 Building dispute: rate of VAT

In a commercial dispute between a builder and two clients, part of the issue was that the builder charged the full rate of 17.5% on certain works carried out in 2010, rather than the 5% rate applicable to alterations or renovations of dwellings. The High Court confirmed that this was correct in the absence of any certificate or other written confirmation that statutory building control approval had been given. The clients appealed to the Court of Appeal, which found no fault with the judge's approach. It seems that the clients sought to argue on appeal that building control approval had not been required, but if that was their case, it should have been pleaded and dealt with as part of the evidence in the High Court. The clients' appeal was dismissed.

Court of Appeal: *Cunningham (trading as Urban Developments) v Buckley and another*

3.3.3 Sub-contractor

A company provided construction services to a main contractor in relation to a new place of worship for a charity. It incorrectly zero-rated the work, even though the "relevant charitable purpose" rules only allow that for the final supply between the main contractor and the charity (because the recipient of the supply has to issue a certificate). The main contractor had "issued" it with a copy of its own certificate. The company accepted that it should have checked the legal position before relying on this.

HMRC assessed for the VAT fraction of the amount received. The company could not collect this amount by issuing a supplementary invoice, because the main contractor was insolvent. It argued that if it had correctly charged VAT, the main contractor would have recovered it, so HMRC were unfairly collecting a "windfall". The amount in dispute was about £220,000.

The judge (Barbara Mosedale) considered arguments based on fiscal neutrality and the CJEU precedent of *Reemtsma* (Case C-35/05). The company argued that this gave it the right to repayment of tax overcollected directly from HMRC, where the normal route (via the supplier) was impossible because of insolvency. The judge did not agree that the position here was analogous, because *Reemtsma* was about a claim for input tax, whereas this was an assessment to output tax.

The company also argued that s.73 VATA 1994 gave HMRC the discretion to assess or not, which had not been considered. The judge did not agree that the FTT has jurisdiction to consider whether HMRC were correct, in a public law sense, to raise an assessment. She disagreed "with respect" with the earlier Tribunal decisions in *Technip Coflexip Offhsore Ltd* (VTD 19,298) and *Hollinger Print Ltd* (TC03117). The judge expressed sympathy for the directors, whose company would have to pay a very considerable amount of money out of its own resources, but in her view the law was clear and gave them no remedy.

First-Tier Tribunal (TC05874): *J & B Hopkins Ltd*

3.3.4 Interaction of taxes

In an article entitled *Home Truths*, Alex Millar and Rob Durrant-Walker consider a number of different tax considerations when selling land, buildings or both to a developer. These include CGT, VAT, SDLT, land pooling and the annual tax on enveloped dwellings for both sides.

Taxation, 18 May 2017

3.4 Input tax claims on land

Nothing to report.

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

Nothing to report.

4.2 Where is a supply of services?

4.2.1 Use and enjoyment

Under the present "use and enjoyment" rules, telecommunications services are subject to the following place of supply principles:

- business to business (B2B) supplies are deemed to be made where the customer belongs, and are subject to the reverse charge if the customer is an EU business;
- business to consumer (B2C) supplies are deemed to be made where the customer belongs, and the supplier must register for VAT in the customer's country (possibly using MOSS) if the customer belongs in a different EU country;
- in either case, if the basic place of supply (based on place of belonging) is inside the UK but the place of use and enjoyment of the supply is outside the EU, the place of supply is shifted to "outside the scope of VAT";
- in either case, if the basic place of supply (based on belonging) is outside the EU but the place of use and enjoyment is inside the EU, VAT should be charged.

This means that VAT is not charged on supplies by UK telecommunications suppliers to UK consumers, if their services are used and enjoyed outside the EU (e.g. in Switzerland or the USA).

HMRC are consulting on draft regulations to change this so that VAT will be charged on B2C supplies of telecommunications services to UK consumers, regardless of the place of use and enjoyment. This is described as being to "bring the UK rules in line with the international approach agreed at the Organisation for Economic Co-operation and Development".

This is achieved by removing telecommunications from the "general exceptions" to the normal place of supply rules (which apply to both B2B and B2C supplies) and inserting a new "exception for supplies to relevant business person" restoring the use and enjoyment provision for B2B supplies only.

The existing provisions continue to apply to radio and television broadcasting services.

SI 2017/Draft Value Added Tax (Place of Supply of Services) (Telecommunication Services) Order 2017

4.3 International supplies of goods

4.3.1 Insufficient evidence

HMRC raised assessments on a company for £159,707 of output tax where there was no evidence that zero-rated supplies had been exported, and £47,397 of input tax where the evidence to support deduction was unsatisfactory. The assessments covered periods from 06/12 to 09/13.

There was an apparent misunderstanding between the parties about the responsibility for production of bundles of evidence. As a result, the taxpayer turned up to the hearing with a bundle that HMRC had not previously seen. The judge ruled that, in the interests of efficiency, the hearing should proceed, but the parties would have time after the hearing to make further submissions.

The Tribunal considered the history of the business, which was based in St Petersburg and specialised in the purchase and sale of deep sea diving equipment for industrial and leisure use. There appear to have been practical problems in running such an international business with normal paperwork: it had to use an employee's bank account in the UK because it was "hard for a business with foreign directors to open a UK bank account", and goods were said to have been transported as accompanied baggage because of their high value and the level of corruption in Russia. The director complained that he had been unable to present some of the goods to the customs officers at Edinburgh Airport because they were short-staffed and he would have missed his flight if he had waited.

The company gave a long list of reasons why the assessments were wrong. These included claims that many of the transactions charged related to goods that never came to the UK – manufactured outside the EU and sold to customers outside the EU – or technical services that were supplied over the internet. HMRC responded that the account given by the company changed during the course of the investigation, that it was contradictory and inconsistent, and that the conditions of Notice 703 had not been met.

The Tribunal considered that the situation was complicated, and the complication was compounded by significant misunderstandings on both sides. For example, sales of goods that were not in the UK had been described on invoices as "zero-rated", implying to HMRC that they were exported; but they should properly have been described as "outside the scope of UK VAT", which would not require compliance with Notice 703 (just evidence that the goods were not in the UK).

The judge (W Ruthven Gemmell) concluded that, on the balance of probabilities, the output tax assessment was ill-founded, and discharged it (and related penalties, which had not been appealed). However, the input tax assessment (slightly reduced by HMRC) should stand. The company had had plenty of time and opportunity to comply with requests for adequate proof of the expenditure and had failed to provide it. The assessment and related penalty were confirmed.

First-Tier Tribunal (TC05743): *Open Safety Equipment Ltd*

4.3.2 Customs debt

German law provides that certain free zones are treated as "foreign territory", so for the purposes of German law they are not in the EU. Questions were referred to the CJEU about the consequences of this rule for import VAT.

The context was a situation in which goods arriving at Frankfurt airport in June 2009 had been sealed and entered into the external Community transport procedure, en route for the free zone at Hamburg. However, they were not presented to the customs office there by the completion date of 17 June 2009; an investigation suggested that they had been unsealed and unloaded in the free zone and sent by sea to Finland and on to Russia. The authorities assessed both the principal and the transporter, but only sought payment from the transporter, which was the party that had failed to complete the transit procedure. The transporter argued that the removal of the seal in a free zone did not incur a liability to import VAT: it was deemed to take place outside German territory, so it could not trigger a customs debt, and a liability to import VAT could not arise separately from the customs debt.

The questions sought clarification of the relationships between the various rules on tax points in articles 61, 71 and 156 of the PVD and articles 203 and 204 of the Customs Code. The Advocate-General's opinion was that free zones are an "arrangement or situation referred to" in art.156 PVD, and it is therefore possible for no VAT debt to be triggered when goods are unloaded there. The full court agreed.

The second question was whether the VAT debt would be automatically incurred at the same time as the customs debt when the goods left customs supervision (by the failure to complete the transit procedure), so triggering a customs debt under art.203 of the Code. The A-G's opinion was that the VAT debt would be incurred, even though the goods were in a free zone at the time, if it was reasonable to presume that the goods were able to enter the economic network of the EU. It would be for the national court to determine that. Once again, the full court agreed. The goods had moved from one art.156 procedure (external transit) to another (free zone), and if they stayed within one or other art.156 procedure throughout, they would not have triggered a tax point.

The full court also agreed with the A-G's opinion that articles 203 and 204 of the Customs Code are mutually exclusive. If a customs debt has been incurred under art.203, but in the circumstances of the case no VAT debt has been incurred because the goods were in a free zone, then art.204 could not be used on its own for the sole purpose of providing a basis for charging VAT.

The order for reference suggested that the referring court regarded the trader's account as credible – that the goods had never been used, consumed or entered into free circulation in the EU. It therefore appears that the trader has succeeded in cancelling the liability.

CJEU (Case C-571/15): *Wallenborn Transports SA v Hauptzollamt Gießen*

4.3.3 Exemption of New Means of Transport

Questions were referred to the CJEU about the rules for exempting an intra-community supply of new means of transport. A Portuguese trader sold a car to an Angolan national for personal use in Spain. The purchaser took the car to Spain and registered it for use there. The applicant therefore took the view that it was an exempt sale. However, the Spanish law did not treat temporary use by a non-resident as qualifying for NMT treatment.

Advocate-General Mengozzi issued an opinion in favour of the taxpayer. In his view, NMT treatment cannot be made conditional on the purchaser being resident in the destination state, nor on the registration being permanent rather than temporary. A trader who has acted in good faith and taken all reasonable steps to be satisfied that the transaction satisfies all the substantive conditions for exemption (in art.138(2) PVD) must be granted the exemption. The essential issue is to determine the Member State in which the final, permanent use of the means of transport will take place: that is not dependent on residence or on the temporary nature of the particular registration.

It would be for the referring court to ascertain whether the vendor had acted in good faith and had taken all reasonable measures within its powers to ensure that the supply of the new vehicle to the purchaser would not result in a breach of the substantive conditions required to classify that transaction as the intra-Community supply of a new means of transport. If that was the case, and there was no suggestion of collusion with the purchaser to avoid tax, the exemption must be granted.

The full court has confirmed the opinion. Art.131 gave Member States the power to lay down rules on the application of the exemptions to prevent avoidance, evasion and abuse; however, the measures in this case went beyond what was necessary to achieve those objectives, and contravened the principles of legal certainty, proportionality and fiscal neutrality. There was a risk of double taxation. Art.138 precluded the vendor being made liable at the time of supply on the grounds that the registration in the other Member State was only temporary; it also precluded the vendor being made liable later, when the temporary registration came to an end; and, even if there was tax evasion by the purchaser, the vendor could not be made liable unless there was objective evidence to suggest that the vendor ought to have known about the fraud and had not taken all reasonable steps to avoid participation in such a fraud. That would be for the referring court to determine.

CJEU (Case C-26/16): *Santogal M-Comércio e Reparação de Automóveis Lda v Autoridade Tributária e Aduaneira*

4.3.4 NAO report

The National Audit Office has published a report of an investigation into the concern that online sellers based outside the EU are not charging VAT on their goods located in the UK when sold to UK customers. Online sales accounted for 14.5% of all UK retail sales in 2016; just over half of these were non-store sales, mainly through online marketplaces. Key findings included:

- HMRC estimate that online VAT fraud and error cost between £1 billion and £1.5 billion in lost tax revenue in 2015-16 but this estimate is subject to a high level of uncertainty.
- HMRC recognised online VAT fraud and error as a priority in 2014, although the potential risk from online trading generally was raised before this.
- HMRC's assessment is that online VAT losses are due to a range of non-compliant behaviours, but has not yet been able to assess how much is due to lack of awareness, error or deliberate fraud.
- HMRC seeks to detect and correct online VAT non-compliance by using intelligence to identify suspected fraudulent traders.
- HMRC has decided to focus enforcement actions against online VAT fraud inland rather than at the border.
- To date, there have been no prosecutions for online VAT fraud but HMRC has carried out many civil operations against suspected evaders.
- HMRC introduced new legal powers to tackle online VAT fraud and error in September 2016.
- HMRC has seen an increase in the number of new VAT registrations from non-EU sellers since the legislative changes were announced and came into force.

www.nao.org.uk/report/investigation-into-overseas-sellers-failing-to-charge-vat-on-online-sales/

4.3.5 Updated Notices

HMRC have updated their Notice *Importing scientific instruments free of duty and VAT*. This is the first full update since January 2002, and it incorporates updates issued in April 2004, September 2004, January 2007 and October 2007. Additional changes are to "your right to be heard", the decision review process, third-party authorisation, multiple-item consignments, necessary record-keeping, proper disposal of goods and the HMRC Charter reference.

Notice 340

HMRC have updated their Notice *Imports* from the January 2017 version with an amended e-mail address for the National Duty Repayment Centre.

Notice 702

HMRC have updated their Notice *Customs special procedures for the Union Customs Code* from the December 2016 version. Annexes A, C and D have been amended, mainly to show that it is no longer necessary to hold a guarantee or guarantee waiver before applying for a special procedure.

Notice 3001

4.4 European rules

4.4.1 Directive against fraud

The EU Council has adopted a directive on the protection of the financial interests of the EU (PIF Directive) providing common definitions of a number of offences against the EU budget, including fraud, active and passive corruption, misappropriation of funds and money laundering. Serious cases of cross border VAT fraud will also be included in the scope of the directive when above a threshold of €10m. Ireland has notified its wish to take part in the adoption and application of this Directive. The UK and Denmark are not taking part in the adoption of this Directive and are not bound by it. If approved by the European Parliament, the Directive will be published in the Official Journal and Member States will have 24 months to implement the provisions at national level.

www.consilium.europa.eu/en/press/press-releases/2017/04/25-new-rules-to-protect-eu-finances/

4.4.2 E-books

The EU Parliament's Committee on Economic and Monetary Affairs has voted by 48 to 1 (with 2 abstentions) to approve the Commission's proposal to align the VAT treatment of e-books with printed books, by allowing member states to apply reduced rates to e-publications. The full Parliament was set to vote on the matter by the beginning of June.

Digital supplies of music and videos, and publications predominantly consisting of music and videos, will continue to be liable to the standard rate.

It is not clear whether this would allow the UK to apply the zero-rate to e-books by allowing the full alignment of the treatment of printed matter and digital versions, or would allow the UK to apply the lower rate to e-books (by adding a new group to Schedule 7A) because it is not permissible to extend the scope of any of the zero-rated categories.

www.europarl.europa.eu/news/en/news-room/20170502IPR73133/meps-vote-to-lower-vat-on-e-books-aligning-them-with-printed-books

4.4.3 Report on e-commerce sector inquiry published

On 10 May 2017, the European Commission published its final report on the e-commerce sector inquiry, which identifies business practices that may restrict competition. Although it is not directly related to VAT, it is an interesting document for anyone involved in international supplies of goods and services through digital marketplaces, where VAT is one of the significant issues.

The report highlights a number of practices that may restrict free competition, including "geo-blocking" – suppliers imposing conditions or restrictions on sales of their products in other marketplaces. The report notes that this can in some circumstances be justified, but that should only be on the basis of objective factors and specific reasons.

http://ec.europa.eu/competition/antitrust/sector_inquiries_e_commerce.html

4.4.4 Digital market proposals

The Commission has proposed new rules for the digital marketplace, probably to apply from April 2021. The intention is to:

- impose a reverse charge for import VAT on businesses that facilitate importation of goods that are delivered to consumers from outside the EU, to close what is perceived to be a current €5bn VAT gap;
- extend the MOSS rules from digital services to cover also distance selling of goods, which currently has a higher but inconsistent threshold for registration in other member states, but no single registration facility for a business that sells into a number of different states;
- introduce thresholds of €10,000 below which a business can use its own domestic VAT registration for cross-border sales, and a higher threshold of €100,000 below which the record-keeping rules are less onerous;
- remove small consignments relief for imports.

The EU Parliament's committee on economic and monetary affairs has put forward draft amendments to the Commission's package.

http://www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&reference=PE-604.735&format=PDF&language=EN&secondRef=01

4.4.5 MOSS extension

The EU Parliament's committee on economic and monetary affairs has published its draft report on proposed amendments to the EU regulation on administrative cooperation and combating fraud in the field of VAT. This includes the proposal for a new one-stop-shop that will cover services beyond the current scope of telecommunications, broadcasting and electronically supplied services and will include distance sales of goods.

www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&reference=PE-604.736&format=PDF&language=EN&secondRef=01

4.4.6 EU cross-border VAT rulings pilot

The pilot scheme for cross-border rulings, that has been running since June 2013, has now been extended to 30 September 2018. The May 2017 update contains 19 published rulings up to the end of 2016. 18 countries including the UK participate in the scheme. Germany is a notable absentee from the list.

ec.europa.eu/taxation_customs/business/vat/vat-cross-border-rulings-cbr_en

4.4.7 Double jeopardy?

Two individuals were subject to criminal proceedings in Italy because companies under their control had not paid VAT. While those proceedings were in progress, the companies were assessed to VAT and penalties. The individuals objected that they were being pursued twice for the same offence, and the Italian court referred questions to the CJEU.

The court ruled that neither art.50 of the Charter of Fundamental rights of the European Union nor art.4 of Protocol No 7 to the European Convention for the Protection of Human Rights and Fundamental Freedoms had been infringed. The "ne bis in idem" principle (not twice for the same thing) applied to actions taken against the same person. In this case, it was clear that the criminal proceedings were brought against the individuals, and the tax penalties had been levied on the companies.

CJEU (Case C-217/15 and C-350/15): *Re Orsi and another*

4.4.8 Independent groups of persons

The Commission took infringement proceedings against Luxembourg in relation to its implementation of the implementation of the exemption for "independent groups of persons" (PVD art.132(1)(f)). This allows such groups to make exempt supplies to its members where those supplies are essential to their own exempt or outside the scope activities, and where the members bear their own shares of the costs of the group's activities. It is mainly used in relation to cost-sharing by exempt or non-taxable persons, but is a difficult piece of legislation to understand or to implement.

The Commission's complaint related to three matters. First, it appeared that Luxembourg allowed the exemption even where the group supplies were used for the purposes of taxed transactions, where the members had up to 30% or even 45% taxable supplies. Second, Luxembourg allowed group members to deduct input tax on supplies that were made to the group. Third, Luxembourg allowed reimbursement of the group to be treated as outside the scope of VAT.

The court upheld the Commission's complaints on the first and third grounds, and on part of the second ground.

CJEU (Case C-274/15): *Commission v Luxembourg*

A-G Kokott has given an opinion in a case referred by Latvia about art.132(1)(f) PVD. She notes that there have only been three cases on the exemption in several decades, but four currently before the CJEU. She begins her opinion with a useful review of the purpose underlying the exemption:

3. The background to the exemption is the decision by the EU legislature not to grant an input tax deduction in principle to undertakings which make exempt supplies, such as doctors or schools. Thus, while the outputs of such undertakings are not taxed, at the same time VAT is charged on their inputs. This results in the supply to the final consumer being only partially exempt, as the non-deductible VAT is generally taken into account in pricing and is thus borne by the recipient not directly, but indirectly.

4. Because there is no input tax deduction for such undertakings, the purchase of (taxable) elements of the supply which could also be provided by the undertakings themselves may have a negative influence on pricing to the amount of the non-deductible VAT. For example, where a private detective is employed by an insurance company, expenditure is incurred to the amount of the personnel costs, but where recourse is had to the services of an external detective, expenditure is incurred to the amount of those personnel costs and the applicable VAT. There is generally

therefore an economic interest in an undertaking making such supplies itself and not purchasing them from another undertaking giving rise to tax liability. Consequently, in the applicable VAT system, through the creation of an exemption without input tax deduction, an undertaking making exempt supplies is treated like a final consumer. A final consumer likewise does not owe any VAT, but also cannot claim any input tax deduction, even if he supplies services for consideration or sells goods.

5. However, for undertakings making exempt supplies too, there may be situations in which it makes economic sense, or is even necessary for competition reasons, to provide individual elements of a supply not alone, but together with other undertakings also making exempt supplies. It may thus make sense if, for example, several social security institutions share the costs of a data processing centre. For cases of this kind, Article 132(1)(f) of the VAT Directive also exempts supplies by the group to its members under certain conditions. The exclusion of input tax deduction does not therefore affect pricing, which leaves the scope of the exemption for the final consumer unchanged. The scope does not then depend on whether the supply as a whole was made by an exempt undertaking or by that undertaking together with other exempt undertakings.

In this case, a Latvian bank was a member of a group of companies with a parent company and fellow subsidiaries in Denmark. These Danish companies recharged amounts to the Latvian company in respect of:

- financial services provided by the parent company DNB Nord AS, established in Denmark;
- IT services provided by the Danish sister company DNB Nord IT AS;
- transmission, under cost allocation arrangements, of software licences purchased from a third party by the grandparent company DNB Bank ASA, established in Norway.

The recharges were at "cost plus 5%". The Danish authorities treated the supplies of IT services as giving the right to deduction to DNB Nord IT; the Latvian authorities took the view that all the costs were subject to a reverse charge in Latvia, which would create "sticking tax". The Latvian authorities referred questions to the CJEU, covering a range of issues, including:

- whether the exemption can apply to cross-border transactions;
- if so, whether it is relevant to consider differences in the way in which the two countries concerned have implemented the cost-sharing exemption;
- whether it is necessary for the "independent group" to have set up a separate entity to make the shared supplies;
- whether the 5% uplift should rule out the exemption, given that it was effectively required by transfer pricing rules for direct tax;
- whether the exemption could apply to a service bought in from Norway, which is not a member of the EU.

The UK made submissions and took part in the hearing. The A-G noted that Latvia only implemented art.132(1)(f) on 1 January 2014, but the referring court considered that it had direct effect in Latvia before that

date. Germany and the UK argued that art.132(1)(f) was not sufficiently precise to have direct effect: Germany suggested that Member States were given the power to determine the sectors to be covered, and the UK argued that Member States would have to adopt rules on the legal form of a group and conditions for membership. The A-G disagreed. In her view, the provision was clear and unconditional, and was not subject to provisions of national civil law. It had direct effect.

The A-G considered the question about the legal form of the "group" to be fundamental. Did the exempt services have to be supplied by a separate entity, or could they simply be supplied between a group of related undertakings as in this case?

The A-G considered that a supply, for the purposes of the exemption, had to be made by "a taxable person acting as such". That would not necessarily have to be a legal person, but it would have to be an "independent" person. She noted that the exemption applies to supplies "by the group to its members but not vice versa". This confirmed her view that supplies by members of a corporate group to each other did not fall within the exemption, because there was no "independent taxable person" making the exempt supplies.

The A-G also considered that a 5% uplift contravened the requirement that the members merely reimburse their exact share of the group's expenses. The fact that a direct tax rule required the uplift was irrelevant.

She also answered the other questions, without such detailed consideration, as follows:

- Art.132(1)(f) covers, for the present purposes, only groups of taxable persons which carry out exempt transactions in accordance with Art.132(1) PVD fall within the scope of art.132(1)(f). Groups of financial services undertakings do not therefore fall within the scope of art.132(1)(f) [because they are exempt within art.135, not art.132].
- The independent group of persons may supply exempt services only to members that are subject to the same legal order, namely its own.

CJEU (A-G) (Case C-326/15): *DNB Banka AS*

The same A-G has given an opinion on a similar case which concerned the "material scope" (whether it could cover insurance), "geographical scope" (application to cross-border transactions), and the stipulation that there should be no distortion of competition.

The Aviva group provides insurance products throughout the EU. It wanted to establish an EEIG (European Economic Interest Grouping), which is a direct tax related structure for sharing services. The EEIG regulations prohibit it from making any profit, so presumably it must only recharge exact shares of underlying cost. It was noted that the EEIG would provide services to group companies in 12 different member states; those group companies would provide mainly exempt services in the insurance sector, but might have some incidental taxable activities as well.

Aviva wanted a ruling that the cost-sharing exemption would apply. The Polish authorities took the view that the "non-distortion of competition" condition would be violated. Questions were referred to the CJEU about the need for domestic legislation specifically dealing with the question of distortion (there were no such provisions in the Polish law); and, if it was

acceptable not to have any specific law, how the principle should be applied. A third question asked how the cross-border nature of the group affected the other questions.

The A-G considered that the purpose of the exemption was to reduce the competitive disadvantages that taxable persons sharing resources would otherwise suffer. This was not, contrary to the submission by the Commission, a departure from the principle of fiscal neutrality. Insurance and banking services were exempted under art.135 for reasons different from those applicable to the activities exempted under art.132 (respectively, the imposition of insurance taxes and the difficulty of determining a taxable amount). Both the purpose, and the positioning of art.132(1)(f) within the "public interest exemptions" rather than as a provision applicable to exemptions in general, suggested to the A-G that it should only apply to art.132 exempt bodies. If the principle should be extended to art.135 exemptions, that would be a matter for the legislature.

The principle of fiscal neutrality did not require the exemption to be available. Neutrality required deduction of input tax if inputs were used for taxable transactions, and equal treatment of similar businesses. Neither of these suggested that exemption should be applied to transactions within a group of insurance companies.

In case the full court took a different view of the basic applicability of the provision, the A-G went on to consider whether art.132(1)(f) should apply to cross-border transactions. She noted that some provisions (e.g. art.11) explicitly ruled out cross-border application, and others (e.g. art.148(e)) explicitly referred to it. Art.132(1)(f) made no mention either way. She therefore took no inference from the wording of the law.

Rather, she considered in some detail:

- the history of the exemption scheme;
- the scheme of the exemptions;
- the evaluation of art.11(1) PVD (which requires VAT groups all to be established in a single Member State);
- the competition clause in art.132(1)(f); and
- the possibility of exploitation of different regimes in different countries.

In relation to the first two points, the A-G noted that art.13 6th Directive was headed "exemptions within the territory of the Member State", and cross-border exemptions are dealt with separately in a later chapter of the PVD.

As art.11(1) only allows grouping (disregard of transactions) between companies established in the same Member State, it would be inconsistent to allow art.132(1)(f) (exemption) apply across border.

The CJEU's approach to distortion of competition required a Member State to consider an activity in itself, without regard to the circumstances of a particular local market. The context of this statement in the *Isle of Wight Council* case suggested that the Member State should consider the operation of the VAT rules in the Member State as a whole. It would be practically impossible for the Member State to consider the circumstances of other countries as well.

The A-G considered that a strict interpretation of the exemption rule would not contravene the fundamental freedoms in the EU Treaty. It would also prevent the possibility of exploitation by international groups that might otherwise organise central buying of services in a non-VAT country such as the USA, followed by an exempt supply to the EU group, avoiding the reverse charge that would be charged on a direct purchase by the EU company.

If the full court considered that the exemption was in principle available, the A-G suggested the following as a way of assessing whether it would create a risk of a distortion of competition:

An indication that the exemption provided for in Art.132(1)(f) PVD is being applied inappropriately may be that the group supplies the same services for consideration to non-members and is to that extent, by exploiting effects of synergy, operating on the market. This may constitute a correspondingly genuine risk of distortion of competition. Another indication may be that the primary purpose of the group's formation is simply to optimise the input VAT burden (that is to say, to create a competitive advantage by switching any necessary peripheral services to a group) rather than to establish reciprocal cooperation with a view to avoiding a competitive disadvantage. Yet another indication may be that the group does not supply any services tailored to the specific needs of its members, with the result that its services could just as easily be offered by others too.

After a long and detailed consideration, the A-G's recommendation to the CJEU for its answers to the questions was very brief. She said that it was necessary to apply a restrictive interpretation of "distortion of competition", even if it was not in the Polish law. The exemption also only applied to supplies by a group to those of its members who are subject to the same legal system as itself, i.e. established in the same Member State.

CJEU (A-G) (Case C-605/15): *Minister Finansów v Aviva Towarzystwo Ubezpieczeń na Życie S.A. w Warszawie*

The fourth case on independent groups is an infringement proceeding taken by the Commission against Germany. The opinion has been given by A-G Wathelet. The Commission has asked for a declaration that Germany's rules, which restrict the scope of art.132(1)(f) to particular professions (in particular, medical and hospital service suppliers), contravene the PVD.

The German government argued that the Member State had the power to determine which sectors could be covered by an exemption for independent groups without creating a risk of a distortion of competition. Germany had considered the matter and decided that only the health sector satisfied this condition. The Commission responded that distortion of competition had to be considered in relation to the facts of an individual case, so it was not possible to take such a general position on distortion in relation to "all sectors other than healthcare".

A-G Wathelet has come to a conclusion rather different from that of A-G Kokott. He does not consider that a "taxable person" is required to make the "group's" supplies; he does not consider that the cost-sharing exemption is restricted to art.132 exempt bodies (and therefore even more

clearly not to healthcare suppliers, which are a subset of art.132). In his view, the objective of the exemption is to prevent a sticking VAT cost being created by a group of exempt businesses sharing costs – that objective applies equally to all exempt businesses, not just those in healthcare or even those exempt under art.132.

The A-G noted that the 6th Directive originally contained permission to restrict this exemption to the healthcare sector. However, that was abolished with effect from 1 January 1990, and was not reintroduced by the PVD in 2006. The A-G examined a number of other detailed arguments, including comments from the *Banka* and *Aviva* cases, and concluded that the German restriction of the exemption was not justified.

He then turned to a second set of arguments about distortion of competition. He agreed with the Commission that distortion could not be assessed in such a general way – it had to be considered in relation to the facts of particular cases. He also did not accept that, even if it was possible to make such a general assessment, the German authorities had done so with sufficient rigour and detailed analysis to justify the conclusion that there was such a general problem in all sectors other than healthcare.

His conclusion was that Germany's restrictive rules did not comply with the PVD.

CJEU (A-G) (Case C-616/15): *Commission v Germany*

4.4.9 Direct needs of a vessel

Services linked to the direct needs of vessels used for navigation on the high seas are exempt (with credit for input tax, i.e. zero-rated) under PVD art.148. Questions were referred to the CJEU from Finland to determine whether this could apply to a sub-contractor who carried out such activities but invoiced someone else who invoiced the person operating the ship.

The Court ruled that the exemption was inherent in the activities, and did not apply only at the final stage of consumption or the end of the commercial chain. Supplies of services made at an earlier stage, such as services supplied by a sub-contractor to an economic operator which then re-invoiced them to a freight forwarder or transporter and, second, services for loading and unloading of cargo supplied to the holders of that cargo, such as the exporter or importer, could also be exempt.

CJEU (Case C-33/16): *A Oy v Veronsaajien oikeudenvalvontayksikkö*

4.4.10 Settlement of tax arrears

A Polish property company was liable for arrears of tax. It reached an agreement with a municipality to discharge some of its tax debt by transferring some of its property. The tax authorities ruled that this was a taxable transaction subject to VAT. The Polish court considered that it was not clear that settlement of a tax debt constituted "consideration" for VAT purposes, so questions were referred to the CJEU.

The Court ruled that, although there was a relationship of debtor and creditor between the parties, a tax debt was a unilateral obligation because the creation of the tax debt did not involve any reciprocity. The Court

therefore ruled that the transfer of property in satisfaction of a tax debt did not constitute the supply of goods for consideration, and it was therefore not in principle subject to VAT.

CJEU (Case C-36/16): *Minister Finansow v Posnania Investment SA*

4.4.11 More overheads

Advocate-General Kokott puts forward an interesting summary of the issues at the beginning of her opinion in a recent case. The answer that the full court gives could be important in an area in which HMRC frequently appear to disagree with taxpayers (and the FTT).

1. How close or broad, from the point of view of VAT law, must be the link between the costs, on which VAT is charged, borne by an operator in order to generate revenue and his taxable transactions for deduction of input tax to be possible? Is it sufficient that the costs were beneficial or necessary for the undertaking? Is the mere cause of the costs by notified revenue enough or must the costs be directly and immediately allocated to the undertaking's revenue liable to VAT?

2. Is it sufficient, for example, if an undertaking arranges the renovation of the municipal waste-water infrastructure in order to obtain building permits for its buildings, which are to be leased on a taxable basis in future? Or do the renovation costs have to be allocated directly and immediately to particular transactions of the undertaking? In the latter case, deduction of input tax by the undertaking for the renovation costs depends on the assessment of the supply to the municipality, as the undertaking supplies the renovation directly and immediately to the municipality in its function as the authority responsible for waste-water disposal.

3. The Court is called on to consider these fundamental questions in these preliminary ruling proceedings. In answering them, regard must also be had to the Court's recent judgment in Sveda. That judgment has created some uncertainty in the Member States over the extent of the deduction of input tax. In the present case the Court now has an opportunity to clarify the statements made in that judgment.

In the case the company owned some land on which a holiday village was to be constructed. Income from letting the holiday accommodation would be taxable. However, the existing waste-water infrastructure, which belonged to the municipality, was inadequate to service the needs of the new buildings. Accordingly, the company entered into an agreement with the municipality whereby it paid for the upgrading of the infrastructure. It claimed input tax on the cost, and the tax authorities refused. The Bulgarian Administrative Court held that the company had provided a service to the municipality free of charge; however, there was a link between the costs and the overall taxable activities of the company, and as a result the input tax was deductible. This decision was reached on the basis of "expert accounting evidence" to show the relationship between the costs of the infrastructure work and the taxable outputs. Questions were then referred to the CJEU.

The Bulgarian law contains a specific disallowance of VAT incurred on costs incurred in improving a property owned by someone else and enjoyed by both parties, if no charge is made. One of the questions asked

whether this was permissible as a matter of law; the second asked whether, regardless of the Bulgarian law, it would be contrary to art.168 PVD to refuse deduction in these circumstances.

The A-G stressed that the manner of reflecting transactions in the entity's accounts could not be relevant for VAT. VAT taxes transactions, not "appreciations", so it ignores the accruals concept and never requires the presentation of a statement of assets and liabilities. How a cost is entered in the accounts will neither strengthen nor weaken a case for deduction.

The A-G went on to disagree with the company and the Commission in relation to the conditions for deduction. She said that both of them argued that "a merely causal link between inputs and economic outputs ... is sufficient for the deduction of input tax". She distinguished between an "economic allocation" and an "economic cause". Allocation was part of measuring profits, but it was not the test for VAT – art.168 refers to "use for the purposes of the taxed transactions", which is more positive than a simple allocation.

She pointed out that the whole scheme of input tax was part of the cumulative method of collecting VAT. Input tax was deductible because the cost was passed on to someone else who would account for output tax. If there was not such a specific relationship between inputs and taxed outputs, there was a risk that final consumption would not be taxed.

She drew a distinction between the costs in this case, and costs that were not related to anything particular, but were nevertheless connected with the economic activity as a whole. Such costs were costs components of the goods or services that the entity supplied, and the CJEU has held them to be deductible. However, if there is a direct link with a particular output, then using that output is the more precise method for determining the entitlement to deduct input tax. The more precise method takes precedence over a general consideration of total turnover.

It made no difference in the present case that the renovation of the infrastructure was a condition for the implementation of the construction project. The underlying purpose or motive was also irrelevant. The crucial factor was who – the taxable person or a third party – actually used the input and whether this would give rise to untaxed final consumption. In this case, only the municipality directly used the construction services for waste-water disposal, because only it maintained and operated the renovated infrastructure.

The situation was distinguished from *Sveda*, because in *Sveda* the company used the mythology trail for its own economic purposes. There was a direct and immediate link to its taxable outputs that was missing in the present case.

The A-G commented on the possible application of art.26 PVD to a supply of services "free of charge". It was possible that this was a barter transaction: the supply of the infrastructure improvements in exchange for the advantage of being granted building permits. In that case, the input tax would be deductible, but output tax of the same amount would be due. Otherwise, there would be no output tax, and no input tax either. The "deemed supply" in art.26(1)(b) would not apply because the costs were not incurred for "purposes other than the purposes of the business".

This opinion, if upheld, will clearly restrict the application of *Sveda*, but it is less clear exactly when either case will apply.

CJEU (A-G) (Case C-132/16): *Direktor na Direktsia 'Obzhalvane i danachno-osiguritelna praktika' — Sofia v 'Iberdrola Inmobiliaria Real Estate Investments' EOOD*

4.5 Foreign refund reclaims

4.5.1 No economic activity

A company incorporated in the Cayman Islands leased, and then bought, tools from a UK VAT registered company, and then leased them to a Netherlands group company for no consideration. It made a claim for repayment of the input tax under the 13th Directive; HMRC refused the claim on the grounds that there was no economic activity, because there was no consideration.

The company argued that it had an overall economic activity that including no non-economic activities and no exempt activities. It made taxable sales of spare parts (separate from the tools that it leased in and leased out intra-group). On the basis of *Sveda*, the input tax on the leasing of the tools related to the whole of its economic activities and should be allowed.

The judge (Jonathan Richards) said that the CJEU had set out two tests in *Sveda*. The claimant must have incurred the input tax in the capacity of a taxable person and there must be a direct and immediate link to the person's taxed outputs. That link does not have to be individual and specific, as it can apply to the taxed outputs as a whole; however, it must exist.

The judge considered precedents including *Sveda* and *Associated Newspapers*. He commented that the facts of those cases were clear and it was easy to see a direct link between the claimed tax and the outputs of the business as a whole. It was less clear in the current case. No clear explanation had been given for the decision to obtain the tools at a cost and then lease them to a group company for no consideration. The company's witness had speculated that it might be something to do with direct tax, but whatever it was, the judge considered that it was not economic. There was no direct and immediate link between the tool costs and the taxed sales of spare parts, because they were a separate activity. The decision to incur cost and not to make onward charges was not the decision of an economic operator. Accordingly, neither of the *Sveda* tests was satisfied, and HMRC were correct to refuse repayment of the tax.

First-Tier Tribunal (TC05806): *JDI International Leasing Ltd*

5. INPUTS

5.1 Economic activity

5.1.1 Article

In an article entitled *On The Right Track?* Neil Warren questions HMRC's policy and understanding on overhead input tax. He analyses the *Sveda* decision and comments on cases in which HMRC do not appear to have absorbed its significance.

Taxation, 1 June 2017

5.2 Who receives the supply?

Nothing to report.

5.3 Partial exemption

5.3.1 Company's PESM considered

VW Financial Services have been engaged in a long-running dispute with HMRC over the appropriate way to apportion and recover overhead input tax in a business providing hire purchase finance for cars. The problem is that a HP financier buys and sells the car, so it has substantial taxable turnover as well as exempt interest income; but HMRC have regarded it as essentially a financial business that should not recover input tax on overheads.

The FTT (TC01401) upheld the company's appeal against a refusal by HMRC to accept its proposed partial exemption special method. In late 2012, the Upper Tribunal overturned that decision. The Court of Appeal reversed it again, restoring the FTT's decision. The Supreme Court has now confirmed the Court of Appeal's decision, ending the matter (for now, unless HMRC manage to come up with a better argument for later periods).

Background

There has been a long-running dispute between the leasing industry and HMRC about the proper attribution of overhead input tax. In R&C Brief 31/2007, they declared a new policy to be applied from 1 April 2007 onwards: HP finance was to be treated as a wholly exempt activity, even if legally there was a taxable supply of goods, and as a result the overhead input tax incurred by an HP financier was to be regarded as wholly attributable to making exempt supplies. The logic behind this approach was explained as follows:

"*In most HP transactions, the goods are resold at cost without any margin to cover overhead costs. As there is no margin on the HP goods, the cost of the overheads will normally be built into the price of the supply of*

credit. In this scenario, HMRC's view is that the overheads are purely cost components of the exempt supply. Otherwise the business would continually enjoy net VAT refunds despite:

- *making no zero-rated or reduced rate supplies; and*
- *charging a total consideration under the HP agreement that fully recovers its costs and an element of profit.*"

This Brief was later reissued as RCB 82/2009.

VW Financial Services agreed a partial exemption special method with Customs in August 2000. It was based on a 1984 agreement between the Finance Leasing Association and Customs that restricted recoverable overhead input tax in a finance business to 15%. However, the FLA withdrew from the 1984 agreement during 2000. In 2007, VWFS returned to HMRC with a suggestion for a new PESM. By this time, the new policy was in operation, and the company's proposal could not be agreed – they suggested that the overhead input tax in relation to retail business should be determined by the proportion which taxable transactions bore to total transactions. This transaction count was based on every HP agreement being two transactions (one taxable, one exempt), every leasing transaction being two transactions (both taxable) and every fixed price service and maintenance contract as one (taxable) transaction. On this basis, 50% of the residual input tax referable to HP transactions was recoverable.

For the four periods 10/07 to 07/08, the company applied its preferred PESM and received assessments against which it appealed. After that it operated HMRC's preferred method and made voluntary disclosures to claim more input tax, and appealed against HMRC's refusal to pay these. The total amount in issue before the Tribunal was about £500,000.

First-Tier Tribunal

The FTT examined the organisation of VWFS into eight departments and the way it did business. It also went through the PESM in detail. The company's approach was to apportion overhead input tax between the number of taxable and exempt transactions (i.e. payments received, rather than contracts entered into) in each period, without regard to their value. HMRC divided the input tax between the different classes of business, but then used a value-based apportionment in which no account was taken of the initial value of the taxable car. A small amount was still recoverable under HMRC's method because there were other taxable supplies such as settlement charges and option to purchase fees.

The FTT considered a number of precedents on the basis for deducting input tax on overheads, including *BLP Group plc*, *Abbey National plc*, *Midland Bank plc, Kretztechnik*, *Cibo Participations* and *AB SKF*. The FTT came to the conclusion that HMRC's approach was not logical: to attribute overheads entirely to the exempt part of a mixed transaction was inherently unfair and unreasonable. It was not necessary for the input tax to be passed on to the consumer in the form of a directly identifiable element of the price charged. The input tax was incurred in relation to both taxable and exempt transactions, and VWFS's approach was a reasonable one.

The FTT considered that it had to make a choice between the proposals by the two parties: it could allow the appeal and uphold what the company suggested, or dismiss the appeal and accept what HMRC suggested. It concluded that, of the two, the company's approach was more fair and reasonable.

Upper Tribunal

The Upper Tribunal considered that it was necessary to characterise the trader's business. If it was truly engaged in taxable vehicle sales, the FTT decision would be reasonable; if, as HMRC argued, it was purely a financial business, then the overhead costs did not have a link to the taxed transactions, and a PESM which produced such a high recovery would not be reasonable.

HMRC submitted that the company made no profit on the taxable transactions, so it had to bear all of its costs out of its exempt income. HMRC's counsel argued that this meant its overheads were only a cost component of its exempt supplies and could never be recoverable. The Tribunal rejected this conclusion, holding that it was necessary to look at the facts of each case to determine whether there was a sufficient link to taxable activities to justify some recovery.

However, the Tribunal concluded on the basis of the facts of this case that VWFS is a financial business and its input tax recovery has to be viewed in that light. It takes no part in the sale of the cars, and cannot affect the price at which they are sold; those sales are not even shown in its statutory accounts. The judge commented:

We feel that the FTT may have been misdirected by looking at the matter purely through VAT-tinted spectacles. What is required is a focus on economic realities. It is true that VWFS's transactions will always involve a taxable transaction and an exempt transaction inextricably intertwined. But the finance transaction is, to put the matter colloquially, the 'main event' for VWFS. It is what VWFS is all about. Without it, VWFS would be a wholly unnecessary intervener.

The decision was that VWFS's PESM was not a fair and reasonable method. HMRC's assessment was based on a different PESM which excluded the value of the car itself, and as the UT has upheld the assessment, that implies approval of the imposition of that method.

Court of Appeal

The company appealed to the Court of Appeal. It argued that the UT was wrong to conclude that none of the overhead input tax of the company was incurred in making taxable supplies of motor vehicles. The CA agreed: the company was not a pure financial services business such as a bank. To make its supplies of HP finance, it had to make supplies of the cars as well. Neither part of the business could exist without the other. The FTT had therefore been entitled to conclude that the general overheads had been used to some extent in making taxable supplies.

HMRC maintained that they had put forward an alternative argument that a lesser apportionment than the PESM's 50% recovery was appropriate, if they were wrong that no recovery should be allowed. The CA did not accept that this had been part of the argument in the FTT. The challenge had been based on the view that no attribution to taxable supplies was

permissible. As the FTT had rejected this point of principle, it had no alternative but to allow the company's proposed PESM instead. The CA was satisfied that the FTT's decision contained no error of law, and restored it, overturning the UT's decision.

Supreme Court

HMRC appealed to the Supreme Court, which has decided to refer questions on the main issue to the CJEU.

In a brief decision, the Supreme Court considered a subsidiary ground of appeal by HMRC. They argued again that the FTT should have taken a middle road between the company's unduly favourable recovery and HMRC's proposal, if it regarded HMRC's proposal as insufficiently generous. HMRC relied on the judgment of Carnwath LJ in *Pegasus Birds Ltd* (2004), in which he had suggested the Tribunal should not only be concerned with whether HMRC had exercised best judgement, but whether the right amount of tax had been assessed. The Court disagreed that this was relevant. That had not been a statement of general principle, but had been applicable to the particular facts of that case. Here, the tribunal was dealing with substantial litigants, represented by experienced counsel: it was entitled to assume that the parties would have identified with some care what they regarded as relevant issues for decision. The FTT had described the issue before it clearly as "The dispute is not on the weighting, but on whether any part of the residual input tax should be attributed at all to the taxable supply of the vehicle." There was no indication that it had misunderstood its task, nor that it had come to the wrong conclusion on that task on the basis of the evidence before it.

HMRC's appeal on this secondary ground was dismissed again.

Supreme Court: *Volkswagen Financial Services (UK) Ltd v HMRC*

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 Related company invoice

HMRC denied a company a deduction of input tax amounting to £33,350 for its return period 03/13, together with a penalty of £28,346 based on deliberate and concealed behaviour. This related solely to one invoice for £200,097, including VAT, issued by a connected building company. The two companies were part of a group involved in the property sector and controlled by a family. The company that claimed the input tax had acted as a developer; the building contractor had gone into liquidation. HMRC objected to the deduction on the grounds that there had not been a genuine supply; that the invoice did not contain an adequate description; that the supply had not been paid for; and that the fact that the supplier had not paid over the output tax constituted *Kittel* grounds for disallowance.

The Tribunal started with the CJEU decision in *Barlis 06* (Case C-516/14), which considered the effect of inadequacies in VAT invoices. That drew the familiar distinction between the "formal conditions" for deduction (a compliant invoice) and the "substantive conditions" (receipt of a supply for consideration to be used in taxable transactions). The Tribunal was satisfied from the evidence before it that the substantive conditions for the deduction were met in this case, in spite of problems with the paperwork.

The Tribunal accepted that offsetting the debt for the invoice against balances due to the appellant constituted "payment" for VAT purposes, which meant that s.26A VATA 1994 was not applicable.

As regards *Kittel* and the penalty, HMRC argued that the supplier had delayed raising or posting the invoice until after the liquidation commenced and it was therefore unlikely that the output tax would be paid to HMRC. The Tribunal accepted the evidence of the director that this was due to administrative errors rather than dishonest conduct. The staff concerned were helping the insolvency practitioner and there was muddle and confusion rather than fraudulent intent. There had been a genuine hope that the insolvency procedure would rescue the supplier company.

The appeal was allowed against both the assessment and the penalty.

First-Tier Tribunal (TC05867): *Oval Estates (Bath) Ltd*

5.8.2 Televisions and missing traders

A wholesaler of electrical goods appealed against HMRC's denial of input tax totalling £107,838 for monthly accounting periods 10/09 and 08/10 – 10/10. The disallowance related to alleged connection with missing trader fraud. Somewhat unusually, this related to only a small part of the company's trade, being specific transactions in televisions. The total turnover was much higher, most of it not in dispute.

The FTT (TC04625) examined the background to the trade, the due diligence carried out, and warnings given by HMRC about missing trader fraud. It concluded that, in relation to the deals on which HMRC sought to disallow input tax, the due diligence had been inadequate. A reasonably diligent trader would have asked more questions and would

have concluded that the deals were not honest: this constituted "means of knowledge", and the appeal against the disallowance was dismissed.

The company appealed to the Upper Tribunal, arguing that the FTT had erred in law in its interpretation the evidential burden placed on HMRC by the *Kittel* test, as expounded by the UK CA in *Mobilx*. According to the company, in order to show that there was "no possible explanation other than a connection with fraud", HMRC would have to eliminate all other possible explanations. The judges (Mrs Justice Proudman and Judge Greg Sinfield) considered the precedent cases before dismissing this argument quite briefly. The company's argument placed a weight on the words used by Moses LJ in *Mobilx* that they cannot bear. It would be unreasonable to expect HMRC to consider all other possible reasonable explanations, and to gather evidence to counter them, even where the appellant has not sought to rely on them.

By contrast, if the trader actually puts forward a different explanation, both the Tribunal and HMRC accepted that it may be necessary for HMRC to show that the only reasonable explanation was fraud. It was clear from *Davis & Dann* that the FTT's task in such a case is to have regard to all the circumstances, both individually and cumulatively, and then decide whether HMRC have proved that the appellant should have known of the connection with fraud. In assessing the overall picture, the FTT may consider whether the only reasonable conclusion was that the purchases were connected with fraud. Whether the circumstances of the transactions can reasonably be regarded as having an explanation other than a connection with fraud, or whether the existence of such a connection is the only reasonable explanation, is a question of fact and evaluation that must be decided on the evidence in the particular case. The appeal was dismissed again.

Upper Tribunal: *AC (Wholesale) Ltd v HMRC*

5.8.3 MTIC decision upheld

An amazingly long FTT decision (TC04341) considered claims by two companies to £15m in relation to deals in April to June 2006. Over 915 paragraphs, Judge Demack examined the trading of the companies in great detail, and reached the conclusion that the due diligence carried out was mere window-dressing: the directors knew that their transactions must have been connected with fraud, and none of the input tax should be repaid.

The company appealed to the UT, putting forward 12 grounds for arguing that the FTT had made errors of law. The UT agreed that it had done so: there were minor issues with four of the grounds and more significant ones with another three. Nevertheless there was a sufficient basis for the FTT's decision, which was based on a wide range of evidence and the conclusions reasonably drawn from that evidence. After another 188 paragraphs, the appeal was dismissed again.

Upper Tribunal: *BTS Specialised Equipment Ltd (in liquidation) and another v HMRC*

5.8.4 Alternative evidence

A trader was assessed to £124,980 plus interest for periods from 08/11 to 11/12. His business was the facilitation of a "grey market" trade in prestige vehicles such as Porsches, Mercedes and Range Rovers. Manufacturers and dealers in the UK would not want their sales to be exported by a commercial company to Singapore; to get around this, the trader purchased the cars in his own name and sold them on to a company, Great Harvest Ltd, which exported them. To prevent the manufacturers becoming aware of the arrangement, other individuals purchased the vehicles on behalf of the trader. However, the trader claimed that the dealers were well aware of what was going on, and in some cases actively sought him out in order to make sales. The main problem was that the trader's purchase invoices were in the names of the individuals rather than the trader.

The FTT (TC04651) considered a number of precedents on the question of accepting alternative evidence to support an input tax claim. These included *Everycar Contracts Ltd and Sabrina Hammon trading as SJM Group* (TC02801), *McAndrew Utilities Ltd* (TC02406) and *ReemstmaCigarettenfabriken GmbH v Ministero delle Finanze* (CJEU Case C-35/05). It concluded that HMRC must exercise their discretion to allow alternative evidence having regard to the principles of neutrality and effectiveness under Community law.

HMRC argued that the trader had not shown that it was virtually impossible to obtain a valid VAT invoice. In effect, he had chosen not to do so. In respect of a small part of the assessment which related to road fund licences recharged to customers, HMRC argued that these were not non-VATable disbursements, but rather part of a single supply of a taxed vehicle.

The FTT found the trader an honest, credible and helpful witness. It made a number of findings of fact, confirming matters that were not really in dispute. It appeared that HMRC officers had only one reason for denying the input tax claim on the purchase of vehicles: they had considered exercising discretion, but had decided not to do so only because the trader had not produced valid VAT invoices in his own name.

The judge did not agree with HMRC that it was not "virtually impossible or excessively difficult" to obtain those VAT invoices. The whole point of the trade made it unlikely that the dealerships (as opposed to individual managers with whom the trader dealt) would issue replacement invoices. The Tribunal listed the matters that had led it to the conclusion that HMRC's decision was unreasonable:

(1) The inability to obtain VAT invoices in Mr Boyce's name as set out in paragraph 43 above.

(2) The Agency Agreements clearly evidenced the true relationship between the Dealerships, the Named Purchasers and Mr Boyce.

(3) Mr Boyce's bank statements evidenced the payments to the Named Purchasers and tallied with the Dealerships' invoices.

(4) HMRC had previously investigated Mr Boyce's affairs and were presumably satisfied that these arrangements constituted supplies to Mr Boyce.

The FTT noted that HMRC had won the *Everycar* case on apparently similar facts. However, that decision was not binding on the Tribunal, and the judge saw a number of differences of detail in the reasoning underlying the two review decisions by officers. In particular, the officers' decisions in *Everycar* referred to the need to prevent fraud, whereas that was not part of the present case. Also, the dealers in *Everycar* had changed their practice so they did provide regular invoices later; here, the FTT concluded that it was and remained excessively difficult for the trader to obtain them.

The FTT agreed with HMRC that the road fund licence and registration fees were not disbursements; the trader had purchased and sold "taxed and registered cars". The appeal was therefore allowed in respect of £100,663 and dismissed in relation to £2,452. The remainder of the assessment had been agreed between the parties before the hearing.

HMRC appealed to the Upper Tribunal. Mr Justice Arnold accepted their principal ground, that the FTT had misunderstood and misapplied the concept of "effectiveness". The reason for Mr Boyce's inability to obtain proper VAT invoices did not arise from the implementation of EU law in the UK, or from any administrative practice in the UK. It arose from the nature of the transactions he chose to undertake. HMRC had the unfettered discretion to accept alternative evidence to support his deduction of input tax under reg.29; their refusal to exercise that discretion did not mean that the doctrine of effectiveness was infringed, but rather meant that the reasonableness of their refusal should be considered. The judge considered that their refusal could not be said to be a decision that no reasonable body of Commissioners could make; indeed, he agreed with it.

HMRC's appeal was allowed. Rather than remitting the case to another FTT for reconsideration, he remade the decision in HMRC's favour.

Upper Tribunal: *HMRC v Boyce t/a Glenwood*

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 HMRC revise their guidance

HMRC have updated and revised their much criticised guidance from 2014 on the recovery of input tax by holding companies. It now covers the following matters:

- When a shareholding is used as part of an economic activity
- Is the Holding Company the recipient of the supply?
- Is the Holding Company undertaking economic activity for VAT Purposes?
- Shareholding acquired as a direct, continuous and necessary extension
- Intention to make taxable supplies
- Contingent consideration for management services
- The effect of a holding company joining a VAT Group
- Stewardship Costs
- Mixed economic and non-economic activities

The first section, on "use of a shareholding for an economic activity", refers to a change of policy following the CJEU decision in *Larentia + Minerva*. HMRC now state:

In order to be able to deduct VAT incurred on costs of acquiring shareholdings in subsidiaries the following conditions must be satisfied:

- *the holding company making the claim must be the recipient of the supply*
- *the holding company must be undertaking economic activity for VAT purposes*
- *that economic activity must involve the making of taxable supplies.*
- *If the holding company is VAT grouped with its subsidiaries, it makes taxable supplies or loans for which it earns interest and the loans support the making of taxable supplies by the VAT group.*

If the holding company is not the recipient of the supply, or is not undertaking economic activity, it will not be able to recover VAT.

The second condition will be satisfied if the holding company has contracted for the supply, including by novation, and it has made use of the supply, been invoiced and paid for the supply. This is similar to the "*Redrow*" conditions, but it remains an arguable point following such cases as *Airtours*.

The third section, on economic activities, contains the following statement that may still be the subject of further dispute:

Where the Holding company is passive with no economic activity of its own, any VAT incurred on the costs of acquiring subsidiaries is not

recoverable, and this will still be the case if the holding company joins a VAT group with the acquired companies.

There is no clear case law precedent dealing with acquisition costs in a VAT group, but it is at least arguable that they are overheads of the overall economic activity of the deemed single entity.

The section also contains the following statements:

However, if a holding company incurs costs on acquiring shares in subsidiaries intending to make taxable supplies to some of them, but not others, the acquisition of the latter subsidiaries is an investment activity and not an economic activity for VAT Purposes. Accordingly, the VAT incurred should be apportioned between the economic activities and the investment activities.

Alternatively a holding company may incur costs on acquiring shares in a subsidiary to which it both provides management services and makes a loan in respect of which it earns exempt interest. In those circumstances any VAT incurred on costs relating to the holding must be apportioned between the taxable and exempt supplies in line with the company's partial exemption method.

The first paragraph appears to be consistent with the CJEU decision in *MVM*, covered in the April 2017 update. The second is consistent with the older decision in *EDM*. The extent to which inputs are used to make the taxable and exempt supplies is likely to be a complicated assessment, and the standard method is unlikely to be appropriate.

HMRC include, as they did in 2014, the idea of acquiring a subsidiary as a direct, continuous and necessary extension of the taxable economic activity of the holding company. This includes purchasing a subsidiary which owns a property that is used by the holding company, or purchasing a key supplier, customer or competitor. In these situations, HMRC accept that acquisition costs give rise to deductible input tax without the need for a link to management services. This is contrasted with the acquisition of a free-standing enterprise with the intention of returns in the form of dividends or an eventual capital gain.

The following comment is interesting and possibly generous:

The VAT on costs incurred by the target of an acquisition, such as vendor due diligence costs, may also be deductible provided it can be shown that the target is the recipient of the supplies in question and those supplies were received for the purposes of the business carried out by the target.

The guidance acknowledges that a holding company may claim input tax on the basis of an intention to make taxable supplies of management services, in which case it is advisable to keep evidence of that intention. If the intention is not carried through, the normal principles of input tax recovery in relation to aborted activities will apply.

The section on contingent consideration for management services is based on the principles of the *Norseman Gold* case, commenting that there is only a direct link between consideration and the service if the consideration is payable independently of any uncertain factors such as the outcome of the subsidiary's trade.

The section on VAT grouping remains questionable, and may eventually lead to arguments in the Tribunal. It starts with the following statements:

Joining a VAT group does not, of itself give rise automatically to an entitlement to recover VAT. It cannot change a non-economic (i.e. out of the scope) activity into an economic activity. Nor does it automatically create a direct and immediate link between all input costs of a holding company and the taxable outputs of other VAT group members unless such a link can be traced through the intra group supplies, or the input costs are such that they are properly and naturally attributable to the VAT group's taxable outputs.

VAT grouping has the effect that all supplies are treated for VAT purposes as made to and by the representative member and imposes joint and several liability on all the members. It doesn't have any other effect. If a member of a VAT group incurs costs which it uses for non-economic activities, then the VAT on those costs still relates to the non-economic activities and VAT grouping does not change that. The supplies are treated as being used by the representative member for non-economic purposes.

It is clearly correct that VAT incurred for non-economic purposes is and remains not recoverable. However, the suggestion that input tax in a holding company is recoverable by being traced through intra-group supplies appears to ignore the disregarding of those intra-group supplies. The sentence "It doesn't have any other effect" also appears to understate the deeming of a single taxable entity that may incur overheads that are attributable to its economic activities as a whole, and which therefore do not need to be traced item by item to particular outputs.

The section on stewardship costs is also of unclear relevance:

It is important to determine whether the supplies are received by the group for the purposes of the holding company's activities, or for the purposes of the VAT group as a whole. Some supplies may be invoiced to the holding company for convenience (generally referred to as stewardship costs), even though they are for the purposes of the group as a whole. The most common examples are the general audit fees of the group, regulatory compliance, brand defence, bid defence and group legal costs. In those circumstances any input tax incurred should be treated as a cost of the group as a whole, rather than as a cost of the holding company.

These costs are undoubtedly holding company costs. If the holding company is VAT-grouped, they are clearly an overhead of the deemed single entity. If it is not VAT-grouped, they will be recoverable only if they can be related to taxable economic activity in the holding company. There is no special status of "stewardship costs" that gives them any different treatment to other holding company costs.

Lastly, the guidance confirms that a holding company with a mix of economic and non-economic activities will need to apportion its VAT on costs in order to claim a fair amount.

www.gov.uk/hmrc-internal-manuals/vat-input-tax/vit40600

6.2 Other registration rules

6.2.1 Two businesses or one?

A married couple both worked in hairdressing. The husband ran a men's barber's shop from their house, employing ladies to cut hair, and the wife ran a ladies' salon in a converted garage (a separate building). The business had been started by the husband in 1997; the wife gained experience working in her husband's business, then opened her own in 2005.

In 2006 they were approached by an accountant who offered to handle tax matters for them. He prepared accounts and tax returns, and submitted them to HMRC after the couple signed them. He prepared the returns on the basis that the business was a partnership. The profits were divided equally.

HMRC opened an investigation in 2015. The officer determined that the partnership had exceeded the turnover threshold in the 12 months to November 2005, giving a mandatory registration date of 1 January 2006. The officer estimated that the VAT due was £136,000, which in due course led to a belated notification penalty of £15,829.

He contacted the traders and spoke to the wife, who told him that there were in fact two separate businesses, with different premises (separately rated by the council), separate staff and separate tills. There was only one bank account, because the couple had always used a joint bank account since they were married.

The Tribunal found, on the evidence, that each part of the business bore its own expenses, although there were some elements in common. The net takings of each part were then combined and shared 50:50. Both the husband and the wife said that they would make their own independent decisions in any matter of taking a partner or selling their part of the business.

In the Tribunal, the taxpayers' representative put the officers through cross-examination, referring them to various sections of the HMRC manuals on "VAT Single Entity and Disaggregation". The officers accepted that they had not considered the intentions of the parties when they had set up their business (VATDSAG03200), nor carefully distinguished between the personal and business relationships between the married couple (VATDSAG03250).

The representative concentrated on the rules in art.11 PVD which allow a Member State to treat different entities as a single taxable person. This is a little confusing, because HMRC were not applying the related UK legislation in para.1A Sch.1 VATA 1994, but rather simply asserting that there was a single taxable person – a partnership, or business carried on in common with a view of profit. Nevertheless, the representative successfully argued that the way in which the two individuals operated was as two independent small businesses that happened to be in the same location and happened to be operated by people married to each other. They did not share profits as business partners, but as husband and wife.

HMRC put great emphasis (not surprisingly) on the submission of partnership tax returns, and all the elements that were in common – the trading name, the bank account, the insurance and music licence. Their

representative said that he was not asserting that the couple's evidence, that they did not know or understand the meaning of what their accountant was submitting for income tax, was untrue; however, HMRC contended that they were responsible for the accuracy of the information submitted.

The judge commented that a decision in this area was highly fact-specific, so the various Tribunal decisions that had been cited were not of great assistance. He considered instead the principles expounded by the CJEU in *Christine Nigl and others v Finanzamt Waldviertel* (Case C-340/15), which concerned several different operations run by different members of the same family. The necessary objective assessment of independence is to be carried out by examining 'whether the person concerned performs his activities in his own name, on his own behalf and under his own responsibility, and whether he bears the economic risk associated with the carrying-out of those activities'. The judge considered the separate hiring and firing of staff, the immediate assertion by the wife from the outset of the enquiry that there were two separate businesses, and the evidence about separate decisions on a sale, were strong pointers towards independence.

He then considered whether the submission of partnership tax returns counteracted this. He confessed to finding it "puzzling" that they agreed to do this, and that the accountant who filed those returns never considered the possibility of VAT registration. He concluded that the couple did not understand the significance of what they were submitting, and the various common factors were not enough to outweigh the overall objective indicators that they were separate businesses.

The appeal against the registration date, VAT and penalty was allowed.

First-Tier Tribunal (TC05891): *Graham and Christine Belcher*

This case is the subject of an article by Neil Warren in *Taxation*. He describes it as his favourite decision of the year so far.

Taxation, 22 June 2017

6.2.2 Transfer date

A trader appealed against a decision that he should be compulsorily registered from 1 April 2012 to 31 July 2014, together with the assessment for resulting VAT and late registration penalty. He had taken over a convenience store from another trader who was VAT-registered. Contradictory accounts of the date of the transfer had been given to HMRC; at the hearing it became apparent that the transfer had happened later, probably on 12 October 2012. The transferor had continued to file VAT returns up to that date. That required a recalculation of the VAT and the penalty, but in other respects the Tribunal confirmed the decision. In particular, the judge agreed that the penalty should be levied on the "deliberate, not concealed, prompted disclosure" scale. He also expressed dissatisfaction with the figures in the trader's income tax returns, which did not appear to match those in the VAT returns; however, they were not at issue in this appeal. The appeal was allowed in part.

First-Tier Tribunal (TC05910): *Ahmed Rasouli*

6.3 Payments and returns

6.3.1 Change of flat rate

An estate agency partnership registered for VAT and operated the FRS from 1 July 2006. It had applied the same rate, 11%, throughout. HMRC undertook an assurance visit in February 2015, resulting in an assessment for underdeclared VAT on the basis that the rate should have increased to 12% from 4 January 2011.

The trader objected on the grounds that it had not been notified of the increase in rate. HMRC responded that this was not a defence, as it was the trader's responsibility to apply the correct rate. The assessment amounted to £3,420 plus interest. The trader appealed, claiming that HMRC should have "published" the change of rate by writing specifically to the trader. It did not use the internet. HMRC said that it would have received VAT Notes 3/2010, which included the changes.

The Tribunal agreed with HMRC that the trader has the responsibility to make sure that it is aware of the current applicable rules and rates, because VAT is a self-assessed tax. The appeal was dismissed.

First-Tier Tribunal (TC05717): *Hylton Hill*

6.3.2 Leaving the FRS

In an article entitled *Flattening Out*, Mike Thexton confirms the procedures for leaving the Flat Rate Scheme if it is clearly disadvantages following the changes on 1 April 2017. If a business wants to leave the FRS they do so by notifying HMRC, either by writing in or by sending an email to frsapplications.vrs@hmrc.gsi.gov.uk. They need to provide their VAT registration number, the name of their business and the date they are leaving the scheme. The date of leaving is normally the date they notify, but an earlier date can be agreed. If a business has not already submitted a VAT return under the FRS for a period, HMRC will agree a leaving date at any time in the period, even before the date of notification. It is still necessary to notify, but the business can use standard VAT accounting (i.e. start to recover input tax again) from the date that it has chosen without waiting for a response from HMRC. VAT Notice 733 has been updated to show that HMRC will agree the earlier leaving date.

Taxation, 20 April 2017

6.4 Repayment claims

6.4.1 Direct claim against HMRC

Following the CJEU judgment in *JP Morgan Fleming Claverhouse*, HMRC made repayments of VAT charged by investment managers to investment trust companies. This would have been subject to the principles of unjust enrichment – i.e. the managers would have had to pay the money back to their clients, the ITCs – and also subject to capping, in that only 3 years' worth would be repaid. Several ITCs claimed compensation directly from HMRC in respect of the amounts which were not repaid because of the cap.

High Court

In early 2012, the High Court considered that the issues were similar to those in a group action brought by other companies in respect of corporation tax (the "FII Group Litigation"). In that case, the Court of Appeal had held that the claims were time-barred because they were made more than 6 years after the periods concerned. Normally a restitutionary claim can be made within 6 years of the time that the loss could with reasonable diligence have been discovered by the plaintiff – in this case, it was accepted that this would have been the CJEU's ruling in *JP Morgan*.

The judge decided to hold over the litigation pending consideration of the FII Group case by the Supreme Court. In the light of that judgment, which was issued later in 2012, and also the CJEU ruling in *Littlewoods Retail Ltd*, both parties made further submissions to the High Court.

The judge gave a further judgment following these submissions, holding that one of the claims succeeded and another two failed – therefore making sure that both HMRC and the taxpayers were likely to appeal.

The judge was concerned that a claim by someone who bore the burden of the tax, but was not liable to pay it to the authorities (i.e. a customer rather than a registered trader), should be a last resort rather than a freely available alternative. In his view, the precedents showed that, as a matter of EU law, those people should have an effective right to recover tax suffered in breach of the Directive, if no other right was available to them. They could not recover the tax outside the capped period through the suppliers, because those suppliers were subject to the cap; therefore they ought to be able to recover it directly from HMRC.

Three particular trusts were considered in detail: Kleinwort, which was VAT registered and in general recovered 58.4% of its input tax; and F&C and M&G, which were not VAT registered and therefore bore the full cost of any VAT charged. Diagrams were presented to illustrate the flows of fees and VAT in relation to a notional fee which generated output tax of £100; it was supposed that the investment manager might have recovered £25 in input tax as a result. The investment manager would therefore have been able to reclaim £75 under s.80, if a claim had been in time. The judge had to consider whether the claimants had a right to restitution from HMRC in respect of £100, or £75; and if £75, whether there was a separate right of restitution against the investment managers for the remaining £25.

The claims also related to different periods:

- the managers of F&C and M&G had made claims in 2004 for repayment of VAT in respect of the periods from 2001 to 2004, and these were settled by HMRC (and returned to the trusts) after the CJEU decision in JP Morgan;
- Kleinwort had been put into liquidation and had received no management services since 1998, so no claim was made in 2004 because the cap was thought to apply;
- the managers of all three trusts made further *Fleming* claims for periods up to 4 December 1996, and these were also settled by HMRC with interest;

- the claims before the court therefore related to the "dead period" from 4 December 1996 to 20 March 1998 (Kleinwort), 6 April 2001 (F&C) and 1 April 2001 (M&G). The amounts claimed by these three companies was £333,478, £262,289 and £1,790,850; the other claimants were asking for in total £4,844,817.

There were also slight differences in the amounts claimed:

- Kleinwort and F&C claimed the output tax for the dead period, although Kleinwort's claim would be restricted to 41.6% of the output tax as it would have recovered the other 58.4%;
- M&G also claimed the input tax not refunded by HMRC to its manager under the *Fleming* claim, i.e. the £25 in the above notional supply example.

The judge held that the claimants had a restitutionary claim for the full £100, even though HMRC could only have been "enriched" by £75. However, under domestic law, the claims were barred by s.80(7): "*Except as provided by this section, the Commissioners shall not be liable to credit or repay any amount accounted for or paid to them by way of VAT that was not VAT due to them.*" The judge held that this did not only apply to claims for overpaid VAT by the person who accounted for it to HMRC – it would also prevent a claim by a customer who had borne the tax. If a claim could not be made outside s.80, the time limit in s.80(4) would apply.

The judge therefore considered the EU law position. The claimants had "San Giorgio" rights to claim directly from HMRC, either by (a) disapplying s.80(7); (b) allowing the claimants to choose between a "Woolwich" cause of action or a claim based on the principles set out in *Deutsche Morgan Grenfell Group plc* with its extended limitation period; but (c) limiting those claims to a three year limitation period by analogy with s.80(4). The judge decided that, applying these principles, only M&G's claim for the uncapped period could succeed – it should be repaid the £25 not recovered through the manager for the early 1990s, but none of the claims succeeded in respect of the output tax.

Court of Appeal

Both sides appealed. The Court of Appeal had to consider:

- whether HMRC had been unjustly enriched – this is fundamental to any claim for restitution;
- whether the claimants had a claim in restitution against HMRC, arising from the fact that they had paid VAT on the managers' services, even though they had not been accountable for it to HMRC;
- whether the judge had erred in his interpretation of s.80(7) as applying a bar to indirect claims for VAT as well as direct claims;
- whether the claimants could claim for the gross amount of the VAT overpaid to the manager, or could only claim for the net amount that the manager would have been able to recover after adjusting for input tax.

The court decided first that HMRC had only been "enriched" by the net VAT they would have had to repay – the £75. This is because they would have collected the £25 anyway if the UK law had been correctly transposed – it represented output tax properly charged on supplies to the managers, which would not have been credited to the managers if their supplies had been treated as exempt. Any claim for restitution in respect of the £25 could therefore only succeed against the managers, not against HMRC. This was not "virtually impossible or excessively difficult" under the domestic law, so the EU legal claims were not necessary.

The court also decided that the judge was wrong in applying s.80(7) to restitutionary claims. The wording of the section appeared to apply only to claims made by persons who had accounted for the VAT to HMRC, and the judge's construction was "surprising". A person who could claim under s.80(1) could not make any other sort of claim because of s.80(7); but a person who could not claim under s.80(1) was not restricted by it. As a result, the court decided that the claims for £75 in the "dead period" succeeded (reduced by 58.4% in Kleinwort's case).

In effect, both appeals were allowed – HMRC succeeded in reversing the repayment of "the £25" to M&G, but all the companies succeeded in establishing their claims to "the £75" for the dead period.

Supreme Court

Again, both sides appealed. The Supreme Court overturned the decisions below in favour of the taxpayer, and found entirely in favour of HMRC. The claimants had no claim under the UK law of restitution against HMRC – they could only claim against the managers, and they had done so. Even if they had such a claim, it would be ruled out by s.80(7) VATA 1994, which provided that claims for overpaid VAT could only be made under s.80 (i.e. by the trader who had overpaid it). Although EU law provided for direct claims in exceptional circumstances, it did not appear that those exceptional circumstances applied; there was no need for a reference to the CJEU, because the UK's limitations on repayment claims (in their current form) had been held to be compatible with EU law.

The end result, therefore, is that the customers could recover the amounts reclaimed under s.80 by the suppliers, but no more than that. One question remains unanswered: given that the limitation period for claims by the supplier from HMRC is four years, and the limitation period for a customer who has been overcharged by a supplier is probably rather longer, what happens if a customer sues a supplier for six years' worth of VAT that should not have been charged? That does not appear to be considered by this decision.

Supreme Court: *HMRC v Investment Trust Companies*

In an article entitled *Hidden dangers*, Gordon Watt reviews the above case and considers the ramifications of missing reclaim deadlines for possible professional negligence claims against advisers.

Taxation, 29 June 2017

6.4.2 Unjust enrichment

A water utility company was privatised in April 1990 and charged standard rated VAT on certain infrastructure works until 4 December 1996, after which they were treated as zero-rated. The company reclaimed that VAT by a *Fleming* claim filed on 30 March 2009. The amount was approximately £12m: it had not been precisely quantified, but the parties believed it could be agreed if the Tribunal determined whether it was repayable as a matter of principle.

HMRC accepted that the supplies should have been zero-rated, so VAT had been overpaid. They claimed that repayment would unjustly enrich the trader (s.80(3) VATA 1994). That question was the sole issue for the hearing.

The parties agreed that the burden of proof lay with HMRC to show that the VAT had been passed on to the customers. The trader accepted that it had a regional monopoly of supply, so it could not have lost business by charging more for its services. The cost of water connection was so minimal in relation to the cost of a new building that the VAT on it was unlikely to have any effect on the customer or on demand. The company always levied infrastructure charges at the maximum amount allowed by its regulator. The only question for the Tribunal was therefore whether the regulator would have allowed a higher charge if the work was known to be zero-rated. If not, the trader would have suffered no economic damage by levying VAT and handing it over to HMRC.

The maximum amounts set by the regulator were treated as "excluding VAT". Therefore the company had always charged the amount allowed and had added VAT to that. The Tribunal also noted that many of the company's customers would have been developers of new houses or taxable commercial buildings who would have been entitled to recover the VAT charged.

The Tribunal (Judge Barbara Mosedale) considered expert witness evidence relating to the way in which the regulator set the charges and the economic basis underlying the charging system. After detailed consideration of a number of factors, she concluded that it was more likely than not (the standard of proof required) that the regulators set the maximum levels of infrastructure charges without considering VAT at all. That meant that the charges would have been the same even if it had been known that they should have been zero-rated, and the company had suffered no loss. The appeal was dismissed.

First-Tier Tribunal (TC05852): *Anglian Water Services Ltd*

6.4.3 Limitation periods

A taxpayer won an appeal in 2006, showing that certain supplies that it had made were zero-rated takeaway food rather than standard rated catering. When the *Fleming* window for retrospective claims opened, it reclaimed output tax accounted for in historic periods. In due course, it objected to the fact that the *Fleming* window was different for output tax claims (overpaid up to 4 December 1996) and input tax (underclaimed up to 30 April 1997). It argued that the different limitation periods were contrary to its EU legal rights, and it should be allowed to recover the output tax for the period from 4 December 1996 to 30 April 1997.

Questions were referred to the CJEU about the application of the principles of fiscal neutrality, equal treatment and effectiveness.

The CJEU held that the situations of a trader reclaiming overpaid output tax and a trader exercising the right to deduct input tax were not comparable. One was the correction of an error, and the other was simply the application of the VAT system. There was no reason to regard a difference in the rules applicable to the two situations as infringing the principle of equal treatment or fiscal neutrality. The UK law did not breach the PVD or the principles set out in the *Marks & Spencer* judgment.

CJEU (Case C-38/16): *Compass Contract Services Ltd v HMRC*

6.4.4 VAT repayments taxable

A company that operated vending machines received a repayment of £950,000 of VAT and interest in relation to a *Fleming* claim. It showed the receipt in its profit and loss account for its July 2010 period "below the line", and appealed when HMRC ruled that both the VAT and the interest were subject to corporation tax.

The FTT followed the Supreme Court judgment in *Shop Direct* and confirmed the corporation tax liability. The company appealed to the Upper Tribunal, arguing that the corporation tax was an unlawful deduction from the repayment of the VAT that arose from an EU right. The deduction therefore breached the principle of effectiveness, in that its right to a repayment ought to be unfettered. The UT disagreed, ruling that the corporation tax liability was not a deduction from the repayment. The repayment had been made in full, and that exhausted the EU right. What was subject to corporation tax was a profit, and that was only a matter for national law. None of the cases cited by the appellant supported the proposition that the taxation rules must be disapplied when a restitutionary payment leads to a profit recognised in the recipient's trading accounts.

Upper Tribunal: *Coin-a-Drink Ltd v HMRC*

6.5 Timing issues

Nothing to report.

6.6 Records

Nothing to report.

6.7 Assessments

6.7.1 Determination of exact amounts

In TC05327, the FTT gave decisions of principle about the assessment of VAT underdeclared by a takeaway, and related penalties. The parties were subsequently unable to agree the exact amounts from applying these principles, so they had to return to the Tribunal. The main point at issue was that the method recommended by the first decision produced “negative assessments” for some periods; the taxpayer wanted these to be netted off against the liabilities for other periods. On second hearing, the FTT decided that this was not possible – the minimum amount for any individual period was nil, and this should not affect the liability for other periods. The judge determined the exact amounts due for each period.

First-Tier Tribunal (TC05719): *Balti Hut (Gloucester) Ltd and another*

6.7.2 Best judgement

A cash and carry business was assessed for underdeclared VAT totalling £479,000 over the periods from 09/12 to 03/13. The trader appealed, arguing that HMRC’s “best judgement” assessments were excessive (while accepting that there had been underdeclarations). The Tribunal considered the way in which HMRC’s figures had been calculated, and the alternatives proposed by the taxpayer. The following is a useful summary of the Tribunal’s approach:

In determining whether Fio’s had discharged the burden of proof to show positively what corrections should be made to HMRC’s assessments to make them “right or more nearly right”, we considered the following questions in particular as well as all the relevant facts and circumstances:

(a) is the methodology reasonable in principle?

(b) is the methodology adequately supported by underlying business records, and are those records reliable?

(c) does the methodology proper account of the particular facts?

(d) does the methodology produce any surprising or counter-intuitive results and, if so, is there a good explanation for them?

Some minor aspects of the taxpayer’s criticism of HMRC’s methodology was accepted, but this was not so serious as to undermine the validity of the assessments as a whole. There were serious doubts about the reliability of the figures underlying the taxpayer’s alternative suggestions, so the Tribunal concluded that it had not satisfied the burden of proof required to displace the assessments. The appeal was dismissed.

First-Tier Tribunal (TC05820): *Fio’s Cash and Carry Ltd*

HMRC assessed a cafe for underdeclared tax covering a period of two and a half years. The taxpayer’s agent made substantial complaints about the way the investigation was handled and the assessment was raised; when the appeal reached the Tribunal, the technical application of this was to argue that the assessment was wholly invalid as not made to best judgement.

The taxpayer's accountant appeared on its behalf. He put forward a number of criticisms of the calculations used by the HMRC officers, but he did not provide sufficient alternative evidence to support different figures. As the onus was on the trader to displace the assessment, and he had been given ample opportunity to give better information about the way the business ran from day to day, the use of "broad brush estimates" by the officers was justifiable and inevitable. There was an honest attempt to calculate the right amount of tax. The appeal was dismissed.

First-Tier Tribunal (TC05895): *La Belle Vie Ltd*

Another cafe business (sole trader then company) was assessed in relation to an inaccurate split between zero and standard rated sales. The appellants argued that 55% was standard rated, while HMRC considered it should be 85%. VAT of nearly £15,000 was assessed on the sole trader and the company, and penalties of £10,350 were assessed on the "deliberate not concealed" scale. The Tribunal reviewed the calculations and came to the conclusion that the trader had not discharged the burden of proof. Apart from reclassifying one element as zero rated and recalculating the VAT accordingly, the assessments were upheld.

On the other hand, the Tribunal considered that the taxpayer had merely failed to exercise reasonable care, rather than deliberately filing incorrect returns. The penalty was therefore reduced to 22.2% rather than 52.5% of the VAT amount.

First-Tier Tribunal (TC05935): *Michael Llamas and another*

6.8 Penalties and appeals

6.8.1 Default surcharge

A golf club appealed against a 10% surcharge of £649 for late payment of its VAT for 06/16. The trader claimed that previous surcharges and notices had not been received, but the Tribunal considered this unlikely. The return had been submitted on time, and the payment was made late because of a holiday. The Tribunal was satisfied that the correct percentage had been used and there was no reasonable excuse.

First-Tier Tribunal (TC05731): *Oxfordshire Masters Golf Ltd*

A company appealed against a 15% surcharge of £3,430 for its 05/16 period. The company had defaulted a large number of times before, but the penalties had never been this high because the liabilities were lower. The payment was only four days late.

The Tribunal considered the trader's excuse, which was essentially "shortage of funds arising from a particular customer not paying as expected". HMRC responded that the customer had only been invoiced on 29 June, so expecting payment by 7 July was cutting it fine. The trader had not considered asking for time to pay or making a partial payment. Taking into account the many warnings received, the judge did not consider that these were the actions of a reasonably diligent trader. The appeal was dismissed.

First-Tier Tribunal (TC05845): *Morgun Ltd*

A company appealed against surcharges for 18 periods from 05/11 to 09/15 totalling £27,548. The judge examined a long history of confusion and dispute between the taxpayer and HMRC in relation to VAT and other taxes, which included complaints to the trader's MP. He concluded that, although there might be fault on HMRC's side, the trader had consistently filed and paid late, and the surcharges were correctly calculated and not disproportionate. The appeal was dismissed.

First-Tier Tribunal (TC05876): *Total Façade Solutions Ltd*

A company appealed against a 10% surcharge for 02/15 of £8,898 and a 15% surcharge for 05/15 of £8,258. There was a history of defaults and a number of applications for time to pay. In August 2014, the trader had submitted an unsigned change of address form, which HMRC had not actioned because of the lack of signature; they notified the trader of this, but a new signed form was not promptly submitted. This led to other post being returned to HMRC, whereupon HMRC inhibited the account on the basis that the trader had "gone missing". This in turn led to the trader being excluded from the agent system, so when its tax agent tried to submit the 11/14 return, he could not get access. As a result, the 02/15 return covered a 6 month period. The payment was made late in several instalments.

HMRC did accept that the trader had attempted to pay the liability for 11/14 while its account was inhibited, and reduced the 02/15 surcharge to remove the 11/14 element of the liability from the surcharge (even though all of it was only paid after 7 April 2015). The trader made a point of having tried to pay this liability without success, but the judge pointed out that HMRC had given full credit for doing so.

Other excuses offered for 02/15 were rejected, being generic cash flow difficulties and a request to offset CIS deductions. In respect of 05/15, however, there was a *Steptoe* argument – a customer had suddenly started to pay by instalments, and that contributed to an unexpected shortage of funds that resulted in the HMRC direct debit being returned unpaid.

The judge noted a number of features that counted against the application of *Steptoe*, including the fact that the trader was on cash accounting. However, after careful consideration, she decided that the trader had acted with sufficient diligence in this instance to warrant a reasonable excuse defence. The appeal was allowed in respect of the second surcharge.

First-Tier Tribunal (TC05877): *DM Specialist Joinery Ltd*

A company appealed against a 5% surcharge of £877 for its period 07/16. The return had been filed on time, but the payment was made in two instalments, both late. The trader appealed. Its representative argued that the automatic computer generation of surcharge assessments was wrong in law, because someone ought to decide to assess; the liability had not arisen on the date the assessment was issued; and HMRC could not assess a surcharge without having assessed the VAT due for the period.

The Tribunal rejected these arguments. HMRC's programming of a computer to issue assessments in the circumstances of surcharge was appropriate, because it was a purely mechanical and arithmetical exercise. The argument that the liability did not exist on 16 September when it was assessed was based on a misunderstanding of the proper construction of s.59. The argument about "assessment of the VAT due" was based on

s.83(q), which was about hardship applications, and was wholly irrelevant. The appeal was dismissed.

First-Tier Tribunal (TC05878): *Dentech Dental (Materials and Equipment) Ltd*

A company appealed against a 10% surcharge of £25,876 for its 12/15 period. HMRC raised no objection to the appeal being brought late. The trader's grounds of appeal were essentially that the director had not realised the consequences of late payment, and had been too busy on the day in question to organise the payment any quicker. This did not constitute any kind of exceptional circumstance, and the appeal was dismissed.

First-Tier Tribunal (TC05894): *Jestic Ltd*

A firm of solicitors appealed against a series of default surcharges from 05/06 to 05/11, and some s.63 penalties for paying inadequate assessments without pointing out the inadequacy. The appeal finally came to a hearing in May 2017, when the proprietor of the business failed to turn up, saying that she had thought it was listed for July. The Tribunal decided to proceed in her absence.

As no substantive defence was offered, the Tribunal was satisfied – subject to the possibility of the decision being set aside under rule 38 if the appellant objected – that the surcharges had all been correctly calculated and were due. However, there appeared to be a legal hiatus between the repeal of s.63 VATA 1994 and the imposition of the new Sch.24 FA 2007 for paying an inadequate assessment. This meant that the s.63 penalties levied for periods 05/07 to 08/08 should be cancelled.

First-Tier Tribunal (TC05902): *RT Coopers Solicitors*

A company appealed against a number of surcharges, claiming reasonable excuse because of the director's personal circumstances. These included the death of one brother and the serious injury of another (who later died) in a car accident, and the premature birth of a baby to his wife, that led to both mother and child being hospitalised for six months. HMRC accepted that this constituted a reasonable excuse for some periods but not for others, an attitude that the judge found "somewhat baffling". However, he also recognised that the trade had continued during the period in question, so the failure to deal with the VAT returns probably went on longer than it should have done. He allowed the appeal in respect of periods up to 01/15, but not for the periods after that. This would lead to the cancellation of some surcharges and the recalculation of others. The appeal was allowed in part.

First-Tier Tribunal (TC05907): *ABSS Consulting Services Ltd*

A company appealed against five surcharges for periods spanning 11/11 to 08/15, totalling £81,643. By the time of the hearing, it had dropped the appeal in relation to 2011 and 2012, but maintained an appeal against a 2% surcharge for 05/15 of £4,073 and a 5% surcharge for 08/15 of £16,244.

The company moved onto the POA regime on 1 December 2014. It failed to appreciate that it could no longer pay by direct debit, and it took some time before it had sorted out this misunderstanding and started to pay on time. The Tribunal had some sympathy with the trader's representatives, but could not accept that this was a reasonable excuse. HMRC had sent notices explaining the consequences of moving onto POA.

First-Tier Tribunal (TC05944): *Havenridge (Stevenage) Ltd*

A company appealed against 15% surcharges for 03/15 and 06/15 of £19,281 and £15,438. The company argued reasonable excuse (belief that TTP was in place), shortage of funds arising from the economic situation, and disproportionality (the surcharges were more than the average annual profit). The Tribunal also considered the possibility that there might have been a reasonable excuse for one preceding period, 06/14.

The Tribunal examined in detail HMRC's records of contact with the trader to discuss TTP, noting dates of conversations and whether TTP had been agreed and whether it had been adhered to. The judge decided that a TTP request made for 06/14 on 8 August was too late, even if the tax would normally have been collected later than that by direct debit; it was after the due date, and it did not suspend surcharges, even if the agreement was made and adhered to. For 03/15, TTP was applied for by the due date and subsequently agreed by HMRC, but it was not adhered to by the company. For 06/15, TTP had not been agreed. The Tribunal also rejected a defence based on a "reasonable belief that TTP had been agreed".

The other grounds could not constitute a reasonable excuse, so the appeal was dismissed.

First-Tier Tribunal (TC05945): *Finlayson Media Communcations Ltd*

6.8.2 Penalties

A company was assessed to a penalty under s.60 VATA 1994 amounting to £89,001 (60% of the VAT evaded). A notice was issued under s.61 to allocate the penalty to the sole director. This was upheld on review. There was some confusion on both sides about the nature of the appeal: the recipient of a s.61 notice is supposed only to be able to appeal against the attribution of the penalty to his conduct, not against the penalty itself. Only the company can appeal against the penalty. The Tribunal tried to resolve the legal procedure and concluded that, legally speaking, the hearing was only concerned with an appeal under s.61(5)(a), that is, it was about attribution to the individual. The question before the Tribunal was whether the director had acted dishonestly with the result that his company did not pay overdue VAT for nine successive quarters.

The Tribunal examined the history of the trader's difficulties with HMRC – the company had fallen behind with VAT accounting and payments, but the director argued that he had never deliberately intended not to file or not to pay. He had had difficulties with inadequate services from a firm of accountants that had contributed to the delays. The judge decided that HMRC had not discharged the burden of proof to show that the director had acted dishonestly, and allowed the appeal against the s.60 penalty (even though he had earlier said that the appeal was about the s.61 notice).

The judge also commented that he would have set off default surcharges against the s.60 liability. HMRC said that they were two different penalties that were levied for different types of misconduct, so there was no "double jeopardy"; the judge disagreed. However, this point will only be relevant if HMRC appeal the s.60 decision.

First-Tier Tribunal (TC05823): *Plant Force (Leeds) Ltd*

A trader started a new cleaning business and registered for VAT under the flat rate scheme. He had difficulty filing returns, and received a series of estimated assessments. To start with, he made various attempts to resolve the problems with filing, and the judge accepted that this constituted "notification of the inadequacy of the assessment" for the first two periods. After that, there was no such notification until he received a VAT control visit, following which his problems with filing were resolved.

He argued that he had paid a larger amount of VAT each quarter than the amount assessed, and that this was notification of the inadequacy of the assessments. It still turned out to be less than he finally owed, because of further problems discovered at the visit. The judge (Anne Fairpo) decided that merely paying amounts to an HMRC bank account, without further information, could not constitute notification that an assessment was inadequate. The appeal was allowed in respect of the first two periods, and dismissed in respect of the remainder.

First-Tier Tribunal (TC05854): *Silvergate Support Services Ltd*

A trader appealed against a penalty for belated notification of liability to register of £41,666 (mitigated to 12% as an unprompted disclosure of a non-deliberate failure). The due date for notification was 30 January 2012, and the date of notification was 13 May 2014. The trader asked for the penalty to be removed on the basis of special circumstances (not reasonable excuse): he had relied on his accountants, and had acted with due promptness when he changed accountants and became aware that previous advice had been incorrect. He relied on the case of *Hillis* (TC02611) in which a solicitor setting up a new practice had a belated notification penalty mitigated to nil. The trader also argued that he travelled abroad a great deal on business and was unable to respond quickly to HMRC "snail mail".

The Tribunal considered that the case was not "on all fours" with *Hillis*. The delay here was longer, but the trader had notified as soon as he had become aware of the problem, which was not the case in the earlier decision. The Tribunal also rejected a suggestion from HMRC that the much larger amount of tax was relevant to the question of whether mitigation should apply.

The trader also argued for greater mitigation, on the basis that HMRC had not given the maximum discounts for "telling" and "helping". The Tribunal accepted this, increasing the mitigation from 90% to 95% of the difference between the maximum and minimum penalties of 30% and 10%. However, the judge rejected the idea that the nature of the business constituted "special circumstances". The penalty was confirmed in the amount of £38,194.

First-Tier Tribunal (TC05839): *Dance with Mr D Ltd*

6.8.3 Procedure

In a brief directions hearing, the Tribunal allowed an application by the taxpayer to submit additional documents, and an application by HMRC for an adjournment to give sufficient time to consider the documents. Although the applications were late, the Tribunal considered the overall objectives of the process and noted that both parties now considered that Alternative Dispute Resolution might enable them to come to an agreement.

First-Tier Tribunal (TC05850): *Botleigh Grange Hotels Ltd*

6.8.4 Hardship

A company appealed against a refusal by HMRC to accept a “hardship application” in relation to an appeal about £771,430 of disputed input VAT. The company had had its authorisation as a customs warehousekeeper withdrawn in March 2015, after being assessed to claw back input tax in respect of 01/13 to 04/14 in January 2015.

The assessment was in respect of purchases of fizzy drinks that HMRC considered were connected to MTIC frauds. The company hotly denied that it knew or ought to have known of any such connection, and argued that the withdrawal of its approval involved it in considerable expense and loss of profitability. The company was not willing to approach its bankers for additional facilities because they might “pull the plug”. Other lenders were approached, but it would still cause hardship to have to pay so much tax.

The FTT (TC04976) considered a number of precedents on hardship and noted that the purpose of the rule was to allow appeals to proceed without harming the business, where they were more than just a delaying tactic to put off “the evil day” when the tax would have to be paid. Although the judge had no material before him to decide whether this appeal had substantial merit, he did not consider that it was such a delaying tactic. He accepted the claims of the taxpayer that the company could not realistically borrow the money, or sell or charge fixed assets, without harming its business.

The appeal was allowed, and HMRC appealed to the Upper Tribunal. HMRC argued that the FTT had made errors of law in considering that Elbrook’s ability to borrow was irrelevant to the question of hardship, and also in failing to take into account a number of relevant factors. The judges considered the principles, including the fact that a hardship application is “all or nothing”, and hardship should be considered as at the date of the hearing, not at the date the appeal was made.

They then examined and dismissed HMRC’s first ground of appeal. The FTT had made no error of law in concluding that the company could not borrow on its existing facilities, and also in deciding that borrowing against its fixed assets and investments did not constitute “readily available resources”.

The various matters complained of by HMRC in their second ground were also considered in turn. The UT concluded that, while the FTT decision might in places have been "more felicitously worded", there was no error of law either individually or in combination. HMRC's appeal was dismissed.

Upper Tribunal: *HMRC v Elbrook (Cash & Carry) Ltd*

6.8.5 Late appeals

An individual applied for leave to appeal late against various assessments to income tax, NIC, PAYE and VAT. The judge considered a long history of non-compliance with tax obligations, as well as the lateness of the appeals under review, and weighed these against the significant prejudice to the taxpayer if he refused the application (as HMRC were seeking over £1m). He concluded that the taxpayer's delays were so serious and lengthy that his application should be refused.

First-Tier Tribunal (TC05952): *Stuart Browne t/a Sound Solutions*

6.9 Other administration issues

6.9.1 Finance Act

The shortened Finance Act was passed before the election with many sections withdrawn. Clauses that survived the cull included the changes to zero-rating of adapted motor vehicles. The Making Tax Digital legislation was all withdrawn, and the timetable may be delayed by the outcome of the election. New rules on disclosure of VAT avoidance schemes, and penalties for facilitating VAT fraud, were also withdrawn.

http://www.legislation.gov.uk/ukpga/2017/10/contents/enacted

6.9.2 Avoidance spotlight

HMRC have added Spotlight 38 to their targeted list of tax avoidance schemes. They warn that they will open an enquiry into the tax affairs of anyone identified as using an avoidance scheme, generally seek full payment of the tax upfront, and charge penalties and interest if appropriate.

Spotlight 38 is a VAT scheme, described as "attempts to avoid VAT by splitting a single supply of goods or services into separate supplies". This results in a lower rate of VAT on each separate supply than on the single supply, and is classed as supply splitting. HMRC view all VAT supply splitting arrangements that have been designed to reduce the amount of VAT owed as tax avoidance. HMRC consider that such arrangements should be taxed as a single supply where:

- multiple suppliers are used where the same elements could be provided by one supplier;
- the customer has no opportunity to decline to take one of the individual elements.

HMRC won't offer advice regarding VAT supply splitting. Anyone who thinks that they might be at risk of a challenge needs to decide whether their arrangements could be classed as supply splitting based on HMRC's approach to single and multiple supplies and take appropriate action.

If they find that VAT supply splitting has taken place, they say they will continue to challenge these arrangements, which may include applying the *Halifax* abuse principle and taking cases through the courts.

Other VAT spotlight schemes are:

- Spotlight 22: VAT contrived non-profit-making bodies scheme to obtain exemption for sporting or educational/training supplies (July 2013)
- Spotlight 2: VAT artificial leasing
- Business Spotlight 2: VAT Supply splitting avoidance (9 February 2011)
- Business Spotlight 1: VAT Relocation of telecommunication service providers, Internet service providers and broadcasters (9 February 2011) – Withdrawn July 2015 because of the POSMOSS changes on 1 January 2015

www.gov.uk/government/publications/vat-supply-splitting-tax-avoidance-schemes-spotlight-38

6.9.3 Statutory demand

HMRC issued a statutory demand on a taxi driver, claiming he owed them £180,000 in income tax, VAT and penalties for a 14 year period. He applied to have the demand annulled, in order not to be declared bankrupt, because he had a pending appeal to the FTT. The High Court dismissed his application, on the grounds that the Practice Direction precluded the Bankruptcy Court from inquiring into the validity of the assessments on which the statutory demand was based, even if there was an appeal pending. The court should only consider whether to adjourn the application to annul; that would be more likely to be granted in a case where the taxpayer had appealed in time and a decision of the FTT could be expected reasonably soon. In this case, the taxpayer only appealed after service of the statutory demand, was out of time for doing so and, thus, was dependent on the FTT giving him permission to appeal out of time. His appeal was dismissed.

High Court: *Vieira v HMRC*

6.9.4 Recovery of assets

An individual who created a fake trade in computer memory sticks to fraudulently claim millions of pounds of VAT repayments has been ordered to pay back £3.3m. The CPS announced that £2.3m will be recovered almost immediately from restrained assets.

CPS press release, 19 May 2017

6.9.5 Use of labour providers

HMRC have updated their guidance on due diligence procedures for businesses that use labour supplied by a third party. This is intended to help safeguard the business from financial and reputational risk whilst maintaining flexibility of the workforce. HMRC say "We are committed to tackling non-compliance, fraud and illegal working practices so that we fund essential UK services, stop modern slavery, and create a level playing field for all those businesses complying."

www.gov.uk/government/publications/use-of-labour-providers

6.9.6 Campaigns

HMRC have issued guidance on making a disclosure of undeclared income in relation to two "campaigns" – let property and second incomes – but in each case, the guidance points out that VAT is not covered by the process. VAT underdeclarations should be notified in accordance with the VAT notice on correcting errors.

www.gov.uk/government/publications/second-incomes-campaign-your-guide-to-making-a-disclosure; www.gov.uk/government/publications/let-property-campaign-your-guide-to-making-a-disclosure

6.9.7 Article

In an article entitled *Make Sure It's Not You*, Ian Hyde explains the new offence of "failure to prevent the facilitation of tax evasion", commenting that more than three-quarters of senior decision makers in British businesses are unaware of their new responsibilities.

Taxation, 8 June 2017

6.9.8 Updated Notice

HMRC have updated their Notice *Insolvency*, with new contact details for members' voluntary liquidations in paragraph 1.4. There are several other changes relating to clarification of the procedure for notifying the commencement of insolvency procedures and other administrative issues.

VAT Notice 700/56