VAT UPDATE
JULY 2018

Covering material from April – June 2018

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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

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

The HMRC website section which reports the progress of appeals originally said that it would be updated monthly, but it appears to be less frequent or regular than that. The list says "last updated 28 February 2018".

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

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

- *DPAS Ltd*: HMRC appealed points from FTT decision to Upper Tribunal, which decided to refer questions to CJEU after considering the judgments in *Bookit* and *NEC* (Case C-5/17: hearing 24 January 2018, decision awaited).
- *Findmypast Ltd*: HMRC have applied to the Court of Session for leave to appeal to the Supreme Court against the CS ruling that "credits" did not trigger a tax point at the time they were purchased.
- *Gala 1 Ltd v HMRC*: Court of Appeal due to hear taxpayer's appeal against refusal of claims for repayment of output tax on bingo – FTT/UT both ruled that only the representative member of the group could make the repayment claim (not on the HMRC list).
- *Hotels4U.com Ltd*: HMRC have applied for the time limit to appeal to be extended while waiting for FTT to rule on whether to refer questions to the CJEU (time limits extended for this and similar appeals to 5 March 2018).

- *Jigsaw Medical Services Ltd*: HMRC are appealing FTT's decision in favour of taxpayer in case about whether provision of ambulances qualified for zero-rating as passenger transport (hearing date to be confirmed).
- *KE Entertainments Ltd*: HMRC have appealed to Court of Session against UT decision that change of calculation of bingo takings constituted an "adjustment of consideration" within reg.38, rather than leading to a time-capped repayment claim under s.80 (hearing date to be confirmed).
- *LIFE Services Ltd*: partial win for HMRC in the Upper Tribunal; one point to be jointly decided in the Upper Tribunal with *The Learning Centre (Romford) Ltd* (hearing scheduled for December 2018).
- *Lowcostholidays and Lowcostbeds*: being heard with *Hotels4U.com Ltd* (time limits extended to 5 March 2018).
- *Mercedes-Benz Financial Services Ltd*: CJEU decision in favour of taxpayer reported in the January 2018 update; HMRC list notes only that the matter has been passed back to the referring court.
- *MG Rover Group Ltd*: taxpayer is appealing to CA for permission to appeal against UT's ruling that its *Fleming* claim could not succeed as it should have been made by the representative member of the group (hearing listed for January 2019).
- *Pacific Computers Ltd*: MTIC case remitted by the UT to differently constituted FTT for rehearing.
- *Privin Corporation Ltd*: the FTT found in favour of a MTIC appellant. HMRC were granted leave to appeal to the UT, but it was agreed that the case would be remitted to a differently constituted FTT for rehearing.
- *SAE Education Ltd*: company has been granted leave to appeal against CA's ruling that it did not qualify for exemption as a "college of a university".
- *Stoke by Nayland Golf and Leisure Ltd*: HMRC are appealing to the UT against the FTT's ruling that a members' club did not fall foul of anti-avoidance provisions and qualified for exemption (hearing date June 2018).
- *Taylor Clark Leisure plc*: HMRC have been granted leave to appeal against the Court of Session's ruling that the company was entitled to a repayment based on a claim made by a former member of its VAT group registration (Supreme Court hearing listed for 11 April 2018).
- *Tesco Freetime Ltd and Tesco plc*: HMRC are appealing to the UT against FTT finding in favour of taxpayer in relation to tax treatment of loyalty points scheme (hearing date to be confirmed).
- *Totel Ltd v HMRC*: Supreme Court granted taxpayer leave to appeal against Court of Appeal's 2016 ruling on requirement to pay VAT before an appeal could be entertained (hearing commenced 25 April 2018).

1.1.1 Decisions in this update

- *Marriott Rewards LLC and Whitbread Group plc*: both appellants' appeals dismissed by the FTT (TC05634) on place of supply issues. However, the FTT found against HMRC on the fundamental direction of supply point. Marriott and Whitbread have both appealed to the Upper Tribunal and HMRC have cross-appealed.
- *Newey t/a Ocean Finance*: HMRC have been granted leave to appeal to the CA 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 January 2018, decision awaited).
- *Summit Electrical Installations Ltd*: HMRC are appealing to the UT against the FTT's ruling that sub-contractor was entitled to zero-rate work on the basis that a building was "dwellings", even after the main contractor had presented a RRP certificate.
- *Volkswagen Financial Services (UK) Ltd*: Supreme Court has referred the main partial exemption issue to the CJEU but found against HMRC on a secondary issue (hearing of Case C-153/17 February 2018, decision awaited).
- *Wakefield College v HMRC*: the college has appealed to the CA against the UT's ruling that it would use its building for a business purpose and therefore did not qualify for zero-rated construction (hearing 7/8 February 2018, decision awaited).
- *Wetheralds Construction Ltd*: HMRC successfully appealed to the UT 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 Other points on appeals

- *HMRC v Citibank NA*: the Supreme Court dismissed the company's appeal against the CA decision (January 2018 update), overturning the UT decision that HMRC should have pleaded and particularised allegations that the company's transactions were part of an orchestrated scheme to defraud the revenue.
- *Kelly and another (t/a Ludbrook Manor Partnership)*: the CA refused leave to appeal against the UT decision that expenditure recharged by one business to a successor had been "consumed" by the predecessor and could not subsequently be recovered by the successor.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Economic activity

The case of *Wakefield College v HMRC* is directly concerned with whether a charity could receive a supply of construction services zero-rated. However, the principles discussed by the Court of Appeal have much wider application, and have highlighted the importance of a CJEU decision that did not appear particularly significant at the time it was handed down.

The issue for the court was whether the college, a non-profit body, was using a new building for a business purpose or for a non-business purpose. The college provided courses to:

- students who paid full unsubsidised fees;
- students who were fully grant-funded by the government;
- students who paid a fixed, subsidised fee.

The college argued that providing courses to the third category was not a business activity, which would have allowed it to receive the supply of the new building zero-rated. The college acknowledged that the first category were "business", but only a small number of such students used the new building; HMRC acknowledged that the grant-funded students were "non-business". It was agreed that the UK statutory term "business" should equate to the PVD expression "economic activity".

The Court of Appeal noted that there were some 50 disputes, representing about £120m of VAT, that depended on this case.

The judgment starts with a rehearsal of the relevant PVD provisions:

Art.2(1):

"The following transactions shall be subject to VAT:

…

(c) The supply of services for consideration within the territory of a Member State by a taxable person acting as such."

Art.9(1):

"Taxable person" shall mean any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity.

Any activity of producers, traders, or persons supplying services, including mining and agricultural activities and activities of the professions, shall be regarded as 'economic activity'. The exploitation of tangible or intangible property for the purposes of obtaining income therefrom on a continuing basis shall in particular be regarded as an economic activity."

The college put forward the following proposition based on the CJEU case law:

- it is necessary first to decide whether there is a "supply for consideration" within art.2(1) – if not, there cannot be economic activity;
- if there is such a supply, it has to be considered whether the activity is carried on "for remuneration" within art.9(1).

The judge noted that the concept of "remuneration" or "income on a continuing basis" was separate from "consideration"; the CJEU decisions use various different French words to distinguish the concepts, and suggested that it was necessary to consider both the French and the English versions of the judgments in this area.

"Consideration" in art.2 simply refers to value given to the supplier in relation to the supply of particular goods or services. It need not be full value or indeed bear any particular relation to the value of the goods or services supplied.

By contrast, "remuneration" has a broader meaning, and may be said to encapsulate the concept of carrying on an economic activity "for the purposes of obtaining income therefrom on a continuing basis". Those words appear in art.9(1) as qualifying only the exploitation of tangible or intangible property, but it is established by precedent that they apply generally to "economic activity". It can readily be appreciated that goods or services may be supplied for "consideration" without the supplier doing so as an economic activity or for "remuneration". In that event, the supplier will not be supplying the goods or services as a "taxable person", so that VAT will not be payable on the consideration.

The first CJEU decision analysed by the court was *Gemeente Borsele v Staatssecretaris van Financiën* (C-520/14). That concerned subsidised transport supplied by a local authority to schoolchildren. The local authority wanted to be treated as a taxable person supplying services for consideration, because the input tax it suffered on the cost of buying in the transport services was greater than the output tax it would have had to account for on the heavily subsidised charges to parents. The service involved the following:

i) For journeys of up to 6 km the municipality did not cover the cost of transporting schoolchildren.

ii) For journeys of between 6 km and 20 km transport was provided in return for a fixed contribution (equal to the cost of public transport covering a distance of 6km).

iii) For journeys of more than 20 km, transport was provided in return for a payment which could not exceed the price of the transport and which was, in the case of each child, calculated taking into account the parents' income.

The CJEU held that the authority was supplying a service for consideration within art.2, but was not doing so in the capacity of a taxable person within art.9. The Court of Appeal noted the way in which *Borsele* clarified and expanded the earlier decision in *Commission v Finland* (Case C-246/08), in which payments charged to legally aided persons were held not to be chargeable to VAT. There, the A-G had held that part-payment by a client did constitute consideration; but the fact that the amount to be paid by the client was wholly depended on that person's

income, and was in no way linked to the cost of providing the service or its value, meant that the activity could not be regarded as "economic".

On the same basis, the CJEU held in *Borsele* that the local authority was not acting as a taxable person, because it was not carrying on the activity "to obtain income". It was not a market participant, in that it did not offer transport services to anyone else – rather, transport services were a minor and ancillary part of its activities in providing education. The fact that the income only recovered 3% of the costs also counted against this being an economic activity. The local authority was a consumer of transport services, not a supplier.

This distinction between "consideration" and "remuneration" was then applied to the facts of the present case. The subsidised fees paid by students were clearly "consideration" within art.2. The question was whether the level of the subsidy and the nature of the activities were sufficiently similar to *Finland* or *Borsele* so that the activity was not "economic".

The judge noted that the parties had apparently agreed that supplies of courses to the three different classes of student were separate activities that could be considered separately, even though it was possible that students of each type might attend the same course.

The judge gave seven separate reasons for concluding that the provision of courses to subsidised students was an economic activity:

- First, the sole activity of the College, in the most general terms, is the provision of educational courses. It is not comparable to the municipality in *Borsele* for whom the provision of school transport was very much ancillary to its principal activities.
- Second, the provision of courses to students paying subsidised fees is a significant, albeit minority, part of the College's total undertaking.
- Third, the fees paid by such students are significant in amount – the total income from fees earned by the new building was nearly £300,000 in the first year.
- Fourth, the subsidised fees made a significant contribution to the cost of providing courses to the students paying those fees, to the extent of some 25 – 30%.
- Fifth, the level of fees was fixed by reference to the cost of the courses. The national base rate for a course, with an adjustment for a more costly course, may not have precisely equalled the cost to the College of providing the course but it was intended to reflect the cost of the course.
- Sixth, the fees were not fixed by reference to the means of the students or employers or others paying the fees. The fee was a fixed fee for each course, published each year in the College's prospectus. It was set at a low level to encourage students with limited means to apply, but there was no means test.
- Seventh, it is undeniable that there is a market in the provision of further and higher education, whose viability is underpinned by a combination of grant aid and fees. There is no reason to suppose that the College is other than a typical participant in that market or that it

provides courses to students paying subsidised fees on anything other than a typical basis, allowing no doubt for some variations between different institutions.

On the basis of all these factors, the College was held to have acquired the new building for an economic activity, or in UK terms, a business. It was therefore not entitled to the zero-rating relief on the cost.

Court of Appeal: *Wakefield College v HMRC*

2.1.2 Who made the supply?

HMRC became aware of two invoices that purported to be issued by a registered trader which renovated and restored car engines. The invoices related to a supply of silver "scrap bars" for a total consideration of £360,374. The company denied having issued the invoices or made the supplies.

The main director and minority shareholder had explained to HMRC that his family had been negotiating to sell the company to an individual for £5,000. During the course of these negotiations, the individual began to treat the company as his own and made various payments into the company's bank account. The director objected and was told to whom to make repayments of the deposits. The bank statements disclosed payments in and out totalling nearly £360,000.

It appeared that the silver had arrived in two crates during this period. The director had refused to accept them on behalf of the prospective purchaser, and asked for them to be removed. HMRC did not accept these explanations and concluded that the company had bought and supplied the silver.

The Tribunal decided that, on the balance of probabilities, the company did not supply the silver. The invoices were in a different format from the normal invoices issued by the company, and had different e-mail addresses and logo. The explanations given by the director were accepted. There were certain aspects of the director's explanations that were puzzling, but they did not amount to evidence that the company had supplied the silver.

The company's appeal was allowed.

First-Tier Tribunal (TC06403): *Quality Engines Direct Ltd*

2.1.3 Consideration or compensation?

The Advocate-General has given an opinion (not available in English) in a case very similar to the UK appeal by *Esporta Ltd*. It concerned a Portuguese telecommunications company which imposed a minimum contract term on customers. Anyone attempting to cancel the contract early, or simply stopping the monthly instalment payments, was pursued for the unpaid instalments to make up the minimum contracted amount. The company argued that this was compensation (which is what it was called in the contracts) and outside the scope of VAT; A-G Kokott has given an opinion in line with the UK courts in holding that the payment of the contracted amounts was for the delivery of the service, and the way in which it was charged, paid and enforced did not change the VAT treatment. It was all subject to VAT.

The A-G distinguished the situation in *Eugenie-les-Bains* (Case C-277/05) where a forfeited deposit for a hotel room was held to be non-VATable compensation. In that case, there was no service provided, and it was clear that the forfeit was to compensate the hotelier for the breach of contract by the customer. This situation was more similar to *Air France/KLM* (Case C-250/14) and *Hop! Brit-Air* (Case C-289/14), in which the "forfeit" was simply the whole price of a pre-paid air ticket. The fact that the whole price was paid in advance, and a seat was reserved for the passenger, meant that a service had been provided – even if the customer did not turn up to receive the benefit of it.

The A-G noted that the "compensation" was not usually collectable; even so, the tax authorities had sought to assess the VAT on it, using the amount invoiced as the net value of the supply. The taxpayer protested that this could not be right, as at the very least, the VAT fraction should be applied. The A-G said that non-payment should be relieved under art.90 PVD, when it is established with sufficient certainty that its contractual partner will not pay.

CJEU (A-G) (Case C-295/17): *MEO – Serviços de Comunicações e Multimédia v Autoridade Tributária e Aduaneir*

2.1.4 Redemption of shares for transfer of buildings

A Polish pharmaceutical company planned to restructure its share capital through the buy-back of part of the shares held by another company, using a method provided for by Polish company law. The shareholder would receive compensation for the buy-back in the form of a transfer of some land, buildings and equipment. The company applied for a ruling on the VAT treatment of both parts of this transaction – the transfer or redemption of the shares, and the transfer of the physical assets.

The company argued that the redemption was a single complex transaction that should be treated as entirely outside the scope of VAT. It appealed against the Finance Ministry's ruling that the transfer of assets was a taxable transaction, and questions were referred to the CJEU.

The court ruled that it was necessary to consider the two parts of the transaction separately. The redemption of the shares was likely to be an investment transaction that was not subject to VAT, in accordance with the principles of such cases as *Wellcome Trust*. However, there was no reason to disregard the transfer of the buildings and equipment, if they had been used in the economic activities of the company. They were "supplied", and the mutual exchange of rights with the shareholder satisfied the definition of "supply for consideration" according to the case law of the court. The transfer of the buildings might fall within the exemption for land, but it was within the scope of VAT.

CJEU (Case C-295/17): *SZEF Krajowej Administracji Skarbowej v Polfarmex Spółka Akcyjna w Kutnie*

2.2 Disbursements

2.2.1 Solicitors' search fees

During April, the Law Society issued a press release noting that it was aware of firms receiving letters from HMRC about their treatment of search fees following the *Brabners LLP* case last year. Anyone receiving such a letter was encouraged to contact the Society. The Society was "in the process of reviewing its guidance on VAT on disbursements, following the decision in Brabners LLP", and was "engaging with HMRC on the inconsistencies arising from the decision."

www.lawsociety.org.uk/news/stories/vat-on-disbursements-update(1)/

On 30 May, the Law Society published interim guidance on the issue. The guidance discusses the reasoning for the Tribunal's decision and notes the inconsistency between the treatment of postal searches (by concession, regarded as disbursements) and electronic searches (the subject of the case, which was decided on the strict law).

HMRC have confirmed to the Law Society that they do not intend to change the approach set out in their published guidance as to whether a property search fee should be treated as a disbursement for VAT purposes; if the search is passed on to the client without comment or analysis, HMRC says the fee may be treated as a disbursement. However, if the firm uses the search itself, for example in providing advice, or a report, HMRC's view is that the fee will form part of the charges for its services and will be subject to VAT.

HMRC also indicated that the department is willing to work with the Law Society to improve its knowledge of current working practices within the conveyancing sector in order to provide clearer guidance to the profession on the VAT treatment of items of expenditure in the future. The Society welcomed this.

HMRC are reviewing the operation of the concession in relation to postal searches, and have ruled out any possibility of extension to electronic searches. In the circumstances, the Law Society suggests that, in the absence of a binding ruling from an upper court, members "may wish to follow HMRC's guidance" in deciding whether to charge VAT on such recharged expenses.

www.lawsociety.org.uk/news/stories/vat-on-electronic-property-searches--interim-guidance-to-firms/

2.3 Exemptions

2.3.1 Loan administration services

A company provided loan administration services to a UK bank. It asked for a non-statutory ruling in May 2015 in relation to the liability of its supplies, and appealed against HMRC's decision that it was making taxable supplies of management of loan accounts.

Both parties agreed that the supply was a complex compound supply. The appellant acted as undisclosed agent for the bank with limited discretion. It dealt with the entire lifecycle of a loan, apart from the making of the loan. It did not set interest rates, and although it dealt with arrears, decisions on enforcement action were taken by the bank.

The company's appeal was based on the contention that it was exempt either under Sch.9 Group 5 Item 1 (transactions concerning payments/debts) or Item 8 (the operation of a current or deposit account). The judge noted that both the PVD and Group 5 exempt "the granting and the negotiation of credit and the management of credit by the person granting it".

In relation to Item 1, the judge summarised the principles of the CJEU decision in *SKD* (Case C-2/95):

(1) In view of the linguistic differences between the various language versions of Article 13B(d)(3), the scope of the phrase "transactions … concerning" cannot be determined on the basis of an exclusively textual interpretation, and reference must be made to the context in which the phrase occurs and consideration given to the structure of the Sixth Directive (paragraph [22]);

(2) the transactions that are exempt under Article 13B(d)(3) are defined by the nature of the services provided, not by or to whom they are provided, except where they cover services which, by their nature, are provided to customers of financial institutions (paragraphs [32] and [48]);

(3) the manner in which a service is performed, whether electronically, automatically or manually, does not affect the application of the exemption (paragraph [37]);

(4) the services provided by SDC to customers of the banks (as opposed to its own customer, being the bank) are "significant only as descriptors and as part of the services provided" by it to the banks (paragraph [47]);

(5) the fact that a constituent element is essential for completing an exempt transaction does not warrant the conclusion that the service which that element represents is exempt: to be exempt, a package of services must "form a distinct whole, fulfilling in effect the specific, essential functions" of an exempt transaction (paragraphs [65] and [66]);

(6) a transfer involves a change in the legal and financial situation, and since a transfer is only a means of transmitting funds the functional aspects, rather than the cause of the transfer, are decisive (paragraphs [53] and [66]); and

(7) it is necessary to distinguish a "mere physical or technical supply, such as making a data-handling system available to a bank", or "technical and electronic assistance to the person performing the essential, specific

functions": these are not exempt; in particular the court must examine the extent of the supplier's responsibility, and whether it is "restricted to technical aspects" or "extends to the specific, essential aspects of the transactions" (paragraphs [37] and [66]).

She noted the limitation placed on this by the later decision in *Nordea Pankki Suomi Oy* (Case C-350/10), in which the mere transmission of instructions was not enough to confer exemption. The question was whether the supplier's responsibility "is restricted to technical aspects or whether it extends to the specific, essential aspects of the transactions".

In *ATP Pension Service* (Case C-464/12), the CJEU concluded that the reference to payments and transfers in Article 13B(d)(3) covered services by means of which the rights of pension customers were established through the creation of accounts within the pension scheme system and the crediting of those accounts.

The processing of direct debits was held to be within "transactions concerning payments" in *Axa UK plc* (Case C-175/09), but subject to the exclusion from exemption of "debt collection and factoring". The principle of strict interpretation of exemptions required a broad interpretation of the exclusion from exemption.

The company placed significant reliance on the 2003 CA decision in *C&E v EDS Ltd*. EDS also provided administrative services to a bank in respect of loans. Its principal functions were to receive initial applications for loans and record details of applicants, validate the applications using the bank's credit rating system, produce and forward loan agreements (signed on behalf of the bank), direct debit mandates and other documents to borrowers who passed the validation process, verify documents received from borrowers, release funds to borrowers, and collect payments on behalf of the bank using the direct debit system. The interest rates and the maximum and minimum sums that could be lent to any one borrower were fixed by the bank (with EDS performing the necessary calculations to apply interest to loans), and the bank also retained the functions of advertising and dealing with arrears.

The judge examined the nature of the services and contracts involved, then summarised the company's arguments. HMRC contended that the company was either excluded from exemption under debt collection, or was managing credit without granting it. The correct approach was to analyse the elements comprising the company's supply and to ask whether any of those elements qualified for exemption. Only if they did so would it be necessary to go on to the next stage of determining which element was the principal service (*CPP*) or which element(s) predominated overall (*Levob* or *FDR*).

The judge reviewed precedents on this question of characterising a complex supply, in particular the recent Upper Tribunal decision in *Metropolitan International Schools*. She concluded:

I think it is clear that the starting point is to identify the individual elements of a single complex supply. Whether that supply falls to be treated as exempt will generally (but not necessarily exclusively) be determined by reference to predominance, but this might either be a single predominant element or in some cases a combination of elements. The test is an objective one, from the perspective of a typical consumer,

and based on the contract and the economic realities. I agree with Mr Cordara that the reference by Advocate General Tizzano to "economic purpose", referred to by Jonathan Parker LJ in Tesco is relevant.

Turning to the question of whether the supply was "transactions concerning payments", the judge distinguished what the company did from the card processing services in *Bookit* and *NEC*. The CJEU held that where a service provider itself debits or credits an account directly, or intervenes by way of accounting entries on the accounts of the same account holder, that permits a finding that there is a transfer or payment within the exemption. The card processors simply made a demand or request for payment, in essence an exchange of information, rather than anything that could constitute a payment or transfer.

The judge went on to examine at length, but dismiss, the possibility that the company operated current or deposit accounts. She considered that expression to be restricted to the traditional types of account that banks offer their customers, not the loan accounts in this case, which had much more limited functionality.

The key to the problem was then the question of whether the debt collection exclusion applied. The judge was satisfied that it did: she was bound by *Axa* to accept that the expression covered the collection of debts as they fell due, as well as overdue debts, and it was clear that this is what the company did for the banks. She was strengthened in this conclusion by the fact that the Directive was changed in 1991 to remove the possibility of exempting credit management without granting the credit; that was an apt description of what the company did, and although it sought to qualify for exemption under another heading, the fact that it was excluded under art.135(1)(b) was relevant.

The appeal was dismissed.

First-Tier Tribunal (TC06459): *Target Group Ltd*

2.3.2 Part-funded students

A college appealed against HMRC's refusal of a repayment claim for £871,323. This was based on an argument that UK law did not correctly implement the PVD in relation to the exemption for education. Because the college was a commercial entity, it had not been treated as an eligible body, and had accounted for output tax. The claim related to all its supplies from May 2011 to February 2015.

Approximately 160 students were on the courses at any time, training for a national diploma in professional dance or music theatre. About 60 of the students would have all or part of their fees paid for by the Secretary of State for Education. No VAT was accounted for on amounts paid by the Secretary of State, but VAT was accounted for on all other fees.

The judge commented that she had not been asked to determine a question of fact, so she considered the legal position in relation to different possible factual situations: both if a partially funded student receives a partially exempt supply, and also if the supplies from which a partially funded student benefits are two separate supplies, one to the student and one to the Secretary of State.

The college argued that, by treating the grant-funded education as exempt, the UK had recognised it as 'other organisation recognised by the Member State concerned as having similar objects'. It further contended that the distinction drawn between 'funded supplies' and 'un-funded supplies' exceeded the limits of the discretion allowed and breached the concept of fiscal neutrality.

The UK law exempts supplies of education by non-eligible bodies to the extent that they have received state funding. The judge noted that this was in accordance with PVD art.133(a), which allows but does not compel Member States to restrict various exemptions to not-for-profit bodies.

The judge considered two main precedents for consideration by the CJEU of the scope of the discretion allowed to Member States:

- *Minister Finansow v MDDP* (Case C-319/12)
- *Finanzamt Steglitz v Ines Zimmermann* (Case C-174/11)

The judge considered that the distinction drawn in the UK law – to distinguish between state funding and other fees of a non-eligible body – was not permitted by the wording of art.132(1)(i) itself. However, the partial imposition of the condition in art.133(a) was within the discretion afforded to Member States, provided it did not contravene the principle of fiscal neutrality.

The college argued that it did so: it was possible that there could be 3 students on a course at the college, studying the same course at the same time, one fully funded, where the supplies would be fully exempt, one partially funded where the supply was partially exempt (or was made up of two supplies, one exempt and one not), and one not funded where the supply was not exempt.

The judge considered a number of CJEU precedents on fiscal neutrality, including *JP Morgan* (Case C-363/05) and *K Oy* (Case C-219/13). In each of these cases, the distinction was drawn between one service or supplier, and a comparable, competitor, service or supplier. The judge agreed with HMRC that it was not enough for the college to suggest that it was illogical to treat different parts of the same course differently: it was necessary to show that there was a competitor college which did not suffer the same disadvantage. It could not do this.

The judge was satisfied that, whatever the actual treatment of the supplies to partly funded students (one supply partly exempt, or separate supplies, one exempt and one taxable), the principle of fiscal neutrality was not breached and the UK law was therefore within the discretion allowed by the Directive. The appeal was dismissed.

First-Tier Tribunal (TC06438): *Performers College Ltd*

2.3.3 Sports affiliation fees

Two proprietary golf clubs and one members' club appealed to the FTT (TC04781) against decisions by HMRC concerning affiliation fees collected by the clubs and paid on their behalf to the national golf body. The clubs argued that the fees represented standard rated supplies by the clubs, and could not be regarded as disbursements when recharged by the clubs to their members.

The judge noted that this seemed the opposite of what he would expect a taxpayer to argue. The background was a campaign by a number of clubs, and a representative body that was originally involved in the appeal, to oppose the 1999 Sports Order, which they argued had a disastrous effect on the golf industry, distorting competition between members' clubs and proprietary clubs. They wanted a reference to the CJEU to consider the legality of that legislation.

The Tribunal reviewed the nature of the affiliation fees. Clubs do not have to join their county unions or England Golf, the national body, but they do so to attract members. The main benefits received by members are access to the CONGU handicapping system, being able to play in competitions and a discount card that entitles them to play for lower fees at other participating courses. The affiliation fees are payable by the club, based on the previous year's headcount. They are payable in advance, and the club then tries to recover them from the members, frequently suffering a shortfall.

The Tribunal also noted that the Sports Order had prevented arrangements whereby proprietary clubs could licence their facilities to members' clubs and so enable their members to pay exempt subscriptions. The lead appellant in the present case had won a VAT Tribunal case in 1997 which upheld the legitimacy of such arrangements under previous legislation.

The issues which were put before the Tribunal in relation to whether the supply in relation to affiliation fees was standard rated or exempt were as follows:

1) Were golfers the true beneficiaries of the supply?

2) Even if they were true beneficiaries were CONGU handicaps essential to participating in sport?

3) Even if golfers were true beneficiaries and the CONGU handicaps were essential could the supply be exempt in so far as it was the case that golfers did not regard the CONGU handicap as a benefit or had not for that reason or another paid the fees?

The judge considered that it was necessary to come to an objective view of the nature of the transaction, independently of what might be the intention of individual golfers. It would not be possible to base the VAT liability on whether a particular golfer was or was not interested in having a CONGU handicap.

He considered that the true beneficiaries of the supply were indeed the golfers. The clubs argued that they paid the fees for their own reasons (because not being affiliated would lead to a loss of members), but that was incidental. In *Canterbury Hockey Club*, the CJEU held that it was common for sport to be organised by structures such as clubs for administrative reasons, and a supply to a club could be for the benefit of the people actually playing the sport. The judge saw no reason why this principle should not be extended to a sport played socially and individually, as well as the more competitive team sports such as hockey.

Although a handicap is not essential to playing golf, it is essential to taking part in competitions. It is therefore closely linked with playing sport. The judge was satisfied that it potentially qualified for exemption as a sporting service.

However, it was clear that it did not meet the conditions for a disbursement when charged on to the members. If the fee paid to the national or county bodies was exempt (because they could be eligible bodies), when a proprietary club charged it on to a member, that would constitute consideration for a taxable supply. HMRC had operated an ESC since 2000 to allow proprietary clubs to treat such recharges as disbursements; the appellants argued that this was contrary to the legal position, in order to advance their argument against the whole legal basis of the regime in the UK. The judge noted that both parties agreed that the legal conditions for a disbursement were not met, and the question of whether HMRC were right to operate a concessionary treatment was a matter for judicial review.

Turning to the question of distortion of competition and the appellants' request for a reference to the CJEU to consider the legality of the Sports Order, the judge noted that none of the appellants actually operated the kind of arrangements that the Order made ineffective. The question was therefore purely hypothetical in the context of the affairs of these appellants. He could not make a reference in relation to hypothetical questions – only if there was a genuine legal issue between the parties on the facts of the case. He therefore refused to do so.

The overall conclusion was that the fees would be standard rated when recharged by the proprietary clubs to their members, and that could not be prevented by the principle of fiscal neutrality; the CJEU had in *Bridport and West Dorset Golf Club* confirmed that fiscal distortion was inherent in the law in this area, and the clear words of the PVD had to be followed.

The clubs appealed to the Upper Tribunal. Leave to appeal was refused by both the FTT and the Upper Tribunal; the clubs applied for judicial review, where the judge allowed the application to proceed on two out of three grounds. At this point, HMRC withdrew their objection to the appeal proceeding, and it therefore went before the Upper Tribunal on the two grounds that the judicial review application had favoured.

The first ground was that the FTT had misinterpreted the CJEU judgment in *Canterbury Hockey Club* (Case C-253/07) in concluding that the exemption for affiliation fees was available to commercial clubs as well as members' clubs. The judges examined the arguments and the precedent case, and disagreed. Neither the PVD nor the CJEU seemed to require such a distinction. Nor, until April 2018, did HMRC, because they operated an ESC allowing commercial clubs to treat affiliation fees as disbursements; the fact that the appellants chose not to take advantage of that was a matter for them and their members.

The second ground was that the FTT had misinterpreted the 2009 High Court judgment in *British Association for Shooting and Conservation Ltd v HMRC* in holding that CONGU handicaps were "essential for golf". The judges considered precedents about the use of the expression "essential" in the context of exemptions, and concluded that the FTT had applied the correct tests; the appellants had not been able to point to any irrelevant matters that had been taken into account, or relevant ones that had not been considered. The decision could not be faulted.

The appeals were dismissed again.

Upper Tribunal: *Abbotsley Ltd and others v HMRC*

2.4 Zero-rating

2.4.1 Printed matter?

A company sought a ruling that supplies of certain printed items to Direct Line Insurance Services qualified for zero-rating. HMRC concluded that the service comprised planning, creating and delivering the items; these were services that did not qualify for zero-rating. An assessment for £64,871 was raised and appealed to the FTT.

The company had also zero-rated ancillary elements of its supplies:

(1) Each Printed Item contains personalised information about an insurance policy, but standard terms and conditions (T&Cs) apply to all policies of the same type. The T&Cs are set out in separate documents, which are sent out to policyholders at the same time as the Printed Items, and in the same oversized A4 envelope;

(2) documents called "Appraisals" which are similar to the Printed Items in that they set out the individual's policy details; in addition they also value one or more assets for insurance purposes, and include details of any related loan; and

(3) the envelopes and the postage for the Printed Items, the T&Cs and the Appraisals.

These were subject to appeal. However, the company accepted liability in relation to so-called "C5 packs", which contained a majority of non-qualifying material and therefore fell to be standard rated in full in accordance with para.6.5 of Notice 701/10.

The issues before the Tribunal were to decide:

- first, whether the company was making a composite supply of goods or a composite supply of services; and
- second, if the supply was goods, whether those goods constituted zero-rated booklets or standard rated printed matter.

The judge considered the contract between the parties in detail, and noted that it would be the starting point in deciding what was supplied; it could be overruled if the commercial and economic reality was different. She also examined the different ways of characterising a single composite supply from a number of precedents, including *Metropolitan International Schools*. The contract, which was used by Direct Line for all its procurement, referred to both goods and services. However, the judge was clear from the wording and the context that what the supplier agreed to provide was the disputed items as goods, together with the inseparable and indispensable elements which were required to produce them – receiving and confirming data, streaming data, printing, stapling and enveloping. All those elements fell within the definition of "ancillary", because they were "subservient, subordinate and ministering to something else", namely the production of the goods. This extended to despatch and delivery, which were not separate supplies but part of the single supply.

The discussion of the nature of the disputed items was much briefer. The judge was satisfied that they had the minimum characteristics of "booklets" as set out in a number of precedents, and they therefore qualified for zero-rating.

The appeal was allowed, except in relation to the "C5 packs".

First-Tier Tribunal (TC06415): *Paragon Customer Communications Ltd*

2.5 Lower rate

2.5.1 Insulation for roofs

A company supplied a "solid roof system" which provided insulation for conservatories. HMRC decided that this constituted a supply of a roof, not insulation for roofs, and was therefore standard rated. The company had initially acted as sub-contractor for another company installing a slightly different system which HMRC had accepted qualified for the lower rate; when the other company became insolvent, the company began to act as main contractor, and HMRC considered that its system (involving the addition of roof tiles to give the impression of a new roof) involved such a significant change to the structure that it constituted the supply of a new roof.

In August 2015 the company had applied for a patent of its roofing system, which application was still pending at the time of the hearing. It is registered with the Local Authority Building Control organisation which monitors compliance with building regulations.

In the FTT (TC05552), the director stressed that the system was not a replacement for an existing roof. It was attached to a perfectly serviceable existing roof that could be retained by the customer on its own, or more cheaply replaced with a different new roof. The whole point of the company's supply was to insulate the roof.

The company provided a report from an expert, and the judge noted a number of factors that should be taken into account in weighing expert evidence, including the need for care when only one side provided such a report. The report was analysed carefully: the judge noted that only one conclusion constituted "expert opinion"; others related to facts, which were accepted but only repeated the director's evidence; and some conclusions were effectively "argument" and were rejected.

The judge considered in some detail the UT decision in *Pinevale Ltd*, where the company had been held to supply an "insulated roof" rather than "insulation for roofs". He also considered the CJEU decisions in *Levob* and *CPP* and the difference between them. In his view, the company's supply was a single one that should not be apportioned, and it qualified for lower rating. The appeal was allowed.

The FTT decision was long and complex and also covered a number of procedural problems with the appeal, including the failure of the officer to state that a review was available when making the original decision, and the issue of a further decision about a secondary product against which no appeal had been lodged.

HMRC appealed to the Upper Tribunal, arguing that the FTT had erred in its application of *Pinevale*, and that it had misapplied the principles of determining whether a supply was a single supply, and if it was, determining the nature of that supply.

The Upper Tribunal agreed with HMRC. The FTT had applied the tests in the wrong order. It had considered the *CPP/Levob* tests first and concluded that the predominant supply was "insulation"; it had then purported to apply *Pinevale*, but had really concluded that, because the supply was insulation and it was on the roof, it must be "insulation for roofs". A proper application of *Pinevale* would have led the judge to the inevitable conclusion that what was being supplied was much more than insulation "for" a roof, but rather a new, insulated roof.

The judges also disagreed with the FTT's approach in deciding whether there was a single supply and what that single supply was. They referred to *Metropolitan International Schools* and suggested that *CPP* and *Levob* were not, as the FTT judge had said, mutually exclusive:

'*Whichever test or tests is applied, the process should not involve eliminating from consideration of the characterisation elements which are "ancillary", and then making a binary choice between the remaining elements in order to characterise the supply. That is what the FTT appeared to do in its analysis. The characterisation of a supply should take account of all elements of the supply, while avoiding an unduly detailed dissection of the elements comprised in the supply. We agree with the example proposed by Ms McCarthy, that the characterisation of the supply of a motor car is not to be determined by dissecting the vehicle into its many component parts and then, for instance, determining whether the engine predominates over the chassis, or vice versa. The "typical consumer" posited in Mesto would not hesitate to describe the supply as a supply of a motor car. In this appeal, we consider that a typical consumer of the Solid Roof System would have described the supply as a thermally efficient replacement roof, and not merely as the insulation included within the System.*'

HMRC's appeal was allowed.

Upper Tribunal: *HMRC v Wetheralds Construction Ltd*

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.

In the FTT (TC05722), 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 seemed to be the correct decision, but would give rise to an unnecessary tax cost because the parties did not understand the nature of a triangular transaction.

The company appealed to the Upper Tribunal, reiterating its argument that the FTT (and HMRC) had turned the supplies the wrong way round:

'*If one compared a "normal" transaction in which a brewery supplied products to a publican with the transactions carried out here, it was clear that what happened was that the Publicans agreed to transfer their right to claim a discount to Redwood in exchange for the payments made to them (Method 1) or Redwood's agreement that the Brewers should grant a discount directly to a Publican (Method 2). Accordingly, the Publicans have made supplies to Redwood, and not the other way round. Both parties know how much was paid and therefore how much VAT was payable. The decision of the tribunal in Landmark Cash & Carry Group Ltd vC&E Commissioners supported Redwood's analysis. The FtT had*

failed to explain why this did not accord with the economic and commercial reality. The sum retained by Redwood would never have been due to the Publicans; nor was it linked to the value obtained by the Publicans.'

HMRC responded that the FTT had adopted the correct approach and had come to the correct decision. It was not necessary for there to be identifiable monetary consideration for a supply, nor for the person receiving the supply to know how much that consideration was; there were other examples in the case law of such arrangements being taxed. The publicans did not have any identifiable "rights" that they could supply to the appellant. It was a weakness of the appellant's argument that its analysis produced different results in Method 1 and Method 2 when the purpose of the arrangement in both cases was the same.

The judge reviewed a number of principles relevant to determining "who is supplying what to whom", including the contracts and the need to consider commercial and economic reality. He agreed with the approach of the FTT. He considered that the appellant supplied to the publicans a service of negotiating and administering an arrangement with the brewers whereby the purchases made by the publicans were aggregated, along with those of the appellant itself, with the effect of achieving greater discounts from the brewers than the publicans would otherwise have obtained. In his view, that accorded with the contracts (such as they were) and with the commercial and economic realities.

No difficulty arose in ascertaining the consideration for these supplies: it was simply the amounts received by the appellant. The fact that the arrangement had other effects on the appellant (in receiving increased discounts on its own supplies) was an incidental matter that did not affect the correct analysis of the discount receipts.

The company's appeal was dismissed again, for the same reasons as given by the FTT.

Upper Tribunal: *Redwood Birkhill Ltd v HMRC*

2.7.2 Free wine!

Marks & Spencer made a promotional offer described as "Dine In for £10 with Free Wine". Customers bought three specified food items for £10 and received a "free" bottle of wine. If sold separately, the food would be zero-rated and the wine standard rated. The company argued that no consideration should be allocated to the wine. HMRC's assessments were for £6.5m (February 2014 to May 2015), £1.78m (May 2015 to August 2015), £1.66m (February 2016), and £2.02m (May 2016).

The appeal considered a number of different elements:

(1) The correct VAT treatment of the wine element of the promotion.

(2) The effect of the Bespoke Retail Scheme Agreement entered into between M&S and HMRC.

(3) The effect of the deemed supply rules.

(4) The recovery of input tax by M&S on wine purchased by it and disposed of under the promotion.

M&S had entered into an agreement with HMRC concerning an earlier promotion scheme. The company considered that the "free wine" promotion was covered by that agreement, and it was therefore not required to account for output tax on the gift.

HMRC argued that there was simply a purchase of four items for £10, which had to be apportioned on a fair basis. There was no "gift". That was the commercial and economic reality. It was "heretical" to allow M&S to deduct input tax on the purchase of the wine and then not to require output tax on the sale, when it was in reality generating turnover. There was no written contract between the parties, and the promotional schemes in *Loyalty Management* and *Kuwait Petroleum* were irrelevant because they involved supplies at different times – in this case, all four items were sold and paid for together.

M&S's representative argued that the Tribunal had to respect an arm's length agreement between unconnected persons. There were in reality two separate offers, both of which made commercial sense for M&S: "three food items for £10" and "free wine". There were a number of factors to support the contention that the wine was genuinely free:

(1) The absence of any cash alternative or alternative product in the event of non-availability of the wine.

(2) The fact that the customer does not need to take the wine in order to benefit from the £10 food offer.

(3) The fact that in no circumstances can a customer obtain a cash refund if he returns the wine for any reason.

(4) The absence of any legal right or entitlement to the free wine on the part of the customer.

(5) The fact that M&S's till systems recognise the wine as free, and record it as such on till receipts.

(6) The marketing of the wine as free.

The FTT judge (Thomas Scott) emphasised that his decision was based on the particular facts, and should not be taken as setting a more general principle for the treatment of "free" goods. In his view, there was only one promotion, and it was clear that customers bought four items for £10. It was necessary to apportion that total consideration.

The judge went on to examine the wording and the legal effect of the bespoke retail scheme agreement entered into by M&S and HMRC. For several reasons, it did not assist the taxpayer. In particular, there was a specific clause that stated "in the event of dispute, the normal VAT treatment applies" – that was clearly engaged.

M&S's representative argued that the wine could be ignored under Sch.4 para.5 because it cost less than £50. The judge noted that M&S could not prove that the annual value of supplies to the same person was not exceeded, and they could not take the benefit of the doubt in such a situation. In any case, he was satisfied that there was not in fact a gift.

The appeal was dismissed.

First-Tier Tribunal (TC06471): *Marks and Spencer plc*

2.8 Compound and multiple

Nothing to report.

2.9 Agency

Nothing to report.

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

2.11.1 Article

In an article in *Taxation*, Robin Marks examines the various tax reliefs that are available to charities, and suggests that further improvements could assist them in providing essential social services. The annual cost to charities of irrecoverable VAT on expenses is estimated at £1.5bn. A consultation is currently in progress asking stakeholders for their opinions on the current system and possible ways to improve its efficiency and effectiveness.

Taxation, 31 May 2018

2.12 Other supply problems

2.12.1 Local authority recycling

In September 2016 the Upper Tribunal, acting as a judicial review body, had to consider a preliminary question in relation to the activities of local authorities. The question for determination was:

Where a local authority ("LA") that is a Waste Collection Authority ["WCA"] for the purposes of the Environmental Protection Act 1990 ["EPA1990"] is making supplies of trade waste collection services to business customers (i.e. entities occupying non-residential property) in its area, are those supplies by the LA "activities in which it is engaged as a public authority" within the meaning of s.41A(1) VATA 1994 and/or art.13(1) PVD?

The applicant was a commercial business carrying out certain trade waste collection services. It found itself increasingly in competition with local authority waste collection; it had to charge VAT to its customers, not all of whom could reclaim it, and it considered that it was suffering unfair competition as a result. Its first line of attack was to argue that a LA engaged in waste collection was not acting "as a public authority", and it was therefore obliged to charge VAT, regardless of whether there was distortion of competition.

The judge (Warren J) considered CJEU precedents including *Fazenda Publica* and *Isle of Wight Council*. The *Saudacor* and *Finland* cases confirmed that treatment as non-taxable required the person carrying on the activity to be a body governed by public law, and the activity must be carried out in the capacity of a public authority.

The judge went on to consider the legal basis of local authorities' waste collection activities in great detail, and concluded that it was impossible to make a general statement that local authorities were not acting under a special legal regime (the EPA). It might be the case that an individual local authority was acting as a commercial operator rather than a public authority, but that would require detailed investigation of the particular facts. The preliminary issue was therefore decided against the applicant and in favour of HMRC and HM Treasury, who want to maintain the non-VATable status of local authority waste collection.

The judge commented that the applicant would have to pursue one of two alternative lines to succeed in forcing the local authority to charge VAT: one would be to establish that the "competition proviso" applied, which would have to be tested as a matter between the company and the local authorities in whose area it operates; the other would be to show that there are local authorities who are operating beyond their legal powers and cannot rely on s.45(1)(b) of the EPA 1990 as the "special legal regime" under which they are operating.

The company applied for leave to appeal to the Court of Appeal. Although the application was made in time, the hearing was adjourned for various reasons until it came before Mr Justice Nugee in 2018. The judge noted that permission to appeal should not be granted unless the Upper Tribunal considers that the proposed appeal would raise some important point of principle or practice, or there is some other compelling reason for the relevant appellate court to hear the appeal. HMRC accepted that the point was important, but the judge considered that even then, an appeal should only be allowed to go forward if it had a real prospect of success. Accordingly, that is what he had to decide.

The company put forward three criticisms of the judge's decision:

- that he had erred in concluding that local authorities competing in the waste collection business were operating under s.45 of the EPA;
- that they were doing so under a "special legal regime"; and
- that the question of whether they were operating under a special legal regime had to be considered on a case by case basis by reference to the specific facts of the authority's provision of the services concerned.

The judge examined each of these arguments relatively briefly, without repeating Warren J's decision at length. He could not see any reasonable prospect of success in the appeal, because the first two appeared very well justified conclusions, and the third merely depended on the other two. The Court of Appeal itself might decide otherwise, but he could see no reason to allow an appeal to proceed.

Upper Tribunal: *R (oao The Durham Company Ltd (t/a Max Recycle)) v HMRC and another*

2.12.2 Updated Notice

HMRC have issued an updated Notice *VAT on disposals of antiques or art from historic houses*, replacing the December 2011 version. There are no substantive changes other than to improve the readability of the notice.

Notice 701/12

3. LAND AND PROPERTY

3.1 Exemption

Nothing to report.

3.2 Option to tax

3.2.1 Article

In an article in *Taxation*, Neil Warren comments on the history of the option to tax, pointing out that HMRC's records were centralised from local offices in 2001. Because of the possibility of incomplete evidence about historic options, property owners would be well advised to establish the facts long before considering the sale of their property, because the timescales involved in a sale might not allow for the establishment of certainty.

Taxation, 7 June 2018

3.3 Developers and builders

3.3.1 Sub-contractor supplies

An electrical contractor carried out works in relation to the construction of student accommodation. HMRC ruled that this was "relevant residential purpose" property, which can only be zero-rated at the point of supply to the end user; the company argued that it was also "designed as dwellings", so sub-contractors could zero-rated construction services all through the supply chain.

The design of the building was considered: it is a seven storey building comprising 140 studio flats and associated facilities. By reference to the plans it appears that each of floors 1 – 6 are substantially similar in layout with the majority of the studio flats being the same size approximately 5m by 3m and rectangular in shape. There are some larger studios on some of the floors and these are not all rectangular in shape. On the ground floor there is a communal reception, cycle store, and laundry. In addition management offices, stores, bins and plant rooms are situated on the ground floor. The planning consent required that at least 126 of the flats could only be occupied by students of one of two local universities.

The main contractor had provided the company with a zero-rating certificate, stating that the contractor's client intended to use the building for a relevant residential purpose. HMRC took this as an indication that zero-rating was not possible, because the appellant was a sub-contractor. The developer refused to pay the appellant the VAT on VAT-only invoices, arguing that the supplies had properly been zero-rated.

The questions before the FTT (TC06006), therefore, were whether the studio flats qualified as "dwellings" within Note 2, and if so, whether the appellant had a choice between treating them as dwellings and treating them as RRP. In correspondence, HMRC had stated that the choice had to be exercised by the client, and this would then bind everyone else in the

supply chain. As the client had issued a ZR certificate to the main contractor, in HMRC's view, the building could only be treated as RRP.

HMRC also argued (only a week before the hearing) that there was a prohibition on separate use or disposal, so the building did not qualify as "dwellings" within Note 2(c). The Tribunal referred to the Upper Tribunal decision in *Shields*, which clarified the distinction between a "mere occupancy restriction" (such as this one) and a restriction on separate use or disposal:

"*It is that required link to specific land or premises which is crucial, and which puts cases such as the present in a different category from those which have no such link or to which the link is too general or too tenuous. … No doubt there will be cases which are borderline and therefore difficult to call, but I do not regard the present case as one of those. Here the link between the occupancy of the building and the [fishery] is sufficiently close, specific clear and unequivocal.*"

The Tribunal in the present case was clear that this was a mere occupancy restriction – there was no link to particular land, but rather a restriction to a class of possible occupants.

On the issue of the choice between reliefs, the Tribunal emphatically rejected HMRC's arguments ("there is absolutely no basis for HMRC's policy or submission"), noting that they were initially made without reference to the legislation at all, and subsequently depended on a very particular interpretation of Note 12 of Group 5. The appellant protested that the policy set out in Notice 708 was inconsistent as, in relation to the legislation that applies where, within a period of 10 years, there is a change of use in relation to a relevant residential purpose building a change of use charge arises (in essence removing the benefit of zero rating) unless the building also qualifies as a dwelling or number of dwellings under note 2.

"*As HMRC stated the correct liability to tax is, in most instances, not discretionary. Any subcontractor can establish for itself whether the building that it is constructing meets the conditions of note 2. If the building meets those requirements the subcontractors supplies will be zero rated.*" A supplier whose building fell within both note 2 and note 4 would not care under which provision the supply was zero-rated, but if note 2 was satisfied, the more restrictive conditions of note 4 could be ignored. The appeal was allowed.

HMRC appealed to the Upper Tribunal, arguing only that the FTT had erred in its conclusion on the application of Note 2(c). There was no appeal on the question of the relevant residential purpose certificate.

The UT considered the precedents of *Lunn*, *Shields, Burton*, and *Akester*. The judges accepted that these cases showed that Note 2(c) required a link to some other specific land or premises. It was not enough that there was a link to a business or an activity. References in *Burton* to "the Park Hall fishery business" meant in reality "the business carried on at Park Hall fishery" – that is, they related to the address, not the business.

The only questionable part of the FTT decision was a passage in which the judge had noted that there were about 30,000 students enrolled at the two universities, and appeared to suggest that a restriction to such a large class of possible users ruled out the application of the Note. The size of

the class could not be relevant, but the UT judges took this to be the FTT confirming its conclusion that the use was not restricted to users of some other specific land.

Apart from this one possible doubt, the reasoning of the FTT was approved, and the conclusion was upheld. HMRC's appeal was dismissed.

Upper Tribunal: *HMRC v Summit Electrical Installations Ltd*

3.3.2 Reverse charge for construction services

HMRC are consulting until 20 July 2018 on a draft Treasury order introducing a domestic VAT reverse charge for specified business-to-business supplies of construction services from October 2019. The consultation includes a draft statutory instrument with a draft explanatory memorandum and draft tax information and impact note.

The TIIN explains the impact as follows:

The measure will, for certain supplies of construction services ('specified services'), mean that the customer will be liable to account to HMRC for the VAT in respect of those purchases rather than the supplier (the 'reverse charge'). The reverse charge will apply through the supply chain up to the point where the customer receiving the supply is no longer a business that makes supplies of specified services. Also excluded from the reverse charge will be businesses that supply specified services to a connected party within a corporate group structure.

The types of construction services covered by the reverse charge are defined in the draft secondary legislation. These are based on the definition of 'construction operations' used in the Construction Industry Scheme (CIS) under FA 2004 s.74. Exclusions from the definition are also based on the CIS rules.

The draft legislation also excludes supplies of specified services that are made to customers who are not construction businesses such as a high street retailer. Also excluded are supplies of specified services where the supplier and customer are connected in a particular way, and for supplies between landlords and tenants. The meaning of connected is defined in the legislation and only applies where the customer is not a construction business and the supplier is part of that customer's corporate group. These exclusions are defined in the draft legislation as excepted supplies. Unlike for CIS, there will be no deemed contractor provisions whereby purchases become subject to reverse charge because the purchaser buys a certain amount of such purchases in a given period.

Where a VAT-registered business receives a supply of specified services (which are not excepted supplies) from another VAT-registered business on or after 1 October 2019, it accounts for that VAT amount through its VAT return instead of paying the VAT amount to its supplier. It will be able to reclaim that VAT amount as input tax, subject to the normal rules. The supplier will need to issue a VAT invoice that indicates the supplies are subject to the reverse charge.

www.gov.uk/government/consultations/draft-legislation-vat-reverse-charge-for-construction-services

3.3.3 Article

In an article in *Taxation*, Julie Butler considers a number of tax planning points concerning succession and potential sales of farms and farmhouses. The main VAT points in the article relate to issues around demolition and rebuilding of dwellings, or renovation of farmhouses that have not been in use for two years; and also the need for an analysis of expenditure on buildings between business and non-business use.

Taxation, 26 April 2018

3.3.4 Sale of redeveloped property

A developer carried out renovations to two residential properties in Southport and sold them, claiming input tax on the basis that they had both been empty for ten years before the project started. HMRC initially disallowed all the input tax; they subsequently accepted that one of them qualified, but maintained that the sale of the other property was exempt. The company appealed to the FTT.

The evidence provided by the company mainly comprised a statutory declaration by the former owner of the property, who confirmed briefly that the properties had (along with several others owned by her in the same street) fallen vacant "from in or around 2005/2006". The properties were sold by her to the developer on 10 August 2016.

The company also had a letter from the local council confirming that the property had remained empty "from 28/11/2008 to date". This appeared to be based on the last date for which Council Tax was paid in respect of the property.

HMRC relied on a printout that was supposed to be based on the electoral roll, showing someone resident from 2005 to 2007 and two people resident from 2008 to 2009, and also a printout from their own PAYE records showing someone resident up to 27 November 2008. This was only produced to the company's representative shortly before the hearing; he did not object to its admission but disputed its significance.

The judge weighed the evidence and found that, on the balance of probabilities, the property was occupied until November 2008. The company's evidence was not enough to displace that provided by HMRC. The appeal was dismissed in relation to the disputed property, and the parties were left to agree the amount that would be allowed in respect of the other property where HMRC had accepted zero-rating.

First-Tier Tribunal (TC06514): *Fireguard Developments Ltd*

3.4 Input tax claims on land

3.4.1 DIY claim

A married couple decided to demolish their garage and construct a new building. They claimed VAT of £3,903 under the DIY builders' scheme, which was refused on the grounds that planning conditions linked the use of the new structure to the house they lived in. HMRC also did not accept that the building was "self-contained living accommodation", being rather an annexe to provide work and leisure space. It had no kitchen.

The FTT considered a number of precedents about the minimum requirements for "self-contained living accommodation". The judge accepted that the ability to install and operate a microwave oven was sufficient.

However, it was clear that the planning consent was of the type that contravened Note 2(c). Claims by the appellants that they had discussed this issue specifically with HMRC officers by telephone could not override the clear words of the law; the Tribunal had no jurisdiction to hear an appeal on such an argument.

The appeal was dismissed.

First-Tier Tribunal (TC06418): *Colin James Mitchell and another*

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 Abuse of international supply rules?

The Court of Appeal has decided to refer the *Newey* case back to the FTT for further consideration. This has been running for a long time, with the original facts dating from the 1990s. Although HMRC have clearly succeeded in their first aim – overturning the Upper Tribunal decision in favour of the taxpayer – it is still possible that the FTT will confirm its original decision.

Background

A UK-based loan broker found that his business was suffering VAT on advertising costs, while his competitors were not. On accountancy advice, he established a new structure:

- he set up a wholly-owned Jersey company which obtained the appropriate credit licences and which carried on a loan broking business;
- he entered into a service agreement with his company in which he allowed it to use his trading name, and he agreed to carry on the processing of loan applications for it;
- the company entered into an agreement with a Jersey-based advertising agency to place adverts for the loan broking business in the UK.

The effect of this was that the advertising was treated as supplied outside the EU and was therefore outside the scope of UK VAT. The sub-contracted work was also a financial service supplied to a person belonging outside the EU, so it would have been outside the scope with recovery of input tax. The licensing of the trading name (for commissions of 50% and later 60% of the gross revenue on loan business written) was supplied where received under Sch.5 VATA 1994, and therefore outside the scope of VAT.

HMRC argued that the loan broking business was in reality still carried on by the UK individual, and therefore the advertising services were received by him. According to the CJEU judgment in the case, "*In practice, potential borrowers contacted directly Mr Newey's employees in the United Kingdom who processed each file and sent the applications which satisfied the credit eligibility criteria to Jersey to Alabaster's directors for authorisation. The approval process generally took around one hour to complete and, in fact, no request for authorisation was refused.*" As a result, there should be a reverse charge, which would be irrecoverable because it was being used for exempt supplies (the assessment was for more than £10m).

The First-Tier Tribunal (2010) examined the arrangements in detail and allowed the trader's appeal, both on the question of who received the supplies and on the question of abuse of rights. Although the arrangement had been set up initially to achieve a VAT advantage, nevertheless it had been carried through properly so that the Jersey company had commercial substance and reality. The agreements were not at arm's length, but the FTT held that the parties did make the supplies that were described in them – that is, the Jersey company made supplies to UK customers, and the appellant made supplies of processing to the Jersey company. Accordingly, the advertising services were received only by the Jersey company, and there was no reverse charge.

Considering abuse of rights, the FTT did not accept that the situation was the same as in *Halifax*, where the CJEU had held that it was contrary to the purpose of the 6th Directive for an exempt business to recover input tax. This arrangement did not result in the recovery of input tax: it resulted in certain transactions being taken outside the scope of VAT. Although the effect (certainly from HMRC's point of view) might be similar, the FTT did not believe that this was contrary to the purpose of the Directive.

The FTT did consider the other aspects of the abuse issue in case it was wrong on that first question. If the arrangement was contrary to the Directive, then HMRC were justified in arguing that it had been established to achieve a tax advantage, and it would be correct to recharacterise it by regarding the business as still carried on in the UK, which would mean that the advertising services were supplied directly to the UK-based appellant. However, as the first essential feature of abuse was not proved, the appeal was allowed.

HMRC appealed to the Upper Tribunal, which decided to refer questions to the CJEU:

1. *In circumstances such as those in the present case, what weight should a national court give to contracts in determining the question of which person made a supply of services for the purposes of VAT? In particular, is the contractual position decisive in determining the VAT supply position?*
2. *In circumstances such as those in the present case, if the contractual position is not decisive, in what circumstances should a national court depart from the contractual position?*
3. *In circumstances such as those in the present case, in particular, to what extent is it relevant:*
   - *Whether the person who makes the supply as a matter of contract is under the overall control of another person?*
   - *Whether the business knowledge, commercial relationship and experience rests with a person other than that which enters into the contract?*
   - *Whether all or most of the decisive elements in the supply are performed by a person other than that which enters into the contract?*

- *Whether the commercial risk of financial and reputational loss arising from the supply rests with someone other than that which enters into the contracts?*
- *Whether the person making the supply, as a matter of contract, sub-contracts decisive elements necessary for such supply to a person controlling that first person and such sub-contracting arrangements lack certain commercial features?*

4. *In circumstances such as those in the present case, should the national court depart from the contractual analysis?*
5. *If the answer to question 4 is 'no', is the tax result of arrangements such as those in this case a tax advantage the grant of which would be contrary to the purpose of the Sixth Directive within the meaning of paragraphs 74 to 86 of the Judgment in Case C-255/02 Halifax Plc and others v CCE?*
6. *If the answer to question 5 is yes, how should arrangements such as those in the present case be recharacterised?*

The CJEU (in 2013) referred to Cases C-53/09 and C-55/09, *Loyalty Management UK* and *Baxi Group*, as authority for the importance of considering the economic and commercial realities in applying the common system of VAT. "*Given that the contractual position normally reflects the economic and commercial reality of the transactions, and in order to satisfy the requirements of legal certainty, the relevant contractual terms constitute a factor to be taken into consideration when the supplier and the recipient in a 'supply of services' ... have to be identified.*"

However, the contractual terms should not be followed if they constitute a "purely artificial arrangement" which does not correspond with the economic and commercial reality of the transactions. It is for the referring court to decide whether this is the case, but the CJEU implies that the decision could depend on whether the relationship between the owner, the Jersey company, the lenders and the advertising agency, suggested that the advertising services were in reality "used and enjoyed" by the owner in the UK, rather than by the Jersey company outside the EU.

The CJEU did not spell out who should win. It is interesting that its comment on the fifth and sixth questions was:

"*In view of the answer given to the first to fourth questions, there is no need to reply to the fifth and sixth questions referred by the referring court.*"

That suggested that the answer to question 4 should have been "yes", but no method of recharacterisation was spelled out.

CJEU (Case C-653/11): *HMRC v Paul Newey t/a Ocean Finance*

In 2015 the Upper Tribunal considered the case again, and decided that the FTT's decision could not be overturned. The UT judge considered that the FTT had concluded that the business was genuine, and had therefore effectively decided the question of "commercial and economic reality".

HMRC appealed to the Court of Appeal. Henderson LJ rehearsed the history of the dispute, the facts and the law. He noted that the UK's

leading authority on abuse of law is now the Supreme Court's 2015 decision in *Pendragon*, in which a scheme to exploit offshore transactions was held to be abusive. In that case, Lord Sumption had said:

"The selection as the funding bank of an offshore institution which was not a taxable person cannot in itself be regarded as objectionable. It is no part of the policy of the legislation that a party should be restricted in its freedom to select as its commercial partners firms whose place of residence gives dealings with them a tax advantage, even if that is the only reason for their selection. The particular method by which SGJ was brought into the chain of contracts, involving successive transactions by which Pendragon navigated its way from one VAT exemption to another, was an unnecessary and artificial way of involving them."

The judge considered other precedents, including *Weald Leasing* and *RBS Deutschland*, where the CJEU had rejected HMRC's arguments that arrangements should be recharacterised, and *University of Huddersfield*, where the Court of Appeal had agreed with HMRC.

He then turned to the detailed judgment of the CJEU. He noted that it was clear that the CJEU did not rule out the possibility that the arrangements were abusive. It was for the referring court to determine that, "by means of an analysis of all the circumstances, to ascertain whether the contractual terms do not genuinely reflect economic reality and whether it is Mr Newey, and not Alabaster, who was actually the supplier of the loan broking services and the recipient of the supplies of advertising services provided by Wallace Barnaby."

He reviewed the FTT's original decision and the UT's 2015 confirmation of it, noting that the UT judge had decided that, even if he might have disagreed with the conclusion of the FTT if he were considering the matter himself, he did not think it was appropriate for him to overturn it on a point of law.

The judge then turned to HMRC's grounds of appeal. There were four:

- that the scheme as a whole is an abuse of law, the FTT did not determine the issue on the correct basis, and the UT did not properly direct itself in accordance with the CJEU guidance;
- that the UT had decided that the scheme had to be "wholly artificial" to be an abuse, which was too high a bar;
- that the FTT had erred in law in deciding that the Jersey business did not make any exempt supplies in the UK (it made financial services supplies to lenders, which would have been supplied where received), and the UT had concluded that the FTT "could not have overlooked this";
- that the purpose of the Directive is defeated where the place of supply rules are engaged artificially in a situation in which the effective use and enjoyment of the services takes place in the EU.

The judge agreed that the UT had been too sympathetic to the FTT on the question of Alabaster's supplies. That was an error of law, and it entitled the UT to overturn and remake the FTT decision. According to *Pendragon*, the UT should consider the question of abuse afresh, rather than limiting itself to considering whether the FTT had been entitled to come to the conclusions it did.

The main problem was that the FTT had considered the question of artificiality without the benefit of the CJEU judgment – which was inevitable, as the CJEU judgment followed three years after the FTT decision. The judge decided that, as a matter of judicial procedure, that was a sufficient error of law to set the FTT decision aside; in the circumstances, it would not be possible for the higher courts to remake the decision with any confidence, so it should be remitted to the FTT to reconsider the evidence in the light of the CJEU's comments. He pointed to the type of question the FTT should consider:

"Can it then make any difference to this analysis that Alabaster was incorporated on the instructions of Mr Newey, as part of a tax avoidance scheme which was designed and implemented with the sole object of relieving him from the burden of irrecoverable VAT previously borne by him as a sole trader in the UK? In my judgment this is the critical question. As A-G Maduro said in para.85 of his opinion in *Halifax*, 'the normative goal of the principle of prohibition of abuse within the VAT system is precisely that of defining the realm of choices that the common VAT rules have left open to taxable persons.' Thus it is necessary to ask whether the common system of VAT has left it open to Mr Newey to choose to restructure his business in the way that he did."

"It is in this context, as it seems to me, that the evaluation mandated by the CJEU in the present case must be performed. The CJEU cannot have meant that the threshold choice of structure should be disregarded merely because it was purely tax driven, because in that case the outcome would have been obvious, and it would not have been merely 'conceivable' that Mr Newey was still to be regarded as the supplier of the loan-broking services and the recipient of the advertising services. The CJEU must therefore have meant that the question of artificiality has to be assessed by reference to the business relationships actually entered into between Mr Newey, Alabaster, the lenders and Wallace Barnaby, with a view to testing whether they reflected underlying commercial reality. A central focus of this enquiry would naturally fall on the continued role of Mr Newey himself, and his relationship with Alabaster. Was the board of directors of Alabaster truly independent from him, or was he a shadow director with whose instructions or wishes they invariably complied? Were the loan processing functions which he and his staff continued to carry on in Staffordshire now genuinely provided to Alabaster pursuant to the Services Agreement, or was the commercial reality that Mr Newey was still carrying out the work on his own behalf? Were the advertising services provided by Wallace Barnaby to Alabaster genuinely the product of an independent commercial relationship between those two companies, or was this just elaborate machinery set up to enable Mr Newey's decisions on advertising in the UK to be implemented via his meetings with Ekay Advertising, the recommendations made by Ekay Advertising to Wallace Barnaby, and the power which he retained to approve the content of advertisements? And what is the true significance, in this context, of the fact that late advertising space offered to Alabaster was on occasion not taken up because an Alabaster director was unavailable to approve it?"

The judge said it should be left to the FTT to decide how it wished to proceed – whether it would hear fresh evidence, or whether it had enough from the original hearing to decide the question on the new basis. The CA

judgment leaves the issue balanced: it is not clear that HMRC will win, nor is it clear that the taxpayer will win. It has been remitted to a Tribunal that originally found in the taxpayer's favour, but the instruction to consider the questions in a different light may lead to a different result.

Court of Appeal: *HMRC v Newey (t/a Ocean Finance)*

The case is discussed in an article in *Taxation* by Madeline Gowlett and Rob Smith.

Taxation, 31 May 2018

4.3 International supplies of goods

4.3.1 Distance sales

A company sold non-prescription health products to retail customers, who placed their orders using the internet, phone and mail order. Between 1 April 2012 and 31 January 2016 ("the relevant period"), the overwhelming majority of its products were despatched from a warehouse in the Netherlands and delivered to customers in the UK. HMRC issued a ruling in May 2016 that the company should be registered in the UK under the distance selling rules with effect from 1 April 2012. The resulting assessment was for £27m.

The company appealed, arguing that it had contracted with a different company for delivery of the goods, and it was therefore not caught by the distance selling rules, because the delivery was not "by or on behalf of the supplier".

HMRC asked for a reference to the CJEU before the hearing of the substantive issue in the UK, but Judge Mosedale declined to make a reference in November 2017. In her view, it was necessary to find the facts before making a reference about the law. The case came before Judge Redston, who decided that she would make a reference in relation to goods supplied to internet and mail order customers by post. It was her view that they were delivered on behalf of the supplier as a matter of economic reality, but she required the guidance of the CJEU to be sure.

The goods had originally been sold from the Channel Islands under the Low Value Consignment Relief, but when this was withdrawn in 2011 the company relocated its operation to the Netherlands. At the time its representatives obtained confirmation from the Netherlands tax authorities that Dutch VAT would be due on the despatches (i.e. the distance selling rules would not apply); customers would be told that the company only sold goods, and if they were not willing to collect them from the Netherlands, they would have to make an arrangement for delivery with a separate company (a fulfilment house). It was clear that the main purpose of all the arrangements was to generate a VAT advantage, but HMRC did not seek to argue that they were abusive.

The particular arrangements were put to the EU VAT Committee in 2015 as an example of an arrangement intended to defeat the distance selling provisions in art.33 and 34 PVD. The VAT Committee published guidelines which agreed with the UK's position, either unanimously or

almost unanimously. In January 2016, the Netherlands authorities wrote to the taxpayer's representatives saying that they had changed their view in the light of the Committee's conclusions. VAT paid in the Netherlands would be refunded if the company paid output tax on the same supplies in the UK. From 1 February 2016, the operation was moved to the UK.

The judge considered the scripts used by agents for dealing with telephone enquiries. There was a dispute between HMRC and the taxpayer about the nature of the argument and possible late changes to the statements of case, with both sides claiming that they had been misled or given late notice of the other side's position; but the judge was satisfied that there was no unfairness in deciding that the telephone customers were invited to enter into a contract for delivered goods, and the delivery company acted as agent for the supplier. Delivery was incidental to the goods and art.33 PVD applied.

The situation was potentially different for internet sales. The delivery company's rates were displayed on the company's website, with detailed terms and conditions explaining that there would be a separate supply of delivery. However, the judge held that the detailed terms failed to create a separate contract between customers and the courier company; as a result, courier deliveries were also subject to art.33. The same analysis applied to mail order sales.

In relation to sales delivered by post, the judge accepted that a separate contract had been made between the postal company and the customer. However, there were difficulties in construing the contract terms which dealt with picking and packing, in relation to the point at which title in the goods was said to pass. In addition, the supplier itself had significant responsibilities in relation to problems with delivery, having the obligation to provide refunds of charges or replacement deliveries at its own cost.

The judge went on to consider the VAT Committee's discussion paper, which the company's counsel said was not binding but HMRC's counsel said was correct. The judge considered the contracts between all the parties and concluded that there were many factors that the appellant was heavily involved in the delivery of the goods. However, she could not be sure without a reference whether the role of the fulfilment house fell within the statutory words "on behalf of the supplier". There was a lack of case law precedent on these words either in the CJEU or the UK courts; there was also a new proposed Directive to cover this situation, which each side relied on to support their case, and the judge did not find any precedent about the role of a new Directive in interpreting an old one. The judge sent a draft question to the parties and asked for their comments.

The appeal was dismissed in relation to supplies to phone customers and all supplies sent by courier. This meant that HMRC's decision on registration had to be upheld. In relation to the resulting assessment, the decision would be stayed pending the answer to the reference to the CJEU in relation to mail order and online sales delivered by post.

First-Tier Tribunal (TC06474): *Healthspan Ltd*

4.3.2 Triangular supplies

The CJEU has heard another case about the treatment of a succession of transactions in which there is more than one supply but only one intra-Community movement of goods. This time it concerned the treatment of triangular supplies.

PVD art.40 states that the place of acquisition is where the movement ends, and art.41 states that it is where the VAT number used to exempt the despatch was issued; art.40 takes precedence as long as acquisition tax is accounted for by the recipient, but art.42 overrides art.41 in the case of triangular supplies qualifying for the simplification procedure.

F was a business established in Germany that also had a VAT registration in Austria, where it intended to set up a fixed establishment. F used its Austrian VAT number when buying goods from German suppliers, and sold them to customers established and registered for VAT in the Czech Republic. The products were despatched directly from the suppliers to the customers.

When F first submitted its EC Sales Lists in Austria in February 2013, it failed to identify these sales as triangular transactions. It only corrected the statements in April 2013. The tax office ruled that the company could not treat the transactions as triangular because of the failure in the paperwork, and could not prove that the customers had accounted for acquisition tax. They should therefore be liable for acquisition tax in Austria.

The first question referred to the CJEU essentially asked whether it was acceptable for a company to use triangulation in this circumstance, given that it was also established in the country of despatch. Did it have a free choice between using the German and Austrian registrations? The court agreed that the bare words of art.141 could be read as imposing a restriction, but the context and the purpose of the Directive had to be taken into account. This was a simplification procedure, and the trader should be able to choose to use any of its available registration numbers.

The second question asked whether the late or incomplete submission of the recapitulative statements could be used by the Member State to justify refusal of triangulation. The court ruled that they could not – they were mere formal requirements, and the proper treatment should follow the fulfilment of the substantive requirements. If the failures in the documentation indicated that there was collusion in a fraud, or prevent the collection of evidence that the substantive requirements had been met, then it would be possible for the Member State to apply art.41 to override art.42; but there was no indication that this was the case in the present dispute. It was for the referring court to establish the facts, but in principle, the trader was entitled to the simplified treatment.

CJEU (Case C-580/16): *Firma Hans Bühler KG v Finanzamt Graz-Stadt*

4.3.3 Fulfilment house due diligence scheme

HMRC have published a Notice to provide guidance on applying for HMRC approval under the new scheme for fulfilment businesses storing goods in the UK for sellers established outside the EU. Certain sections of the notice have force of law from 1 April 2018. Existing fulfilment businesses must register by 30 June 2018; new businesses starting

between 1 April 2018 and 30 June 2018 have to register by 30 September 2018; and businesses starting from 1 July 2018 have to register by 1 October 2018 or the date they start to trade, whichever is later. Record-keeping, due diligence and penalty obligations begin in April 2019.

Notice FH1

4.3.4 Updated Notices

HMRC have issued updated versions of the following Notices, with a brief summary of the main amendments disclosed in the update.

Customs special procedures for the Union Customs Code – new information on the taxpayer's rights in relation to a Customs decision.

Notice 3001

Importing scientific instruments free of duty and VAT – revised details of the procedure for challenging an HMRC decision.

Notice 340

Importing miscellaneous documents and other related articles free of duty and VAT – revised details of the procedure for challenging an HMRC decision.

Notice 342

Importing museum and gallery exhibits free of duty and VAT – revised details of the procedure for challenging an HMRC decision.

Notice 361

Importing decorations and awards free of duty and VAT – revised details of the procedure for challenging an HMRC decision.

Notice 364

Imports and VAT – The value threshold for declaring postal consignments on a single administrative document has increased to £873 (from £750).

Notice 702

4.3.5 Intrastat

HMRC have issued an updated version of the *Intrastat general guide*. The main change (section 6.3) is that corrections are only required where the value of an error on a single data line exceeds £10,000 (previously £5,000).

Notice 60

4.4 European rules

4.4.1 Temporary VAT reverse charge extended

The European Commission has presented a proposal for an amendment to the PVD, extending the temporary reverse charge option and quick reaction mechanism until 30 June 2022. The present arrangements (in art.199a and 199b) are due to expire on 31 December 2018. The intention is that the "definitive VAT system" will enter into force on 1 July 2022.

COM(2018) 298

4.4.2 Definitive VAT system

The Commission has proposed the detailed technical amendments to EU rules on VAT that supplement the recent proposed overhaul of the system to make it more fraud-resilient. The intention is to bring the definitive VAT system into effect by 1 July 2022, and to cut by 80% the annual loss of €50 billion to fraud.

The Commission set out the main "cornerstones" of the system as follows:

Simplifying how goods are taxed

In the current VAT system, trade in goods between businesses is split into two transactions: a VAT-exempt sale in the Member State of origin and a taxed acquisition in the Member State of destination. Today's proposal puts an end to this artificial split of a single commercial transaction. Once agreed, the amendments contained in the VAT rules will define the cross-border trade of goods as a 'single taxable supply' which will ensure that goods are taxed in the Member State where the transport of the goods ends – as it should be. VAT fraud should be dramatically reduced.

A single online portal ('One Stop Shop') for traders

In order to make the change to VAT rules as seamless as possible for businesses, today's amendments would introduce the necessary provisions to put in place an online portal or 'One Stop Shop' for all business-to-business (B2B) EU traders to sort out their VAT, as announced by the Commission's October 2017 reform proposals. This system will also be available to companies outside the EU who want to sell to other businesses within the Union and who would otherwise have to register for VAT in every Member State. Once in force, these businesses will simply have to appoint one intermediary in the EU to take care of VAT for them.

Less red tape

The changes reboot the self-policing character of VAT and will reduce the amount of administrative steps that need to be taken by businesses when they sell to other companies in other Member States. Specific reporting obligations linked to the transitional VAT regime will no longer be needed for trade in goods. Further invoicing regarding EU trade will be governed by the rules of the Member State of the seller, which should make it less burdensome for them.

Seller is usually responsible for VAT collection

Today's announcement clarifies that it is the seller that should charge the VAT due on an sale of goods to his customer in another EU country, at the rate of the Member State of destination. Only where the customer is a

Certified Taxable Person (i.e., a reliable taxpayer, recognized as such by the tax administration) will the acquirer of the goods be liable for VAT.

IP/18/3834

4.4.3 Fraud proposals amended

The EU Parliament's economic and monetary affairs (ECON) committee has published a draft report on the Commission's November 2017 proposal for increased exchange of information and cooperation between national tax authorities and law enforcement bodies. This proposal, involving amendments to the administrative cooperation directive, would introduce measures including a new online system for sharing information within the 'Eurofisc' network and new powers for Eurofisc to coordinate cross-border investigations. These anti-fraud proposals were presented as an important step in the Commission's plans for establishment of the new 'definitive' EU VAT system, published in October 2017.

The committee has amended the Commission's original text to define more clearly the limits of Eurofisc's powers and the use of information. The report stresses the need 'to strike the right balance between requests for and analysing of information on the one hand and data protection and privacy on the other'. References to relevant data protection legislation have been inserted.

The report also removes provisions relating to 'certified taxable persons', as part of a simplified approach to dealing with cross-border VAT refunds and outstanding liabilities. The Commission had introduced the concept of the 'certified taxable person', which is modelled on the existing concept of authorised economic operator in customs matters and who would benefit from certain simplifications, as a key element of its plans for the definitive EU VAT system.

www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&reference= PE-619.275&format=PDF&language=EN&secondRef=01

On 22 June 2018, the ECOFIN council agreed a compromise text on proposals for increased exchange of information and cooperation between national tax authorities and law enforcement bodies, first introduced by the Commission in November 2017. The new rules will apply from 1 January 2020. Elements relating to 'certified taxable persons' and special rules for SMEs have been removed and will be taken forward separately in wider legislative proposals for the definitive VAT system.

europa.eu/rapid/press-release_IP-18-3868_en.htm

4.4.4 European rules and Brexit

The UK Parliament's European Scrutiny Committee has published a report on "VAT: EU proposals for reform and the implications of Brexit". It covers four main areas:

- the single EU VAT area (end of exempt despatches and extension of One Stop Shop);
- flexibility to reduce rates;
- exemptions for small businesses;
- cooperation between tax administrations to counter fraud.

The Committee expressed "serious concerns" about the inability or unwillingness of Government to share a detailed proposition for the VAT treatment of cross-border business after Brexit.

publications.parliament.uk/pa/cm201719/cmselect/cmeuleg/301-xxii/30102.htm

The European Commission and the UK have published a joint statement outlining the progress achieved on the terms of the draft Withdrawal Agreement since the negotiation which took place on 16–19 March 2018. Michel Barnier said: 'We have advanced on some separation issues for which European businesses need certainty, such as customs, VAT, Euratom and certificates for goods. Engagement by the UK on remaining issues such as the protection of personal data and geographical indications is also to be welcomed. Serious divergences remain, however, on the Protocol on Ireland/Northern Ireland. I would like to recall that the Withdrawal Agreement must contain a fully operational backstop solution for Ireland and Northern Ireland.'

Commission Press Release 20 June 2018

4.4.5 Minimum rate

As previously announced, the ECOFIN council has now agreed a VAT directive amendment to make permanent the current minimum standard VAT rate of 15% across the EU. This was confirmed by a Council Directive issued on 22 June 2018.

www.consilium.europa.eu/en/press/press-releases/2018/06/22/vat-minimum-standard-rate-set-permanently-at-15/; Directive 2018/912/EU

4.5 Foreign refund reclaims

4.5.1 International rewards points

A company belonging in the USA (MR) ran a rewards points scheme involving hotels. A customer staying in a participating hotel was awarded points, and the hotel was charged by the company for those points. When a member had earned enough reward points, he could use those points to obtain a free stay at a participating hotel (a reward stay), using a reward certificate. Redeemers (which included the second appellant in the case, WG) were the hotels, or other participants, who provided goods or services on redemptions of points. When points were used to obtain rewards, MR made a payment to the relevant redeemers. Every time a member stayed at a participating hotel and earned points, that hotel was obliged to pay a fee to another group company (G), a company incorporated in Luxembourg. MR did not contract directly with hotels that participated in the programme. Rather it entered into a participation agreement with a large number of other group companies (who were licensors, managers or franchisors of group branded hotels).

A dispute arose between the redeeming company (WG), the promotion company (MR) and HMRC about the VAT treatment. HMRC ruled that the promoter was not entitled to 13th Directive repayment claims from

2010 onwards because it was paying 3rd party consideration for supplies of accommodation to the customers, and was therefore not receiving a supply. Alternatively, if they were consideration for a supply to MR, they were not land-based supplies and would therefore not have been subject to UK VAT. The appeal concerned a refusal of some £8.3m of VAT on payments to redeemers between July 2010 and June 2014.

HMRC also ruled that it was correct for the redeemer (WG) to have accounted for some £2.4m in output tax in relation to various periods that were the subject of historic repayment claims (12/99 to 12/02 and 03/03 to 05/05) on the basis that the money it received was in reality consideration for a supply of advertising services, which meant that it should always have been outside the scope of UK VAT.

There were therefore three different arguments to be considered:

- HMRC's contention that the supplies were in reality made to the consumer, which would be fatal to both companies' claims;
- MR's contention that the supplies were subject to UK VAT after 2010 and properly received by it, which would contradict the basis of WG's claim (although for different periods);
- WG's contention that the supplies were advertising, which would be fatal to MR's claim throughout, because no UK VAT should ever have been charged.

The FTT (TC05634) considered that, even in the absence of a direct legal relationship between the company and the redeeming hotel (stays were arranged through intermediaries), the company was paying for the stay. In line with the decision in *Aimia* (and rejecting HMRC's attempts to distinguish the situation from that case), the FTT considered that the hotel made two supplies:

- one, of accommodation, to the customer, for consideration that amounted to no more than the presentation of a certificate;
- one, to the company, a service of agreeing to provide the member with the reward on terms that the member was not obliged to pay for it. This was not a supply of accommodation.

The economic reality was that MR was receiving supplies of the second service, and was therefore in principle entitled to recover input tax in relation to them. The next question was the place of that supply. Before 1 January 2010, WG wanted a repayment of VAT on the basis that it was supplying advertising services and should therefore have treated the supplies as outside the scope of UK VAT. The Tribunal disagreed: the service was not advertising but a different kind of service relating to the essential structure of the promotion scheme (the agreement of redeemers to provide rewards). That was supplied in the UK and subject to output tax.

From 1 January 2010 onwards, MR argued that it should be entitled to a repayment under the 13th Directive, because the services were land-related. Again, the FTT disagreed: the supplies that MR paid for were not specific to particular land, as a "central and essential element" of the supply. It was a generic service of agreeing to provide reward stays in general. The services supplied to the US company were not subject to any

of the exceptions in Sch.4A VATA 1994, so they were outside the scope of UK VAT. There was no entitlement to a 13th Directive repayment.

The FTT was referred to the Explanatory Notes issued by the Commission in relation to the 2017 amendments to the rules on place of land-related supplies. The judge said that he had come to his decision on general principles, and therefore did not need to rule on whether those Notes were an admissible aid to construction of the law.

The companies appealed to the Upper Tribunal, and HMRC cross-appealed. The UT considered the different structures and different consequences of various reward programme models. The present case was described as a "separate operator" model, in which the promoter undertook contractual obligations to someone else's customers and expended money to fulfil those obligations. That business was wholly distinct from the activities of the sponsors (who issued points to their customers) and the redeemers (who accepted points because they were paid to do so). The *Aimia* case applied to this model, and the FTT had come to the correct conclusion: the payments made by MR were consideration for supplies made by the redeemers to MR. HMRC's cross-appeal was therefore dismissed.

The FTT decision could also not be disturbed on the second issue. What the redeemers supplied was the fulfilment of contractual obligations under the programme; they were not providing accommodation, or any other land-related supply, to MR. The FTT had not failed to consider the relevant evidence, nor had it otherwise misdirected itself. The companies' appeals were therefore also dismissed.

Upper Tribunal: *Marriott Rewards LLC and Another v HMRC*

5. INPUTS

5.1 Economic activity

Nothing to report.

5.2 Who receives the supply?

Nothing to report.

5.3 Partial exemption

5.3.1 One building or two?

Glasgow School of Arts (GSA) submitted a repayment return for 01/16 claiming £405,301, and at the same time submitted a Form 652 applying for £65,778 in respect of costs of a building project. HMRC rejected both claims and replaced them with an assessment for £96,525.

GSA had carried out construction works at its Garnethill campus. There was a difference of opinion as to whether there were two buildings involved, the Reid Building and the Assembly Building; to start with, GSA had referred only to the Reid Building, but later it argued that there were two buildings, while HMRC's position was the opposite of this.

The Tribunal explained that the decision would use "the Assembly Building" to refer to an area of the site occupied by the Students' Union, and "the Reid Building" as an area occupied by GSA itself. However, the whole site had frequently been referred to by both parties as "the Reid Building".

The judge considered the history of the refurbishment project, which involved substantial amounts of demolition and reconstruction. The Assembly Building is an older sandstone structure which shares a party wall with the Reid Building, a modern steel-and-glass construction opposite the historic Mackintosh Building which has recently been destroyed by a second fire in a short period. They were functionally separate, with minimal shared facilities (sprinkler and air handling systems and heating), and access from one building to the other only used for maintenance purposes. The buildings are classified separately for rates, with the Assembly Building classified as a business and the Reid Building as a charity.

The Assembly Building was leased to the Students' Union. The judge noted that the agreement is in reality a Service Level Agreement rather than a lease; the rental is £5,000pa plus VAT. This was at an effective rate of 45p per square foot at a time when the market rate for a city centre bar or restaurant was £7.62 and office space was £12 to £15.

The construction company had originally tendered for the whole refurbishment and reconstruction project as a single contract, and had rendered combined invoices. GSA asked for separate invoices to identify the VAT element of the Assembly Building refurbishment, when it had decided that it ought to be possible to reclaim it. The VAT on the costs

had initially been treated as residual, and had recovered it according to an agreed combined PESM (business/non-business and partial exemption) that had operated since August 2009.

GSA's tax agent wrote to HMRC in December 2013 in an attempt to agree a new "capital item special method" based on the floor area of the whole Reid Building site. This suggested that 16.28% of the combined building was used for wholly taxable purposes. On 14 August 2014 the agent submitted an option to tax covering the whole building. In October 2014, the agent submitted a capital goods scheme adjustment working which produced an overall taxable percentage of 29.98%; the taxable areas included the Assembly Building (rented to the Students' Union), a refectory (operated by a company as agents for GSA) and a retail shop (operated by a commercial subsidiary).

HMRC refused the claims on the basis that the outputs of £102,500 did not fairly represent the economic use of the building costs and did not justify the recovery of £2.1m of input tax.

In correspondence during 2015, the tax agent explained that GSA now maintained that the Assembly Building was a separate building from the Reid Building; although the option to tax had referred to the Reid Building, the clear intention had been to opt the Assembly Building. VAT had been charged and accounted for on all rental income; the Assembly Building had been used for wholly taxable purposes. The agent stated that there was no internal link between the buildings, in spite of supplying plans which clearly showed that such a link existed. Further investigation and correspondence ensued about the nature and possible use of the access doors, which were now only to be used as an emergency fire exit from the Assembly Building.

HMRC's argument was summarised as follows:

(a) There was a single supply which had not been altered by the issue of the credit notes and invoices outwith the accounting system.

(b) VAT had been charged at the time of the supply and deducted using the PESM and BNB then in place.

(c) The supply was properly attributable to all of the appellant's activities so the VAT on the construction services was residual and it is not possible years later to re-attribute part of that supply to fully taxable.

(d) The cost component on the supply of construction of the Assembly Building relates to all of the appellant's activities not just the lease so the deduction should not be limited to the Assembly Building alone.

(e) The cost component test relates to whether there is a "direct and immediate link" between the input and the output tax.

(f) Whilst it is accepted that a business does not require to be profitable to deduct its input tax, and that deduction is not being denied by HMRC, the attribution solely to the lease does not reflect the economic reality.

(g) One should look objectively at purpose and funding when considering the economic use of costs and the grant of a lease at an almost notional cost was not the sole or even principal purpose of the refurbishment funded by the Scottish Funding Council.

GSA's argument was that the separate identity of the two buildings was a question of fact, which necessarily determined that the VAT was incurred on two separate sets of costs; and the VAT incurred on the Assembly Building was then fully recoverable, because it was used for wholly taxable purposes.

The judge considered precedents on whether buildings can be regarded as separate, in particular *Cantrell*. The internal access provisions of Sch.8 Group 5 Notes 16 and 17 only relate to the question of whether something is an "annexe", which had no relevance here. There were factors favouring both possible outcomes, but overall the judge was satisfied that the Reid Building was a single structure with a self-contained area within it. It was "one building constructed as such". The changes to restrict the internal access were made as a result of the HMRC enquiry, not as part of the original plans.

It was still necessary to consider whether there was one supply, on which the input tax would be residual, or two, on which one part was wholly used for taxable supplies. The judge was satisfied that the intention at the time had always been for a single project; in effect, the VAT consideration after the event had led to the "artificial dissection of the transaction". The request for replacement invoices and credit notes did not change the nature of the supply. Even if there were two buildings, there was only one building supply.

The judge also accepted HMRC's argument that the letting of the Assembly Building to the Students' Union did not constitute an economic activity. Although a low rent did not preclude such activity, the judge noted that it would take GSA 500 years to recoup its capital outlay, not allowing for the fact that it bore the insurance and some other costs. It provided the lease and the facilities as part of its necessary support of the Students' Union.

In effect, HMRC won on every argument. The appeal was dismissed.

First-Tier Tribunal (TC06506): *Glasgow School of Arts*

5.3.2 Hire purchase

Advocate-General Szpunar has given an opinion in the *VW Financial Services* case. The dispute has been long and tortuous: 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 in 2017 decided to refer questions on the main issue to the CJEU, but ruled on one question in the company's favour.

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.

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 decided to refer questions on the main issue to the CJEU. The questions were as follows:

(1) Where general overhead costs attributed to hire purchase transactions (which consist of exempt supplies of finance and taxable supplies of cars), have been incorporated only into the price of the taxable person's exempt supplies of finance, does the taxable person have a right to deduct any of the input tax on those costs?

(2) What is the proper interpretation of para.31 of the judgment of 8 June 2000, Midland Bank (Case C-93/98), and specifically the statement that overhead costs "are part of the taxable person's general costs and are, as such, components of the price of an undertaking's products"?

In particular:

(a) Should this passage be interpreted to mean that a Member State must always attribute some input tax to every supply in any special method adopted under art.173(2)(c) PVD?

(b) Is this the case even if the factual circumstances are that the overhead costs are not incorporated in the price of taxable supplies made by the undertaking?

(3) Does the fact that the overhead costs have been actually used, at least to some extent, in making taxable supplies of cars,

(a) entail that some proportion of the input tax on those costs must be deductible?

(b) Is this the case even if the factual circumstances are that overhead costs are not incorporated in the price of the taxable supplies of cars?

(4) Can it be legitimate in principle to ignore the taxable supplies of cars (or their value) for the purposes of arriving at a special method under art.173(2)(c) PVD?'

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.

Advocate-General's opinion

The A-G starts by commenting that there is an 'elephant in the room': the UK's classification of HP contracts, which is, in his view, incorrect. He expresses the problem quite simply:

Under the legislation of that Member State, such contracts are to be treated as two distinct transactions, one being the taxable supply of a vehicle, and the other, an exempt supply of credit. Given that the price of the vehicle charged to the customer must be limited to the exact purchase price of that vehicle, paid by the lessor to the dealer, the amount of output VAT collected is also exactly equal to the input VAT on that vehicle and fully deductible in respect of that supply. The remainder of the lessor's costs, as well as his profit margin, are, on the other hand, covered by the revenue from the exempt supply of credit. The referring court is therefore uncertain as to the correct approach for the deduction of input VAT on the lessor's overhead costs, used to an extent for the purposes of the taxable supply of the vehicle, but which are in fact covered by the revenue from the supply of credit, which, as an exempt transaction, is not subject to output VAT.

The A-G recognises that there is an apparent contradiction in the requirement to relieve traders of the cost of VAT in their expenses, while blocking the input tax relating to exempt transactions, as illustrated by the circumstances of the case. He considered that "any answer given to the referring court will be flawed from the point of view of the coherence of the VAT system". He suggested that, although it was not part of the questions for reference, the issue of the UK's classification of HP transactions as two separate supplies should be addressed by the court.

Turning to the questions themselves, the A-G rehearses the principle that the right of deduction is fundamental to the proportionality and neutrality of the tax, and should not be limited. The Court has affirmed the right to deduct not only where there is a direct and immediate link between particular costs and particular taxable outputs, but also on overheads, where there is a link to taxable transactions as a whole.

The A-G noted that art.1(2) PVD sets out the right to deduct "the amount of VAT borne directly by the various cost components". He described VW's proposed method as a form of cross-subsidy: the overheads were cost components only of the exempt part of the transaction, because the taxable car was sold on at cost. To give VAT relief on the overheads would be to allow a deduction where there is no output tax. Although this may happen in certain situations, for example when a business is starting or closing down, the A-G rejected the idea that this should be systematic to a business sector.

The A-G also had little time for the Commission's submission, which apparently supported VW. He considered their proposal to be artificial, contrary to the UK legislation and factually inaccurate.

Overall, the A-G did not think it possible to reconcile the fact that VWFS undoubtedly used its overheads to make taxable supplies with the problem of allowing input tax on costs that were effectively only paid for out of exempt supplies. He turned instead to an analysis of HP transactions.

In his view, HP constitutes a single transaction that it would be artificial to split. He believes that the lessor bears the risks of ownership until the option to purchase is exercised; "the lessee often benefits from ancillary services, such as vehicle maintenance services". There are, of course, many different types of contract, but the A-G appears to be considering a more complex arrangement than traditional instalment finance. He did not accept the Commission's characterisation of the arrangement as equivalent to taking out a loan to buy the car.

He suggested that the case law of the Court has moved on since decisions that required the extra consideration charged for deferring payment to be treated as a separate exempt supply. He cited the judgment in *Stock 94* (Case C-208/15) as an example of a situation in which the Court had regarded finance costs as an integral part of a single supply, and *Part Service* (Case C-425/06) as authority for the "proper" treatment of this type of supply as a single taxable one.

The A-G did not see any problem with applying VAT in full to HP transactions, and did not appear to believe that this would increase costs. He stated that his new approach could readily be applied in future; those businesses that had benefited from exemption in the past could not now claim a double benefit.

The following comment is particularly hard to decipher:

However, the risk of such unequal treatment does not appear to be present in the case of hire purchase agreements such as those at issue in the main proceedings. According to the distributive property of multiplication over addition, with non-variable financing costs (in terms of the percentage of the value of the goods financed), the cost to the buyer will be the same whether he finances the purchase of the goods with an exempt loan, and pays VAT on the purchase price, or he pays the price of the goods exclusive of VAT, plus the financing costs, and the VAT is then added to the total cost.

It will be interesting to see what the full Court makes of this.

CJEU (A-G) (Case C-153/17): *HMRC v Volkswagen Financial Services Ltd*

5.3.3 Corporate finance

In 2006 Ryanair made a bid to take over Aer Lingus. The bid failed because of competition rules, but the company had incurred costs in connection with the bid. The question of the deductibility of input tax on these costs was referred to the CJEU.

A-G Kokott noted that the fact that the transaction was aborted would not in itself be a reason to disallow the tax. Rather, the question was whether the intended acquisition was undertaken as an economic activity or as an investment activity.

The questions referred by the Irish Supreme Court asked whether there was a sufficient link between the costs and the future intention to provide management services to the target. The issue was split into two: whether the intention constituted economic activity, and whether the intention conferred a right of deduction.

The A-G noted that Ryanair is clearly an economic operator in respect of its airline business. There was also an economic objective in the acquisition, in that it wished to take control of a competitor business, increasing turnover and generating synergy and network effects. The A-G appears to consider that a more direct route to establishing an entitlement to deduction than a consideration of the Court's case law on holding companies, where the right to deduct is dependent on an intention to levy taxable management charges. However, as the referring court had asked the question, she answered it. As the fact-finding court had confirmed this intention as a question of fact, the right to deduct was established and could not be denied just because the supplies never took place.

The Commission pointed out that the case law might encourage artificial structures to generate full deduction on takeover costs: it would be possible to levy a small taxable management charge and receive large outside-the-scope dividends. The Commission recommended some form of restriction "proportionate to the output transactions generated by management services". The A-G did not find this "convincing" – it would be too difficult to apply such a rule to a situation in which the costs would be incurred in different periods to the revenues, and impossible to apply it in the present case, where the revenues never materialised in spite of a genuine intention to generate them. The neutrality of the tax would be undermined.

The A-G then opined that the provision of services was not the only route in the case law to establish a right to deduct. There would also be economic activity if a trader intended to buy all of a competitor's physical assets. The fact that it wanted to buy its shares should not make a difference. "The strategic takeover of an undertaking by which the acquiring company pursues the aim of extending or modifying its operating business is to be regarded as such a direct, permanent and necessary extension of a taxable activity. Although such a takeover is accompanied by the acquisition of shares in the company, it constitutes a measure aimed at (extended) taxable turnover."

There was a direct and immediate link with the airline business as a whole, with the result that full deduction should be allowed.

CJEU (A-G) (Case C-249/17): *Ryanair Ltd v The Revenue Commissioners*

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 Dispute over liability

In 2007 a company V sold six plots of land to another company S. It was treated as a VATable sale of building land; V issued a VAT invoice and S deducted input tax. S then leased the land to V, but V failed to meet its obligations and S therefore terminated the contract in 2009.

V then issued a credit note to S, purporting to recategorise the 2007 transaction as exempt. It claimed that the price paid was unchanged but now included no VAT, and submitted a revised VAT return for March 2007.

S refused to accept the validity of the credit note and made no adjustments, but it was subject to a tax inspection in 2012 following which the tax authority ruled that the transaction had been exempt. An assessment to tax and penalties followed. S appealed, and questions were referred to the CJEU.

The first question assumed that the transaction had indeed been exempt, and asked how art.184 should be applied (adjustment of initial deduction) in a case in which the initial deduction could not have been lawfully made because it related to an exempt transaction. The CJEU answered that such a deduction was required under art.184, and the later articles dealing with the Capital Goods Scheme (arts.187 – 189) had no application.

Art.186 required Member States to lay down the detailed rules for making the adjustment under art.184. The Directive did not prescribe the date on which the obligation to adjust the undue VAT deduction arose, nor the period for which the adjustment had to be made. The Member State should lay down the detailed rules, bearing in mind the principles of legal certainty and legitimate expectations. It was for the national court to determine whether, in these circumstances, those principles had been respected.

CJEU (Case C-532/16): *Valstybine mokesciu inspekcija prie Lietuvos Respublikos finansu ministerijos v SEB bankas AB*

5.8.2 Admissibility of evidence

A long-running dispute, which was heard in the Court of Appeal in late 2016, has moved a step forward with a directions hearing in the FTT.

The company was denied input tax in relation to purchases of mobile phones and denied zero rating on the sale of mobile phones. HMRC alleged that the invoices purporting to support the purchase did not comply with reg.14, because they did not adequately describe the goods: they had evidence that there were not enough of these phones available on the market at that time to fulfil these transactions, so the invoices could not be accurate. If they could prove that on the balance of probabilities, it would not be necessary to allege fraud, knowledge or means of knowledge. HMRC also alleged that the transport documents supporting the supposed despatches to other member states were unreliable, partly because they were issued by a company that was involved in a number of other frauds. Once again, they argued that they did not need to show bad faith by the company, only that the documentation did not satisfy the statutory requirements.

A dispute followed about the admissibility of some of HMRC's evidence, in particular witness statements from two officers. The company claimed that these witness statements implied that the company was involved in a fraud; if HMRC wished to allege that, it should plead it fully with evidence, and if it did not wish to do so, it should not make prejudicial statements of this kind. The First-Tier and Upper Tribunals agreed that the witness statements should be struck out, at least to the extent that they referred to fraud.

The Court of Appeal agreed with the Tribunals in relation to the input tax side, where the witness statement did no more than refer to criminal convictions of certain employees of counterparties. The judge could not see its relevance to a dispute about the invoices. However, he considered that the statement about the despatches (with some passages excised) was relevant to the reliability of the documentation, and should therefore be considered by the Tribunal.

He described his judgment as "taking the short route": rather than considering very detailed arguments of the two counsel about the rightness or wrongness of the principles of the Upper Tribunal judge's conclusion, he considered that it would be appropriate for the case to proceed to a full hearing where the evidence could be tested. Underhill LJ and Arden LJ agreed.

The case came before Judge Tony Beare in April 2018 for directions. He accepted an application from the appellants to bar HMRC from taking further part in the proceedings in relation to the input tax matter, and summarily allowed that appeal. However, he refused a similar application in relation to the despatch side, and made a number of directions about the provision of arguments and evidence for a substantive hearing.

In relation to the input tax dispute, the judge considered that he was bound to follow the principles of the CJEU decisions in *Mahageben* (Case C-80/11), *David* (Case C-142/11) and *Stroy Trans EOOD* (Case C-642/11). These cases showed that a trader could not be denied a deduction on the mere grounds that the supply did not take place; the trader should have either known or had the means of knowing that this was so. If HMRC were not prepared to argue that, it would deprive the CJEU decisions of meaning. HMRC could not rely on a string of domestic precedents that indicated the contrary conclusion, because the CJEU had primacy.

The judge noted that the CA had expressed the view that the facts should be established by a substantive hearing, rather than by the appellant applying for a barring order of this type. The appellant had chosen not to follow that course, but even so, the case law led the judge to the inevitable conclusion that HMRC stood no reasonable prospect of success on the basis of the case they were prepared to put forward.

Turning to the export issue, the judge noted that both sides wished to rely on *Teleos* (Case C-409/04), but did not agree on the principle it established. The appellant argued that it was simply an application of *Kittel*, but HMRC argued that it was subtly different. It was a two-limbed test, requiring the First-tier Tribunal to conclude both that the supplier acted in good faith and that the supplier has taken every reasonable measure in its power to ensure that the supply it was effecting did not lead to its participation in the relevant fraud.

The judge appeared to accept HMRC's argument. The claim that the appellant had not taken every reasonable step did not amount to an allegation of dishonesty, and was a separate test. It could not be determined without a full hearing at which the evidence would be examined to determine whether the appellant had satisfied these obligations, and whether the goods were actually exported. The case management directions may lead to that hearing taking place, but there may still be further procedural appeals before that.

First-Tier Tribunal (TC06481): *Infinity Distribution Ltd*

5.8.3 Time limit for s.33 claims

From 1 July 2018, the time limit for refund claims by public bodies in respect of VAT costs associated with their statutory obligations will be extended from 3 to 4 years. The time limit during which HMRC may seek adjustments relating to claims is also extended from 3 to 4 years. Transitional rules between 30 June 2018 and 30 June 2019 will prevent adjustments for accounting periods ending earlier than 30 May 2015.

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6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

6.2.1 Online marketplaces

In April, HMRC issued a press release urging all online marketplaces operating in the UK to sign an agreement to help tackle online VAT fraud and errors taking place on their platforms. The agreement would help platforms meet their responsibility to ensure their sellers understand the tax rules, and prevent fraud taking place “on their watch”.

HMRC Press Release 25 April 2018

At the same time, HMRC published the text of a cooperation agreement it will encourage online marketplaces to sign, under which marketplaces will exchange certain information about their sellers in the interests of promoting VAT compliance. The Public Accounts Committee made a recommendation in its October 2017 report on tackling online VAT fraud and error that HMRC should develop such an agreement. Commitments made under the agreement are voluntary and do not create binding legal obligations. However, those signing the agreement:

- commit to providing HMRC with data about the businesses operating on their marketplaces;
- agree to provide information to sellers about their responsibilities;
- agree to respond promptly to HMRC notifications of non-compliance;

In late May HMRC confirmed that the first three signatories to the agreement were Amazon Europe Services Sarl, eBay EMEA and Fruugo.com Ltd. On 27 June they added Wolf & Badger Ltd; Etsy Ireland UC and ASOS plc to the list.

www.gov.uk/government/publications/hmrc-and-online-marketplaces-agreement-to-promote-vat-compliance

6.2.2 Article

In an article in *Taxation*, Neil Warren discusses ways in which businesses may stay below the registration threshold, for example by operating as separate sole traders rather than as a partnership, or by encouraging customers to buy goods for the trader to use in providing services (e.g. paint for a decorator, building materials). HMRC can counter artificial business splitting with a direction if two sole traders have organisational, financial and economic links.

Taxation, 17 May 2018

6.2.3 Updated Notices

The Notice *Should I be registered for VAT?* has been updated to reflect the new requirements for online marketplace operators to carry out certain checks on sellers. It also includes the power to direct some non-established taxable persons (NETPs) to appoint a VAT representative who is based in the UK and is fit and proper, and the Statement of Practice about artificial separation of business activities has been moved.

Notice 700/1

The *Budget supplement* to the above Notice confirms that there were no changes to the registration and deregistration thresholds in April 2018.

VAT Notice 700/1 and 700/11

The Notice *Cancelling your registration* has been updated to more information about has to be done when submitting a final VAT return, however short the final return period may be.

Notice 700/11

6.3 Payments and returns

6.3.1 Article

In an article in *Taxation*, Neil Warren reviews the Flat Rate Scheme a year after the introduction of the limited cost trader rules. The financial windfall enjoyed by most FRS traders from 2003 to 2017 has now disappeared in the great majority of cases.

Taxation, 24 April 2018

6.4 Repayment claims

6.4.1 Validity of claim

A vehicle rental and self-drive car hire company argued that it made a *Fleming* claim in respect of the *Italian Republic* and *Elida Gibbs* issues on 30 March 2009. The FTT (TC03799) found in favour of the company, but the UT allowed HMRC's appeal. The CA has agreed with the UT.

HMRC argued that the letter sent on the company's behalf by its solicitors did not meet the statutory requirements for a "claim" to have been made. The question put to the FTT was "whether the claims... are valid claims..."; Judge Berner pointed out that the validity of the claims was not the point at issue, but rather whether "what has been done amounts to a claim at all for the purposes of the relevant statutory provisions."

The solicitors' letter set out some details of the way in which a repayment would be calculated, but pointed out that the companies had been in administrative receivership, so much of the detailed information was not available. Accounts for the relevant years were being obtained from Companies House.

Judge Berner examined the precedents and the statutory words, and concluded that the requirements of reg.37 were not as stringent as HMRC

believed. In particular, HMRC's view appeared to be that a "claim" had to contain enough information for HMRC to be able to determine whether or not to accede to it; it was clearly the case that further enquiry and correspondence would normally follow the making of a claim, so that could not be right.

The judge set out his view of the requirements as follows:

(1) For there to be a "claim" it must constitute a demand for repayment of overpaid VAT.

(2) The requirements of reg.37 of the VAT Regulations are mandatory, in the sense that, even if there is a demand for repayment, such a demand that does not comply with reg.37 will not be a claim for the purpose of s.80 VATA.

(3) The requirements of reg.37 are, on the other hand, exhaustive. It is not a requirement that the claim must set out the prescribed accounting period or periods for which the claim is made. That is part of the enquiry as to whether HMRC are liable to credit or repay overpaid VAT, but is not a requirement in order that a claim may be made.

(4) Similarly, it is not a requirement that the claim must be such as to enable HMRC to determine the issue of overpayment, or that the claim should contain sufficient information as to enable a reasonably competent VAT officer to understand the way in which the amount claimed had been calculated. (That is likely to be the case in practice in most instances, but it is not a relevant test.)

(5) It is not sufficient to refer to a prospective claim, with a promise that details will be sent in due course. However, if the demand does constitute a claim within reg.37, the fact that such a claim does not include the full figures, or has been made at a time when the claimant has not gathered all the information required, but where further details are to be provided as soon as possible, will not prevent that demand from being a claim for s.80 purposes. The question then will be whether the provision of the further information relates to the same subject matter as the original claim, without extension to facts and circumstances outside the contemplation of the original claim, and is therefore an amendment of the original claim and not a new and separate claim.

His third conclusion meant that it was not possible to read in extra words that were not already in the regulation. On that basis, the *Elida Gibbs* claim made by the first appellant satisfied the law: it stated the amount (£1.29375m); it explained how that had been calculated; and it referred to the accounts of the company that would support the calculation. HMRC's only criticism of the letter was that it did not refer to prescribed accounting periods, but the judge did not agree that such a reference was a legal requirement.

The letter referred to an intention to make an *Italian Republic* claim, but did not give a figure. That did not satisfy the law, and any such claim made later would be a new claim and would be outside the *Fleming* time limit.

On the other hand, the *Elida Gibbs* claim could be extended by amendment to other years. The amount stated referred to one year, and the letter explained that the claim related to all the years from 1973 to

April 2007, with details to be provided when the accounts had been retrieved from Companies House. Those further details would constitute amendments to an in-time claim, rather than new claims.

The second claimant had not stated any figure, and could therefore not satisfy reg.37. The appellant's representative had argued that it made no sense to refuse the claim simply because it did not contain a figure – if that was the case, it would be possible to enter a number arrived at by pure guesswork and so validate the claim. The judge disagreed: such a figure would not be "calculated", so it would not satisfy reg.37 either.

The preliminary issue was therefore found for the taxpayer in respect of one of the claims for one of the companies, but dismissed in respect of the other matters.

Upper Tribunal

Both parties appealed. The Upper Tribunal (Warren J and Judge Bishopp) agreed with the FTT that reg.37 was the "form and manner prescribed" for the purposes of s.80(6) VATA 1994: a claim could only be treated as such if the mandatory requirements of the regulation were met. The *Italian Republic* claims therefore failed for the same reason that the FTT had given.

With regard to the claim that the FTT had considered compliant with reg.37, the UT observed that the letter from the solicitors had not attempted to apportion the amount claimed for the year 1989 between the several accounting periods in that year. Although there is no reference to claims being made for accounting periods in reg.37, it is implicit in the wording of s.80(1). The judges considered that there were good reasons for the requirement to apportion a claim between periods: it would affect interest calculations, and could be relevant to determining whether time limits had been observed. The solicitors' letter therefore did not meet the statutory requirements. The UT therefore did not accept that a claim had been made in time, so it also could not be amended.

HMRC's appeal was allowed, and the companies' appeals were dismissed.

Court of Appeal

The company appealed to the CA, which essentially agreed on all points with the UT. Reg.37 had to be read alongside s.80; a claim had to be made "for a prescribed accounting period" for which an amount not due had been paid. Subsections (4) and (4ZA) set time limits for "a claim under this section" which runs from "the relevant date". It was clear that this had to refer to a claim for a specific single accounting period, thus uniquely identifying the relevant date. The language was not apt if a claim could encompass more than one period at once.

Floyd LJ said of the appeal: "Running through Mr Hitchmough's submissions was the suggestion that all that was missing, on HMRC's case, from the letter of 30 March 2009 was an estimation of the amount for each of four prescribed periods and that this could be arrived at by dividing the amount for the calendar year by four. It is certainly possible to imagine a case where the four accounting periods fell neatly into a year, and the overpayments were evenly spread through the year, so that it would possible to make such an estimate, but this will not always be the

case. As I have said, accounting periods do not necessarily coincide with the beginning and end of calendar years. I do not see why this ability to make an estimate in some cases should force a different interpretation of the section."

The taxpayer's appeal was dismissed.

Court of Appeal: *Bratt Autoservices Company Ltd v HMRC*

6.4.2 E-mailed claim

A golf club prepared a "*Bridport/Fleming*" claim in March 2009. Its VAT agent submitted the claim by e-mail in the afternoon of 31 March; but he addressed it incorrectly to martin.nutter@hmrc.gov.uk, when such addresses should be @hmrc.gsi.gov.uk. The e-mail was not received, but the agent did not recall receiving any non-delivery message. He was not surprised at the lack of any acknowledgement (the Tribunal heard from Mr Nutter that 3,500 claims were received in the last 72 hours, 2,500 on the last day).

The taxpayer's representative tried to draw an analogy between this situation and the "making and notifying" of an assessment by HMRC. The judge did not accept that the circumstances were the same: specific words of the law identified making and notifying assessments as separate actions. Previous cases had upheld the principle that a letter put in the post constituted a claim "made" by the deadline, but that presupposed that the letter was correctly addressed. It was unfortunate, but the club had not "made a claim in writing to the Commissioners" by the deadline. The appeal was dismissed.

First-Tier Tribunal (TC06430): *Edgbaston Golf Club Ltd*

6.4.3 Validity of claim

In a footnote to the long-running *Rank* litigation, the FTT had to consider the validity of one of many claims that the company had made. The decision opens with a summary of earlier claims, showing in a table that HMRC had accepted three "bingo" claims and paid out £98m, representing overpaid output tax net of overclaimed input tax.

HMRC had rejected a fourth claim as being made out of time. This related to the periods from 12/96 to 12/02, and the net amount involved was £67m. An appeal against the refusal of this claim was rejected. In June 2013, and followed up in June 2014, the company made a further claim for this amount, arguing that it should not have had to reduce its earlier repayment claims by so much input tax – £67m – when it was effectively "in credit" to that amount. The company argued that this was the application of the principles of the *Birmingham Hippodrome* case, and the claim was made under s.80(1B).

The argument continued that s.81(3) was the relevant operative provision of VATA 1994 that permitted HMRC to set off sums that the appellant was "liable to pay" to HMRC against the gross amount of output tax that fell to be repaid. Ordinarily, the appellant would only be "liable to pay" HMRC an amount in respect of input tax wrongly credited if HMRC made an assessment to recover that input tax and, at the time HMRC dealt with the three claims they had settled, they were out of time to make such an assessment. However, even though HMRC were out of time to assess the

appellant for overclaimed input tax, s 81(3A) required HMRC to set that overclaimed input tax off against the appellant's claim for repayment. According to the *Birmingham Hippodrome* case, HMRC should then take into account all the consequences of the same mistake, and deal together with all other overdeclarations and underdeclarations whenever they had occurred.

HMRC had therefore been wrong to offset all the input tax overclaimed in the periods relating to the three claims – £68.8m. They should have given credit for the overpayment for the period covered by the fourth claim, and only offset £1.8m, leaving a further £67m to be repaid. The company claimed that the incorrect offset amounted to a "payment" by the company at the times HMRC made the repayment (May 2010, February 2011 and March 2011), so the claim made in June 2013 was in time.

The judge noted that there was no agreement between HMRC and the taxpayer about the "architecture" of s.80 and s.81. Following a detailed examination of the law, Judge Jonathan Richards concluded that the offset of input tax against output tax when settling a s.80 claim did not constitute "payment" of the input tax to HMRC by the claimant. If there had been no "payment" in 2010/11, there could be no s.80(1B) claim, and the appeal had to be dismissed.

The judge declined to express a firm opinion on the implications of the *Birmingham Hippodrome* case, although it was argued extensively by both sides. He considered that the effect could be significant, so it would be better if it was only ruled on by a Tribunal where it had a bearing on the outcome.

First-Tier Tribunal (TC06483): *The Rank Group plc*

6.4.4 Repayments by BACS

VAT Notes contains the following reminder about the process for receiving VAT repayments by direct credit to a bank account:

We can send a payment straight to your bank account if you're due a VAT repayment.

To receive your repayments straight to your bank:

- *you need to give us your bank sort code and account number using the VAT online service*
- *the account must be in the name of the registered person or company*

All future repayments will be made direct to that account unless you tell us of a change.

Payments by BACS are faster, safer and more secure than payable orders which can take up to 6 days to clear and will be phased out in the future.

If you've already given us your bank details to set up a direct debit, these details are not available to us to make repayments. We'll still need you to give us your bank details.

The VAT online service has more information about how to register. If you are unable to use the VAT online service you can give your bank account details on form VAT484 or in writing to [the Registration Services at Grimsby].

The request must be signed by the appropriate person. Use the table below to help you with this. You'll also need to tell us your VAT registration number and the relevant period end date.

Type of organisation	*Appropriate person*
Incorporated company	*Director or company secretary*
Limited liability partnership	*Registered member*
Partnership	*One of the listed partners*
Sole proprietor	*Owner of the business*
Non-profit making body	*Chairperson, treasurer, trustee or secretary*

Please allow 14 days for the payment to be shown in your account.

VAT Notes 2/2018

6.5 Timing issues

6.5.1 Prepayments and vouchers

A mobile phone company disputed the treatment for VAT of many of the different charges it made to its customers, in essence arguing that there should not be a tax point at the time of payment. The total amount under appeal was £414m for the periods from 1 June 2013 to 30 June 2016.

The point was that the company had introduced a new system of charging for use outside the UK. Customers paid a fixed monthly amount, but could use their phones outside the EU without incurring a further charge. Because such use and enjoyment outside the EU was not subject to VAT, the company argued that this effectively turned its monthly payments into "multi-purpose vouchers", that would be taxable only when redeemed for taxable services. HMRC, on the other hand, ruled that the payments were still taxable when received, subject to a subsequent adjustment for any actual use and enjoyment shown to be outside the EU.

The crucial difference was not just in relation to timing: as many units of airtime were not used, treatment as multi-purpose vouchers would result in VAT not being accounted for at all. The proportion used outside the EU was approximately 1%; the proportion not used at all was much higher.

There were two main contentious issues of fact. One was why the company referred to "units" on its invoices; on this, the judge (Barbara Mosedale) commented that the explanations she was given by the company's witnesses did not make commercial sense. The other was whether handsets were sold only for an upfront charge, or whether any part of the monthly roaming charges related to it. Broadly, the judge accepted the evidence of the witnesses, while discounting some of it as opinion rather than evidence, and treating some of it as not consistent with documentary evidence and commercial reality.

This point was particularly relevant in relation to the supply of handsets to "pay monthly" customers. The economic reality, as borne out by the

pricing structure, was that the monthly contracted payments (the “MRC”, or “monthly recurring charge”) had to include something for the handset. The MRC was considerably lower if no device was included. This was in spite of the company’s assertion that it did not supply phones on credit, which would have required it to comply with the Consumer Credit Act, which it did not do. The judge considered that there was a single contract when the customer chose a package that included a phone, and part of the monthly charge was in respect of the provision of the phone.

The judge examined the various explanations put forward for the introduction of “price per unit” on customer bills, and could not accept that any of them made commercial sense. They did not appear to enable clearer invoicing, or benefit marketing, or be required by regulations. The question was whether they changed the VAT treatment of the supply.

The company argued that it did so, because it could not tell the liability of the supply until it knew the place of the supply, and it could not know the place of supply until the phone was used, confirming whether use and enjoyment was within or without the EU. There was a sub-issue to this question, which was whether the supply of a package including a handset comprised a multiple or a single supply.

There were three possibilities:

- there was a single supply of telecommunications services;
- there was a single supply of something other than telecommunications services (in which case the appeal failed in its entirety, as there would be nothing subject to use and enjoyment);
- there were multiple supplies which might be subject to different treatments.

The difference between the first and third options would affect the amount of the claim, in that a lesser amount would be subject to use and enjoyment under the third option. The company’s position was that there were separate supplies, and the monthly charge was only for the airtime.

The judge rehearsed the law on compound and multiple supplies, from *CPP*, *Levob*, and *Middle Temple* to *BGZ Leasing* and *Mesto Zamberk*. She drew the conclusions that:

- SIM-only customers received a supply only of telecommunications services;
- customers taking a package had a real choice, and although the handset was obviously a means of enjoying the telecommunications supply, it was not incidental to it;
- it was too simplistic then to treat the upfront charge as for the handset and the monthly payment as for telecommunications – a fair apportionment was required. That part of the monthly charge that related to the handset would have to be excluded from the claim, if it succeeded in principle.

The judge moved on to consider the tax point issue: the company argued that it was not possible to fix a tax point on payment if the place of supply, and therefore the liability, was unknown at that time. HMRC argued that the place of supply was the UK until and unless there was use

and enjoyment outside the EU; there should therefore be a tax point on receipt of payment, with a retrospective adjustment if such use and enjoyment could be shown later.

The company placed reliance on *BUPA Purchasing* and *MacDonald Resorts*, in which uncertainty about the nature of a supply had a significant effect on the treatment of receipts. The judge disagreed with their interpretation. In her view, there was no supply in those cases because there was uncertainty about what would be supplied (unspecified drugs/prostheses, unspecified holiday stays); it was not because there was uncertainty about the liability or the place of the thing to be supplied. The judge was satisfied that a tax point arose when the monthly charges were received, because they related to a particular known supply – the availability of telecommunications services.

The judge went on to reject the company's argument that its "units" were similar to face value vouchers. They were no part of the contract, because they were irrelevant to the customer; they were simply a name, without significance. In effect, the customers paid for telecommunications services.

The Court of Session decision in *Findmypast Ltd* was considered, together with the CJEU decision in *Air France*. Both dealt with situations in which a customer paid for something that was then not used. The judge did not agree with the CS that "uncertainty about whether the units would be used" was relevant to the question of whether a prepayment arose; but it was not critical to the CS decision, because that case involved other uncertainties as well. The judge summarised her conclusions on "relevant uncertainties" as follows:

(a) Is there an uncertain time in which to use up the money paid?

(b) Is there an uncertain price for whatever the credit can be paid for?

(c) Is the subject of the credit uncertain?

These uncertainties all existed in the cases in which a payment was held not to create a tax point. None of them appeared in the present case. So far as customers paying the monthly charge were concerned:

(a) They do not have an indefinite time in which to use up their rights purchased by their payment. On the contrary, they have the billing period at the end of which time their rights to a set number of calls, texts and data downloads in that period will expire.

(b) The cost of the rights for which they have paid is certain. This is because the MRC is certain.

(c) What the MRC purchases is certain. It buys the specified number of call minutes, texts and MB of data downloads.

The only uncertainty was whether the customer would use the full entitlement of minutes, texts and data downloads. That was more akin to the "no show" air passenger in *Air France*, and that was the principle that the judge proposed to apply.

The company argued that a subsequent adjustment for use and enjoyment outside the EU was not provided for in the Directive, and therefore it must be wrong to charge the transaction until the place was known. HMRC acknowledged that there was no explicit provision for adjustment, but

considered that it was implicit in the use and enjoyment provisions, because use and enjoyment can only be measured at the actual time of supply, whereas the PVD routinely advances the chargeable event to before that time.

The judge considered that the company's interpretation would lead to distortions of competition and non-taxation of significant amounts of consumption. It was preferable to interpret the use and enjoyment provisions in a way that was consistent with the objectives of the PVD. There was a justifiable difference between "pay as you go" customers and monthly payment customers, because the nature of the supply was different.

The judge therefore rejected the first ground of appeal, on uncertainty. She went on to examine the face value voucher legislation. This was much briefer, but also based on uncertainty – the judge concluded that the customer did not buy "a voucher representing a right to telecoms services", but bought "telecoms services". The face value voucher rules could not assist the claim.

In closing comments, the judge noted that HMRC treat the purchase of "pay as you go" airtime as the sale of vouchers, which she agreed with because the "relevant uncertainties" existed; in her view, a PAYG top-up should not be treated as a voucher, but should create a tax point at the time of receipt. The fact that, in the judge's opinion, HMRC had applied an incorrectly favourable treatment to one of the company's products, did not mean that a fiscal neutrality argument arose in relation to its other products.

The appeal was dismissed in its entirety.

First-Tier Tribunal (TC06519): *Hutchinson 3G UK Ltd*

6.5.2 Goods on approval

HMRC have published revised guidance on when goods are supplied on approval, and the liability of the delivery charges for these goods. They have concluded that in their guidance (VRS9150) the statement 'normally', in that mail order retailers 'normally supply goods on approval terms', is not correct. Such companies may supply goods on approval terms but often this will not be the case.

'Sale on approval' was considered by the VAT Tribunal in *Littlewoods Organisation plc* (VTD 14977). The Tribunal held that goods were supplied on approval where there is no contract of sale unless and until the recipient concerned adopted or was deemed to have adopted the goods. This is different from a supply of goods with a subsequent right to return them.

HMRC say that the tax point will depend on the facts of each case, and encourage mail order suppliers to read the updated guidance. Where traders have been accounting for tax at the wrong time HMRC will not require amendment of past returns, but they should be making the correct declarations by 3 months from the date of the Brief (18 June 2018).

HMRC point out that in a single supply of delivered goods, the delivery is ancillary to the supply of the goods. Therefore the liability of the delivery charge follows that of the goods being supplied.

Where goods are supplied on approval, the delivery service is not ancillary. As delivery happens before the customer or the mail order retailer know whether there will be a supply of goods, delivery is an aim in itself. If the goods are sent on approval, the purpose of the delivery service is to facilitate the customer inspecting the goods to decide whether or not they wish to purchase them.

The supply of the delivery service is therefore not dependent upon the supply of the goods. Consequently the delivery of goods supplied on approval terms is always a separate supply that is taxable at the standard rate.

R & C Brief 05/2018

6.6 Records

Nothing to report.

6.7 Assessments

6.7.1 Best judgement

A restaurant owner appealed against assessments for income tax, VAT and penalties arising from alleged underdeclared income. The trader's representative complained about the way HMRC had conducted their enquiry; he accepted this was not itself within the jurisdiction of the Tribunal, but he argued that it was relevant to the question of whether HMRC had exercised "best judgement".

The judge examined the evidence and the basis of the HMRC assessments, and was satisfied that they were within the range of what an officer could properly assess. However, she did not consider that HMRC had discharged the burden of proof to show that the trader had deliberately understated income. Rather, he had been careless, and the penalties were reduced accordingly. To that limited extent, the appeal was allowed, but otherwise dismissed.

First-Tier Tribunal (TC06405): *Shah Aziz*

6.8 Penalties and appeals

6.8.1 Default surcharge

A company appealed against surcharges for four periods in 2015 totalling £26,811. It had been in the surcharge regime since May 2011. The company argued that particular events in 2014 had led to an unavoidable shortage of funds that could constitute a reasonable excuse: its mortgage lender had insisted on refinancing, and HMRC had rejected a repayment plan, leading to the issue of Statutory Demands.

The judge considered the history of the company's problems in considerable detail, but rejected the excuses put forward. He gave a number of reasons for concluding that the traders had not shown that they had done everything they might reasonably have done to avoid the problem; for example, they had made no effort to sell their property, even though they had considerable notice of the mortgage lender's action. They asserted that they did not think a buyer could be found, but that was not the same as actually trying to find one.

The judge did reject a suggestion from HMRC's representative that the trader "should have asked for TTP". It was clear that, given the payment history, no TTP agreement would have been reached. The appeal was rejected.

First-Tier Tribunal (TC06451): *Newton Business Parks*

A company appealed against a surcharge of £10,094 for its 06/17 period. There had been cash flow problems in 12/16 leading to the agreement of TTP, which in turn led to the cancellation of a direct debit. The trader did not appreciate that this had happened, and also did not realise that he needed to ask for TTP before the statutory due date of 7th August. When he rang to ask for TTP again on 8 August, it was refused, and although he paid £300,000 in cleared funds by 10 August, with the balance following much later, a surcharge at 2% of the whole liability for the period was levied.

The judge considered the explanations given and concluded that HMRC had failed to explain in relation to the 03/17 period that the DD had been cancelled, or that TTP had to be applied for before the due date, or that a decision had been taken to refuse any further TTP requests. The trader's reasonable belief that he could ring and ask for time on 8 August constituted a reasonable excuse for the £300,000 he then paid by 10 August.

HMRC's representative questioned whether the Tribunal had the power to reduce a surcharge, rather than confirming it or cancelling it in full. The judge stated that he took his authority from s.83(q), which referred to "the amount of any penalty"; the decision was to allow a partial reasonable excuse, reducing the amount of the "outstanding VAT" on which the surcharge was based.

The appeal was allowed in part.

First-Tier Tribunal (TC06485): *Aston Services Group Ltd*

A trader appealed against a surcharge of £4,131 for 07/17. The scope of the appeal was expanded to consider whether there was a reasonable

excuse for earlier periods that would have affected the amount charged for 07/17.

The Tribunal considered a number of different explanations for late payment in different periods, but could not find that any of them amounted to a reasonable excuse. It counted against the trader that he used cash accounting for VAT: the point of that was to defer the liability to account for VAT to HMRC until after the customer had paid. That made it less likely that shortage of funds could constitute a reasonable excuse. The appeal was dismissed.

First-Tier Tribunal (TC06488): *K D Productions Ltd*

A company appealed against surcharges totalling £9,643 from 01/11 to 10/15. The owner was a 71-year old man with various life-threatening diseases and severe hearing loss, who had struggled to maintain a car hire business over a number of years. The judge (Anne Redston) pointed out a basic problem with HMRC's refusal to accept his conduct as reasonable excuses: they said that he should have made alternative arrangements while he was ill, which was what he did, whereupon they said this could not be a reasonable excuse because of s.71 VATA 1994 excluding "reliance on another". The judge held that the taxpayer's actions throughout had been reasonable and responsible. His reliance had not been "mere reliance" but the most appropriate course of action.

The judge was scathing about HMRC's treatment of a disabled "customer", and was clearly astonished that they had asked for a full decision, indicating an intention to appeal. She issued directions that they should make a decision about appealing within 28 days rather than the normal 56, and if they decided not to appeal, they should tell the taxpayer within 5 days of making that decision, by first class post and in clear terms, so that he could close down his business in peace.

The appeal was allowed against all the surcharges.

First-Tier Tribunal (TC06497): *Sandpiper Car Hire Ltd*

A company appealed against surcharges of £8,041 for 08/16 and £217,435 for 09/16. The company operated as a breeder and racer of thoroughbred horses. It acts in association with another company, Zampino Ltd. For many years it had reported nil liabilities, because its outputs were always matched exactly by its inputs: everything was recharged to Zampino. However, HMRC visited the business in April 2016 and stated that this was not correct. There were acquisitions from the EU that would create a net liability each month. The company's accountant said that she had agreed with HMRC that the new treatment would start to operate in the 06/16 period.

The company was then late submitting its 06/16 return, and unsuccessfully tried to set up a direct debit. The Tribunal rehearsed the events leading to the issue of the two surcharges. The accountant had attempted to set up a DD on the HMRC website and had assumed that it had gone through correctly, but it had not. In her view, the failure to pay the 08/16 liability on time was due to HMRC's system failure.

After detailed consideration of the explanations given, the judge (Harriet Morgan) decided that there was a reasonable excuse for 08/16; this

reduced the 09/16 surcharge to 2%, at which level it remained "harsh, but not manifestly unfair". The appeal was allowed in part.

First-Tier Tribunal (TC06515): *Godolphin Management Company Ltd*

6.8.2 Penalties

A builder appealed against a late registration penalty on the grounds that he had limited English and limited understanding of the UK VAT system. Not surprisingly, these were not accepted as defences. The penalty was confirmed on the "careless" scale at 30%, mitigated by 65%. The notification was within 12 months of the date tax would otherwise have become payable, and was unprompted, but HMRC did not operate their concession to forgo the penalty altogether – there was some delay in responding to enquiries, so they did not accept that they had received the appropriate level of cooperation for full mitigation.

First-Tier Tribunal (TC06429): *Domell Builders Ltd*

Two individuals appealed against personal liability notices in the amount of £89,305 sent to them in August 2015. They related to disallowed input tax claimed by a scrap metal company of which they were directors. HMRC allocated the penalties to them on the basis that they knew or ought to have known of the connection with fraud, and the penalties were charged on the "deliberate, not concealed" scale.

The individuals argued that they were being assessed because the company could not pay; it was under the control of a liquidator, who had not appealed the penalties, which was unfair on them because they were not able to do so. The judge examined the facts in detail, concluding that Parliament cannot have intended to impose a penalty with no right of appeal.

The appeal therefore proceeded in a similar manner to a standard MTIC hearing, examining the behaviour and explanations of the various transactions and parties. The judge was satisfied that the two appellants actually knew that their transactions were artificial, and confirmed the penalty levied on the company and its allocation to them as directors.

First-Tier Tribunal (TC06458): *Stephen Bell and another*

A further decision was issued in the same dispute, but the detailed report has not yet appeared on the Tribunals website.

First-Tier Tribunal (TC06502): *Stephen Bell and another*

A company appealed against a penalty of £26,948 for an annual accounting period ending 12/16. The company had experienced significant growth in its second period of trading, and was then late submitting its annual return. As a result, it received an estimated assessment of £35,578 on 17 March 2017; the company paid £46,131, in spite of the fact that it had already made payments on account of £32,500; when the return was eventually submitted in June, it showed a liability £136,603 higher than that shown on the assessment. HMRC charged a penalty at 15% for a prompted disclosure.

The Tribunal noted that the company had been aware when the assessment arrived that it was too small by a significant amount. It took no steps to notify HMRC until well after 30 days later, and after HMRC

had written to ask for further information. The judge was satisfied that the penalty had been correctly levied.

He then considered at length whether it was appropriate to disregard the fact that the company had paid more than the original assessment. HMRC said overpayments of the assessed amount were irrelevant – the "potential lost revenue" was simply the difference between the amount assessed and the amount that was shown on the correcting return. After examining a number of arguments and alternative analyses, the judge concluded that this was correct. It was perhaps harsh not to allow any credit for the "overpayment" of £43,052, but it could not be said to be manifestly unfair, and it was in accordance with the statute.

The appeal was dismissed.

First-Tier Tribunal (TC06460): *Curtises Ltd*

6.8.3 Penalty guidance

HMRC have published a new factsheet *Penalties for transactions connected with VAT fraud*. It explains the penalties HMRC may charge where, after 16 November 2017, taxpayers have entered into transactions they knew, or should have known, were connected with missing trader fraud. These penalties are fixed at a rate of 30% of the amount of VAT at stake. In certain circumstances, HMRC may also publish details about businesses liable to penalties.

Factsheet CC/FS42

HMRC have published a guide to the penalty for "enablers" of defeated tax arrangements that are found to be abusive. The legislation in the F(no.2)A 2017 took effect on 16 November 2017, but it only applies where both the tax arrangements and the enabling action fall on or after that date.

The maximum penalty that can be levied is the full amount of the consideration received for selling the arrangements. The guide gives an example of a lawyer who charges a client £250,000 and pays out £100,000 to another adviser for specialist advice in relation to the arrangements; the total penalty is £350,000, not £250,000.

www.gov.uk/guidance/tax-avoidance-penalties-appeals-and-publishing-details-of-enablers

6.8.4 Strike out

A bingo company sought to make an adjustment similar to that considered in the *K E Entertainments* case (UT 2017). It had made an adjustment to its 12/11 VAT return but this was refused; its then tax agents had informed HMRC that, given the cost of disputing the decision, the company would not appeal. In 2016, a new tax agent sought to take the matter up again, and asked for a late statutory review of the earlier decision. HMRC pointed out that the decision had been made years before and the company had chosen not to appeal it. The company then filed an appeal against that decision.

HMRC applied for the appeal to be struck out on the basis that their letter was not itself an appealable decision. The appealable decision had been taken in 2012 and not appealed. There was a right of appeal against that,

but HMRC would strenuously object to the admission of a late appeal so long after the event, even though the case law showed that the company would probably succeed.

The judge did not accept various arguments put forward by the taxpayer to the effect that its amendment to its 12/11 return was still "live". He agreed with HMRC that there was effectively a time limit in reg.38 – the adjustment to the VAT account belonged in the period in which the company adjusted its accounting records, and that was at latest 12/11. He agreed that there was no separate appealable decision in the 2017 letter, and refused (on *Data Select* grounds) an application to appeal out of time.

The appeal was struck out.

First-Tier Tribunal (TC06487): *Buckingham Bingo*

HMRC applied for an appeal about a post clearance demand notice to be struck out. The appellant complained that this was unfair, and the judge had some sympathy with them. He also noted that the amount of preparation for the strike-out hearing was so great that it might have been simpler and more efficient to have held the substantive hearing.

Nevertheless, the judge was bound by rule 8(2): HMRC were correct that he did not have jurisdiction to hear the appeal, and so must strike it out. That was in spite of the fact that HMRC had initially encouraged the trader to appeal, and had even produced a statement of case, suggesting that the lack of jurisdiction had only occurred to them later.

The point at issue was the classification of certain imported fruit drinks. The company claimed to have based its zero-rating of the imports on the online tariff in 2013; HMRC argued, successfully, that this was effectively only a reliance on "legitimate expectation", which could not succeed before the FTT.

Judge Christopher McNall considered the situation in some detail and struck the appeal out. However, he pointed out that the trader could still apply for a customs decision asking for remission of duty; if that was refused, that would be an appealable decision.

First-Tier Tribunal (TC06534): *K2 (Northwest) Ltd t/a Zima Trading International*

6.8.5 Reinstatement refused

In a case about default surcharge, a trader had failed to comply with an "unless order". She subsequently applied for reinstatement of the appeal, but failed to turn up at the hearing where this would be considered. Not surprisingly, the application for reinstatement was refused, after more detailed consideration than might have been expected.

First-Tier Tribunal (TC06499): *Pauline McInnes*

6.8.6 Appeal not received

A trader was issued with default surcharges for 05/13 and 11/13. The decisions were upheld on review; the trader claimed that an appeal against the review decision had been submitted within 30 days of the review letter, but HMRC claimed that it had never arrived. The Tribunal had to consider whether as a matter of fact the trader had made its appeal within

the time limit, and if not, whether it should be allowed to proceed with the appeal out of time.

The trader's representative started by applying to the judge to bar HMRC's representatives from participating in the proceedings because they were not "authorised" or "exempt" persons under the Legal Services Act 2007 (as he was). The judge examined the legal basis for allowing the officers to participate in detail and concluded that they should not be barred.

The evidence that the trader had submitted an appeal comprised a form completed by the trader's tax agent and dated 2 April 2014. The trader claimed that it had been sent at that time, and a further copy sent later that year, but the Tribunal had no record of either document having arrived. The judge was satisfied on the evidence of the tax agent that the document had been sent, on the balance of probabilities, and the Interpretation Act therefore required the assumption that it had been delivered. However, the assumption is that first class post takes 2 days to arrive, which meant that it would have been delivered one day late – 31 days after the review decision.

On the basis of the decision that the notice had actually been made only 1 day late, the Tribunal allowed the appeal to proceed out of time. Had the judge concluded that the appeal had only been made when the Tribunal finally had a record of it (July 2017), he would have been inclined to refuse the extension of time.

First-Tier Tribunal (TC06495): *Porter & Co*

6.8.7 Appeal out of time

HMRC denied input tax of £1.9m to a company in June 2017 on MTIC grounds. The FTT in February 2018 dismissed the company's application to make late appeals in relation to earlier decisions of HMRC relating to £7.3m. The company claimed that HMRC had not correctly served the decisions so they had arrived late, but an employee had signed for them on the date that HMRC said they were served. For all the usual reasons, and in spite of the very large sums involved, the judge refused the application for leave to appeal out of time.

First-Tier Tribunal (TC06529): *Aim FM Ltd*

6.8.8 Procedure

In a missing trader fraud case involving scrap metal dealing, the appellant applied for a decision summarily allowing part of its appeal on the basis that the officer's assessment could not be to best judgement because the officer had not formed the necessary view that the counterparty's defaults were fraudulent, and HMRC had not produced sufficient evidence to show that they were. The application for a summary decision came before Judge Mosedale, who considered the arguments in detail and refused the application. She also refused most of the company's application for further disclosure of documents by HMRC, but allowed one small part of the application. She issued directions for the case to proceed towards a full hearing.

First-Tier Tribunal (TC06412): *Ronald Hull Junior Ltd*

A trader appealed against a default surcharge and a late filing self-assessment penalty (which is stated, without comment, to have been £1.26). He appealed very late (the penalties related to 2012), so the hearing was about whether to allow the appeal to continue. He did not appear and was not represented; the judge decided to allow the hearing to proceed.

However, he was highly critical of HMRC's skeleton argument, which in his view misrepresented the authority on whether shortage of funds could be a reasonable excuse. He referred to a number of precedents where HMRC have cited the dissenting judgment of the Court of Appeal in *Steptoe* rather than the rationale for the actual decision; he concluded that the taxpayer, not being professionally represented, could not have been aware of the case he had to meet. "In such circumstances, as it would not be in the interests of justice to have heard the appeal without allowing him the opportunity to consider these issues even if he was present, I cannot see how it could be in the interests of justice to proceed with the hearing in his absence."

The judge (John Brooks) therefore postponed the hearing and made directions. He expressed the hope that the matter could be settled by agreement without further recourse to the Tribunal.

First-Tier Tribunal (TC06491): *David Robert Adrian Jones*

On 21 January 2016, HMRC issued a decision to a company that its "bill payment" services were standard rated, rather than exempt as they had been treated in the past. The decision was upheld on review and various assessments were raised. The company appealed on 17 June 2016, within 30 days of the review decision.

The case proceeded with the exchange of statements of case and witness evidence. On 17 November 2017, HMRC wrote to the appellant asking if it would withdraw its appeal on the basis of the result of the 2016 CJEU decision in *Bookit* and the FTT's application of that decision in *Paypoint*. The company responded that it would not withdraw, and pointed out that the points covered in *Bookit* and *Paypoint* were not referred to in HMRC's statement of case and could therefore not be pleaded by HMRC.

HMRC did not accept this, but "out of an abundance of caution" they applied to amend their statement of case. The company opposed the application, and the matter came before Judge Mosedale. She set out her understanding of the point at issue in the case, which was the application of art.135(1)(d) PVD. HMRC's position was that they did not need to plead that the appellant's services were not "payments services" within that provision because the burden was on the appellant to show that its services were exempt; and, in any case, they considered that it was covered by their statement of case.

The judge disagreed with HMRC's view that the burden of proof put the onus on the appellant to prove everything, even matters that were not known to be in dispute. That would require an absurd level of preparation for a hearing, and the possibility of "trial by ambush", which would not be justice. HMRC's statement of case should outline the issues which are disputed and outline the facts relied on to support their position.

The original decision letter contained the "payment services issue" – whether the company's services fell within art.135(1)(d) at all – and also

stated that the services amounted to debt collection. However, the statement of case only asserted that the services amounted to debt collection. Judge Mosedale concluded that the statement of case did not, either explicitly or by implication, plead the question covered by *Bookit*.

The judge was then highly critical of the amendments put forward by HMRC. She did not think that they adequately reflected the argument that HMRC wanted to put. Although the Tribunal should ideally decide on the underlying dispute on the basis of what is right or wrong under the law, it was also necessary to provide "procedural justice". In effect, HMRC had caused their own difficulty by leaving half of their argument out of their statement of case, and then botching an attempt to put that right.

The judge refused the application to amend the statement of case. It seems likely that HMRC will appeal.

First-Tier Tribunal (TC06503): *Allpay Ltd*

In a MTIC dispute relating to the purchase and sale of CPUs in 2006, the FTT (TC04888) held that the director knew or ought to have known that the transactions were connected to fraud. The taxpayer was granted leave to appeal to the Upper Tribunal.

A journalist who writes for a technology and science news website then applied to the Tribunal for copies of various documents relating to the appeal. The sole director and shareholder objected to the documents being provided. The UT considered this objection to be an application under rule 14(8) of the Tribunal Procedure (Upper Tribunal) Rules 2008 (SI 2008/2698).

The UT considered that the principles of open justice required a presumption that documents should be made available, particularly where the applicant had shown a genuine journalistic purpose. The party wishing the documents to be kept secret would have to give a cogent reason; in this case there was no evidence that the director would suffer unfairness or any other real harm. Any damage to reputation had already been done by the FTT's decision, which was publicly available. There was no evidence that the journalist or the website would misrepresent or distort the facts.

The director's application was therefore refused.

Upper Tribunal: *Aria Technology Ltd v HMRC*

6.9 Other administration issues

6.9.1 Digital priorities

On 3 May, following a hearing of the Public Accounts Committee on 30 April, HMRC announced that they would scale back some of their programme of "digital transformation" to make room for work needed to upgrade customs systems in preparation for Brexit. The main areas affected are "simple assessment" and "dynamic PAYE coding"; there is no intention to change the timetable for Making Tax Digital for VAT.

HMRC Press Release 3 May 2018

6.9.2 Updated Notice

HMRC have updated their Notice *Insolvency*, apparently only to correct the telephone number for the VAT 426 processing team and provide a new contact point for partial exemption queries.

Notice 700/56

6.9.3 Tax gap

HMRC have issued their annual review of the calculation of the "tax gap", the difference between the expected revenue and the actual revenue they receive. Their view of the size of the tax gap, and the reasons for it, is an important driver in their planning and administration.

HMRC estimate the tax gap in 2016/17 to have been £33bn, representing some 5.7% of the total tax and duties due. The 2015/16 estimate of £34bn has been revised downwards to an actual figure of £32bn (from 6% to 5.7% of the total). Small businesses made up the largest share of the tax gap (41%), followed by large businesses (21%), mid-sized businesses (12%) and individuals (10%). Criminal activity accounted for 16% of the total.

Failure to take reasonable care is responsible for 18% of the total tax gap in 2016 to 2017 (£5.9 billion) and is the largest behavioural component of the overall tax gap. This means that failure to take reasonable care, together with error 10% (£3.2 billion), make up £9.2 billion in the total attributable to mistakes. This percentage for both error and failure to take reasonable care remains the same as the previous year, however, the cash value has increased by £1 million in both cases. Failure to take reasonable care has remained relatively stable since 2005 to 2006.

The hidden economy tax gap is estimated at 10% of the total tax gap (£3.2 billion) in 2016 to 2017 compared to 9% (£3.1 billion) in 2015 to 2016. This is an increase from 6% (£2 billion) of the total tax gap in 2005 to 2006.

The VAT tax gap was 8.9% in 2016 to 2017 (£11.7 billion) as a percentage of VAT liabilities. This is a slight increase on the previous year where the gap was 8.4% (£10.6 billion). The VAT tax gap shows a declining trend, falling from 12.5% in 2005 to 2006 (£10.4 billion).

HMRC say they have been working hard to reduce the VAT tax gap by:

- bearing down on organised VAT fraud – the (MTIC) element of the VAT gap held for several years at £500 million to £1 billon and has now reduced to less than £500 million)
- introducing anti-fraud measures - 'joint and several liability' for online marketplaces holding them liable for any unpaid VAT of overseas businesses who are non-compliant with UK VAT rules, and a 'domestic reverse charge' for wholesale telecoms, meaning that VAT is based on where customers are based rather than where the supplier is based
- becoming digital by default – introducing online VAT filing, online VAT registration and Notification of Vehicle Arrivals for vehicles imported into the United Kingdom

www.gov.uk/government/publications/issue-briefing-calculating-the-2016-to-2017-tax-gap

6.9.4 Card transaction disclosure programme

HMRC have updated their guidance on the card transaction disclosure programme, which extended the credit card sales campaign, launched in 2014, to include businesses accepting payment by cash, online or telephone, as well as by debit and credit cards. The guidance explains how disclosing past omissions under the programme may lead to lesser penalties. VAT is included in the taxes covered, but there are warnings that certain types of VAT misdemeanour will not enjoy the same lenient treatment (e.g. bogus registrations). The programme can also not be used to gain a better treatment of deliberate and fraudulent actions.

www.gov.uk/guidance/tell-hmrc-about-your-credit-and-debit-card-transactions

6.9.5 Banning order

The Insolvency Service has handed down a 15-year ban to a carbon emissions allowance and metals trader after an investigation revealed that the director was a part of MTIC scheme, which involved VAT fraud that resulted in £7.1m in tax losses for HMRC. Oddly, the company concerned (Masstech Ltd) has been involved in two reported FTT decisions over the years, the first of them a successful appeal against a MTIC disallowance relating to the purchase and sale of alcohol test strips in 2006. The second concerned a dispute over admissibility of evidence.

Insolvency Service Press Release 13 June 2018

6.9.6 Europol announce success

Europol announced the dismantling of a Chinese criminal organisation that fraudulently imported goods into the EU from China. The investigation was carried out in Spain, Portugal and Romania. Officers seized €8m in cash.

During the operation, Europol deployed a mobile office on-the-spot in Spain and it is expected that Europol's mobile office will support the data extraction from telephones, devices and computers.

Europol are interested in specific areas of economic crime such as:

- missing trader intra-community fraud, which involves the criminal exploitation of value-added tax rules in the EU, resulting in lost revenue running into the billions of euros for Member States;
- excise fraud, which refers to the smuggling of highly taxed commodities such as tobacco, alcohol and fuel;
- money laundering, the process of making the proceeds of criminal activity appear legal.

Europol Press Release 25 June 2018

6.9.7 Security

HMRC issued a notice of requirement to deposit security for VAT and PAYE to a company. The company put forward an argument in five strands:

- before reaching the original decision, HMRC did not enter into dialogue with the company, so did not give the appellant the opportunity to provide further information;
- the notice was unreasonable in view of the forecast profit for the next two years (which was not available to the officer making the decision, because of the lack of dialogue);
- the review process was flawed because another HMRC officer could not be independent of the first decision;
- the factual background was different from earlier cases such as *Southend United*, *John Dee* and *Rosebronze*, because the company had only been trading since March 2017 and had a limited history rather than a long trail of defaults;
- a notice had been issued personally to a director, "piercing the corporate veil".

The judge considered each of these arguments in turn and rejected them all. The Tribunal had limited jurisdiction; the burden was on the appellant to show that the decisions had been unreasonable, and had failed to discharge that burden.

First-Tier Tribunal (TC06447): *Derby Access Scaffolding Ltd*