VAT UPDATE
JANUARY 2011

Covering material from October – December 2010

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VAT Update January 2011

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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, HMRC 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 reported the progress of appeals stopped being updated some time ago and now appears to have been dropped altogether. It is now only possible to pick up clues to unsettled cases from Revenue & Customs Briefs which announce HMRC's intention to appeal a decision or to concede defeat.

Awaiting the ECJ:

- *Rank Group plc*: the exemption for FOBT gaming machines (the Upper Tribunal and Court of Appeal have referred questions which were described in the last update)

UK appeals awaiting hearing:

- *Enersys Holdings UK Ltd*: HMRC appeal to the Upper Tribunal after the First Tier Tribunal found a £130,000 default surcharge "disproportionate" for being one day late with a payment
- *Isle of Wight Council and others*: remitted to Tribunal to consider evidence again in light of ECJ's ruling on how "risk of distortion of competition" is to be applied (further developments in this update)
- *Pendragon plc*: HMRC will appeal to the Upper Tribunal after the First Tier Tribunal found a scheme "not abusive"

The following cases from previous lists have now been determined, and the ECJ judgments are in this update:

- *Axa (UK) plc*: payment plan for dentists held not to be exempt
- *Macdonald Resorts Ltd*: nature of supplies where timeshares are sold for "points"

- *T-Mobile Ltd*: additional charges for paying by cheque could not be exempt
- *RBS Deutschland GmbH*: arrangements exploiting differences between UK and German law on car leasing did not constitute an abuse of rights
- *Weald Leasing Ltd*: artificial leasing arrangements constituted an abuse of rights, but not in the way that HMRC wanted

Other appeal cases in this update include:

- *Airtours plc*: accountants' report in relation to refinancing was supplied to the lenders, not to the borrower (Upper Tribunal)
- *London Clubs Management Ltd*: trader's proposal for a special partial exemption method was acceptable (Upper Tribunal)

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Manual update

HMRC have published a new online manual on "taxable persons" which is concerned with the scope of VAT. It deals with some of the basic principles of VAT and will help determine whether a person is making a supply and whether a supplier is a taxable person.

www.hmrc.gov.uk/manuals/vtaxpermanual/VTAXPER10000.htm

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Financial services

In 2006 the Commission published proposals to reform the exemptions for insurance and financial services, but there has been a long silence since then. Now the Council at its 17 November 2010 meeting agreed that work on the modernisation of these exemptions should be pursued as a priority. The following points were made:

- cost sharing by economic operators: it was recognised that there is no need for further work at Council level at this stage;
- the option to tax: the Council asked the Commission to explore the possibilities for allowing a departure from the current VAT exemption;
- definitions of exempt services: it was agreed that due consideration should be given to the need to ensure a level playing field for economic operators and for member states, to the overall competitiveness of the EU's financial industry and to the implications for government budgets. More specifically:
  - the modernisation of the definitions should achieve neutrality and consistency in the application of the VAT exemption to the constituent elements of all exempt services;
  - for investment funds and pension funds, the Council asked the Commission to report on the overall effect of changes in the regulatory climate, so that the available options may be considered;

- for derivative financial products, it was agreed that the measures to be adopted should not affect the inherent taxable nature of goods and services, and the exemption should be limited to transactions that can be considered effectively as exempt financial or insurance services.

http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/117790.pdf

2.3.2 Dental plan

A company operated a "dental plan" for dentists. The dentists signed up their customers to the plan, and the company then collected regular payments from the customers. In exchange for fees payable to the company, the dentists obtained a range of benefits, including payment handling, making reports of payments and non-payments, support in setting fees, training, use of brand name and logos, advertising and some other services.

HMRC ruled that the fees charged to the dentists were wholly taxable, being for administrative and other services. The company argued that they were wholly exempt, being principally for collecting the payments from the customers.

The Tribunal examined the facts and agreements in great detail, comparing them with precedent cases including *Sparekassernes Datacenter* and *CSC Financial Services*. It was decided that there was an exempt supply of making money transfers, and it was a significant part of the supply that the company made to the dentists: part of that supply was therefore exempt. However, it was not true that the financial supply was a main supply to which everything else was ancillary. The other services would also be important to the dentists, so the consideration would have to be apportioned between taxable and exempt.

The appellant and HMRC were sent away to discuss an apportionment. However, both parties appealed to the High Court: HMRC appealed against the decision that there were separate supplies and against the decision that a single composite supply would be exempt; the company appealed against the decision that the various elements of the supply were not merely ancillary to the overall exempt supply.

The judge dismissed both appeals and upheld the Tribunal's decision on both points. The judge held that it was possible for someone other than a bank to "effect transfers" by giving instructions to BACS which would be automatically carried out. HMRC wanted a much more restricted interpretation of that part of the financial services exemption which would limit its scope to banks and those who provided services that were similar to those of a bank.

Both parties appealed again to the Court of Appeal, which referred questions to the ECJ. This is how the Court of Appeal saw the issues:

(1) What are the characteristics of an exempt service that has "the effect of transferring funds and entail[s] changes in the legal and financial situation"? In particular:

> *(a) Is the exemption applicable to services which would not otherwise have to be performed by any of the financial institutions which (i) make a debit to one account, (ii) make a corresponding credit to another account, or (iii) perform an intervening task between (i) [and] (ii)?*
>
> *(b) Is the exemption applicable to services which do not include the carrying out of tasks of making a debit to one account and a corresponding credit to another account, but which may, where a transfer of funds results, be seen as having been the cause of that transfer?*

(2) In the light of SDC, is a trader (which is not itself a bank) performing an exempt service in accordance with Article 13B(d)(3) [of the Sixth Directive] where the tasks he carries out for his client

> *(1) comprise the collection, processing and onward payment of monies due to the client from a third party; in particular, the tasks of:*
>
> > *(a) transmitting information to the third party's bank calling for a payment from the third party's bank account to the trader's own bank account, in reliance on a standing authorisation given by that third party to the bank (pursuant to the "direct debit" scheme); and subsequently, if the bank makes that payment,*
> >
> > *(b) giving an instruction to his own bank to transfer funds from his account to the client's bank account*
>
> *but (2) do not include tasks of (a) making a debit to one bank account, (b) making a corresponding credit to another bank account, or (c) performing any intervening task between (a) and (b)?*

(3) Does it make a difference to the answer to Question 2 (above) if the service described in that question is performed by transmitting the information to an electronic system which then automatically communicates with the relevant bank, even if the transmission of the information may not always result in a transfer being made (e.g. because the third party has cancelled his standing authorisation to his bank or does not have sufficient funds in his account)?'

The ECJ has now ruled that HMRC were right and the Tribunal and High Court were wrong: there is a single supply which is not exempt. The court's reasoning surprised many people, because it classified what AXA does for the dentists as falling under "debt collection", which is excluded from exemption under art.135(d). HMRC may be looking at this decision for implications for other services which have previously been considered to be exempt. The description of the service in the judgment is "*a supply of services which consist, in essence, in requesting a third party's bank to transfer to the service supplier's account, via the direct debit system, a sum due from that party to the service supplier's client, in sending to the client a statement of the sums received, in making contact with the third parties from whom the service supplier has not received payment and,*

finally, in giving instructions to the service supplier's bank to transfer the payments received, less the service supplier's remuneration, to the client's bank account".

The court rejected the view of the Commission that "debt collection" referred to a service provided only when debts are overdue (paras. 34 and 35):

Contrary to the Commission's submission, it is irrelevant that such service is supplied at the time when the debts concerned become due. The final words of Article 13B(d)(3) of the Sixth Directive cover the collection of debts of any nature, without limiting their application to debts which were not paid on their due date. Moreover, factoring, all forms of which are included in the terms 'debt collection and factoring' (see MKG-Kraftfahrzeuge-Factoring, paragraph 77), is not limited to debts in respect of which the debtor has already defaulted. It can also have as its object debts which have not yet become due and which will be paid on the due date.

In addition, in view of the interpretation of the exception to the derogation from the application of VAT given by the case-law cited in paragraphs 30 and 31 of the present judgment, it is also irrelevant to the treatment of the service in question in the main proceedings as 'debt collection and factoring' that it does not provide for coercive measures for the effective payment of the debts concerned.

ECJ (Case C-175/09): *AXA UK plc v HMRC*

2.3.3 Payment processing?

The *T-Mobile* case has been decided by the ECJ. The company levied extra charges on customers who paid by cheque or debit card (about 28% of customers), in order to encourage them to pay by direct debit or BACS transfer. Initially it accounted for output tax on the whole amount received from customers, but then it submitted a voluntary disclosure claiming a repayment of over £4m. It claimed that these "single payment handling charges" were exempt, but in early 2008 the Tribunal dismissed its appeal against HMRC's ruling that they were taxable (and refusal to make the repayment against the voluntary disclosure).

The Tribunal upheld HMRC's policy in this area in all respects. There was no separate supply of payment handling services: the company was simply collecting its debts, even if it purported to make a separate charge for doing so. If the Tribunal was wrong and there was a separate supply, it was incidental and ancillary to the main supply of telecommunications services, so it would take the same liability under *Card Protection Plan*.

The service that the company claimed to provide could be distinguished from that of *Bookit Ltd* and *FDR* (both held by the Court of Appeal to be exempt as involved in payments and transfers) because the company did not collect or transmit authorisation codes for payments – that was done for it by its bank. This effectively approved HMRC's policy on payment charges as explained in Business Brief 18/06 following the *Bookit* decision. HMRC explained there that the Court of Appeal found for *Bookit* because its services included all of the following elements:

- obtaining the card information with the necessary security information from the customer;
- transmitting that information to the card issuers;
- receiving the authorisation codes from the card issuers; and
- transmitting the card information with the necessary security information and the card issuers' authorisation codes to Girobank.

The first three elements would be taxable on their own, but the fourth element was fundamental to the supply and made the whole thing exempt. Accordingly, HMRC accept that card handling charges are exempt if they include the fourth element, but not if they do not. In particular, if a trader simply requires someone to pay more for goods or services because they are using a credit card to pay, that will not constitute separate consideration for an exempt supply of services. It will be additional consideration for the goods or services themselves.

The High Court decided to refer the following questions to the ECJ:

1. What are the characteristics of an exempt service that has "the effect of transferring funds and entail[s] changes in the legal and financial situation"?

In particular:

a. *Is the exemption applicable to services which would not otherwise have to be performed by any of the financial institutions which (i) make a debit to one account, (ii) make a corresponding credit to another account, or (iii) perform an intervening task between (i) or (ii)?*

b. *Is the exemption applicable to services which do not include the carrying out of tasks of making a debit to one account and a corresponding credit to another account, but which may, where a transfer of funds results, be seen in retrospect as having been the cause of that transfer?*

2. Does the exemption in Article 13B(d)(3) of the Sixth Directive for "transactions concerning payments [or] transfers" apply to a service of obtaining and processing payments by credit and debit cards, such as those performed by the taxpayer in the present case? In particular, where the transmission of settlement files at the end of each day by the taxpayer has the effect of automatically causing the customer's account to be debited and the taxpayer's account to be credited, will those services fall within the scope of Article 13B(d)(3)?

3. Does the answer to Question 2 depend on whether the taxpayer itself obtains authorisation codes for onward transmission or obtains those codes through the agency of its acquiring bank?

4. Does the exemption in Article 13B(d)(l) of the Sixth Directive for "the negotiation of credit" apply to services such as those offered by the taxpayer in the present case in relation to credit card payments, whereby as a result of those services the customer's credit card account is debited with further amounts of credit?

5. Does the exemption for "transactions concerning payments [or] transfers" apply to services of accepting and processing payments made using third party agents, such as those offered by the taxpayer through the Post Office and PayPoint in the present case?

6. Does the exemption for "transactions concerning payments [or] transfers" apply to services of obtaining and processing payments made by cheque sent to the taxpayer or his agent, which payments have to be processed by the taxpayer and its bank?

7. Does the exemption for "transactions concerning payments [or] transfers" apply to services, such as those offered by the taxpayer in the present case, of receiving and processing payments made over the counter at a bank for credit, through the banking system, to the taxpayer's bank account?

8. What particular factors have to be taken into account when deciding whether a charge (such as the payment handling charge in the present case) that is applied by a taxpayer to its customer in respect of the customer's choice to make payment to the taxpayer using a particular payment method, and which is individually identified in the contractual document and separately itemised in invoices issued to customers, is a separate supply for VAT purposes?

Presumably the judge thought that a comprehensive reference of this sort would resolve a number of issues and would help with the determination of future disputes. However, the ECJ decided to read to the end of the questions before attempting any of them. The judgment simply states that the answer to the last question is that there is no separate supply, and as a result there is no need to answer the other seven.

The last question is at least answered in some detail, listing the various precedent cases which have dealt with the issue of “incidental or ancillary supplies”, “artificial separation” and supplies which are an “independent aim for the purchaser”. The answer is that the payment handling services, even if itemised separately and given their own apparent price and consideration, cannot constitute an independent aim of the purchaser, and therefore cannot have a VAT liability separate from the main supply.

The answer does not address the distinction that the UK courts have drawn between:

- the situation where there are two supplies, but one is incidental to the other and therefore takes the liability of the main supply (as in *Card Protection Plan*);
- the situation where there is in fact only one supply, because the alleged second supply is so absorbed within the main part that it does not constitute anything at all (as in *College of Estate Management*).

Although the result is the same in either case (a single VAT liability), the arguments about the facts are slightly different, and it would have been interesting to see where the ECJ put this case. It seems likely that these payment charges are like the teaching materials in *College of Estate Management* – not a separate supply at all.

ECJ (Case C-276/09): *Everything Everywhere Ltd (formerly T-Mobile Ltd) v HMRC*

2.3.4 Financial intermediary

An estate agent was engaged to find a buyer of land in the UK. An arrangement was put in place whereby the land was transferred to a Jersey Property Unit Trust in exchange for units, and the estate agent then found a buyer for the units. The estate agent argued that its services were now exempt financial intermediary services (relating to a transaction in units of a unit trust) rather than taxable property management services.

The creation of the unit trust was mainly an arrangement to save Stamp Duty Land Tax. The vendor of the property transferred its whole interest into the trust in exchange for 57 million units (20 March 2006); an associated company then purchased another 250,000 units for £250,000 in cash (21 March 2006). A single company purchased all the units in the unit trust for £57.5m on 28 April 2006 (apart from 10,000 which were transferred to a separate company in Jersey). On 10 October 2006 the property was transferred to the purchaser and, it is assumed by the Tribunal, the unit trust was wound up.

HMRC argued that the "economic reality" of the situation was that the estate agents had acted in the normal way to secure a transaction in property. The use of the unit trust was only to "dress up" the transaction as something else for tax purposes.

The Tribunal decision is brief. As HMRC did not argue that the creation of the units was a sham, there was no question that the transaction which resulted was a transaction in units that fell within Group 5 Sch.9 VATA 1994. To recharacterise them as equivalent to the underlying property would violate the principle of legal certainty. The estate agent was acting in much the same way as a normal estate agent would in relation to a normal property transaction, but the subject matter of the transaction was not normal property. The services fell squarely within the exemption and the appeal was allowed.

First Tier Tribunal (TC00847): *Joiner Cummings*

2.3.5 Unethical lending

The ECJ has ruled that the activities of loan sharks, even if illegal, are nevertheless within the scope of the VAT Directive because they involve the advancing of credit. A member state cannot impose VAT on lending at excessive rates of interest where lending at lower rates is exempt.

ECJ (Case C-381/09): *Gennaro Curia v Ministero dell'Economia e delle Finanze Finanze*

2.3.6 Gaming machines

HMRC have announced that the Government intends to press ahead with the replacement of both Amusement Machine Licence Duty and VAT (where currently payable) on the takings of gaming machines. They will be replaced by a new gross profits tax called "Machine Games Duty". This follows a consultation, the responses to which have been published on the HMRC website.

The VAT dispute is summarised as follows:

The Government believes that exempting gaming machines from VAT will also increase the stability of the tax regime as gaming machines will then have the same VAT treatment as other gambling activities. Product developments are increasingly blurring the boundary between different forms of gambling. Equal VAT treatment will therefore be a more sustainable approach in the long run.

http://www.hm-treasury.gov.uk/d/consult_gamingmachinestax_response.pdf

2.3.7 Another gambling reference

The Belgian court has referred the following question to the ECJ:

"*Must Articles 6(4) and 13(B)(f) ... be interpreted as precluding tax exemption in respect of services supplied by a commission agent acting in its own name, but on behalf of a principal who organises supply of services referred to in Article 13(B)(f)?*"

In line with a string of precedent decisions including *SKD* and *United Utilities*, the answer seems likely to be a brief "yes".

ECJ (reference) (Case C-464/10): *Belgian State v Maître Pierre Henfling, Maître Raphaël Davin, Maître Koenraad Tanghe (acting as trustees in bankruptcy of Tiercé Franco-Belge SA)*

2.3.8 Goods or services?

The last update reported that Advocate-General Sharpston gave an opinion that a scientific procedure should qualify as medical care – the extraction and multiplication of cartilage material with a view to its reimplantation, either in the subject from whom it was extracted, or in another patient.

The question from the German court first asked whether the procedure should be classified as "work on goods", and were clearly directed towards place of supply issues. The overall opinion did not directly answer that part of the question, but gave the overall conclusion that the supply should be regarded as "medical care" and therefore falls within the exemption. Nevertheless, the Advocate-General gave a brief consideration of the "work on goods", and concluded that:

- human cells can be "goods" and are clearly tangible and moveable;
- the "work" is merely the application of existing scientific knowledge and therefore does fall within the expression "work on goods", unlike the services of the vets in the *Linthorst* case;
- where the customer provides a different state's VAT registration number to the supplier, the supplier should not have to charge VAT because the place of supply would be shifted to where the customer belongs.

According to the Advocate-General, it makes no difference whether the cells are used for the person from whom they were extracted or for someone else; it also does not matter that the services are performed by laboratory staff rather than qualified medical practitioners. Although they are only part of the process, they are "an essential, inherent and

inseparable part of the process, none of the stages of which can usefully be performed in isolation from the others”.

The full court has upheld the opinion and ruled that this supply is exempt.

ECJ (Case C-156/09): *Finanzamt Leverkusen v Verigen Transplantation Service International AG*

2.3.9 Ethical trading

The Ethical Trading Initiative was established in 1998 as a company limited by guarantee. Its objective was to promote ethical trading in order to improve conditions for workers and communities in the supply chains of companies which supply products to the UK market. Companies paid subscriptions to be members of the initiative, and the company charged VAT on these (which the companies could usually recover). HMRC ruled that the subscriptions were exempt under Item 1(e) Sch.9 Group 9 VATA 1994, and the company appealed. It did not believe that its objects met the definition: “a body which has objects which are in the public domain and are of a political, religious, patriotic, philosophical, philanthropic or civic nature.” In particular, it did not accept that its objects were “in the public domain”.

The Tribunal agreed with HMRC. The objectives of the company were of a political and philanthropic nature, and they were “in the public domain”, so they met the conditions for exemption.

First Tier Tribunal (TC00690): *Ethical Trading Initiative*

2.3.10 Investment gold?

A company failed to account for output tax on certain supplies of gold. When HMRC raised an assessment, the company claimed that the exemption in Sch.9 Group 15 VATA 1994 applied. The Tribunal agreed with HMRC that the exemption depended on a number of accounting and record-keeping conditions which the trader had not complied with. Ignorance of those requirements could be no excuse: without observing the rules in Public Notice 701/21, the trader could not benefit from the exemption.

The trader argued that he had not received a control visit for several years after registering: if HMRC had told him what was required at an earlier stage, he would have corrected his trading practices and would not have suffered such a large assessment. The Tribunal expressed sympathy with his predicament, but pointed out that it was the trader’s responsibility to familiarise himself with the law. It appears that some of his sales did comply, but this appears to have been accidental rather than deliberate.

First Tier Tribunal (TC00844): *Lal Jewellers Ltd*

2.3.11 Cost sharing

HMRC and HM Treasury have published a list of planned tax consultations. The only one relating to VAT is a consultation on the implementation of the EU cost sharing exemption. No launch date has yet been set for the consultation.

www.hmrc.gov.uk

2.4 Zero-rating

2.4.1 Hot takeaways

After some acrimonious arguments about procedure, a Subway franchisee has lost an appeal about the VAT treatment of a particular type of toasted sandwich. The Tribunal ruled that the dominant purpose for heating the food was to enable it to be consumed at above the ambient air temperature, and it was therefore standard rated.

This was a lead appeal which will bind another 250 or so franchisees who were arguing the same point.

The Tribunal examined the process by which subs are made and heated in great detail. Expert evidence was taken from several professors, one of whom had taken thermal images of a ham toasted sub to illustrate the way in which the temperature varied through it.

The Tribunal report includes extracts from the cross-examination of the franchisee, who maintained that it was her intention to sell a toasted sub rather than a hot sub. The problem with her argument was that her "definition" of hot did not accord with the legislation. She contended that the food was not hot because it was not at the same temperature as a restaurant meal. HMRC only had to show that she intended to heat it so that it could be consumed at above the ambient air temperature. It was clear that the franchisee knew what the legal test was and her stated purpose had to be interpreted in that light. The Tribunal considered that the "factual context" of the heating of subs was different from that portrayed by the franchisee: the purpose in heating the subs was to give the customers what they wanted, and that was something that would not only be toasted but would also be warm.

The decision includes a note about the designation of the case as a lead appeal under reg.18. HMRC had objected to this, arguing that it was illogical to designate a lead appeal where the decision would turn on a subjective intention. However, the designation was confirmed and HMRC must now be happy with it.

First Tier Tribunal (TC00747): *Sub One Ltd (t/a Subway)*

2.4.2 Drinks

The manufacturer of Lucozade Sport sought to rely on the earlier decision in *Science in Sport Ltd* that a powder used to make a sports drink could be zero-rated as a food rather than standard rated as a beverage. The Tribunal distinguished the present case, holding that Lucozade is consumed by many people who are not taking part in exercise. It had been a specific finding of the earlier case that it was very unlikely that the powder would have been used by anyone other than an athlete concerned with nutrition. Costs were awarded to HMRC.

First Tier Tribunal (TC00688): *GlaxoSmithKline Services Unlimited*

The manufacturer of Innocent fruit smoothies accounted for output tax on sales, then made a reclaim on the basis that it should have treated supplies as zero-rated. The Tribunal agreed with HMRC that the smoothies were beverages and properly excluded from zero-rating. They had the

consistency of thin soup, but they were clearly intended to be drunk from the bottle and were therefore not "food" but beverages.

The appellant's counsel argued that "food" is zero-rated under a transitional derogation which requires there to be a social policy reason for the relief. He suggested that the social policy is to zero-rate nutritious items and to standard rate "junk food". The Tribunal chairman was unable to discern a clear social policy behind the exceptions to zero-rating and therefore did not base her decision on that argument.

The Tribunal examined a great deal of evidence and argument, including expert witness statements concerning nutrition, market research, and the detailed composition and preparation of smoothies. However, the result was based on the ordinary meaning of the word beverage, in line with the Court of Appeal's decision on Pringles: such a dispute is more susceptible to common sense than exhaustive legal and scientific analysis.

First Tier Tribunal (TC00771): *Innocent Ltd*

2.4.3 Not a charity

A company appealed for donations of furniture and electrical items. It sold most of these to people who were in need. Even though it was registered for VAT, it did not account for output tax on these sales. When HMRC issued a ruling that they were subject to VAT, the company appealed, arguing that it should be treated as a charity and the sale of donated goods would therefore be zero-rated under Sch.8 Group 15 Item 1. Public Notice 701/1 appears to suggest that a company could be accepted by HMRC as a charity even if it is not registered as such with the Charity Commissioners.

The Tribunal rejected this contention, while acknowledging that the Notice was "unfortunate" in its wording. The company was not a charity and did not qualify for the relief.

First Tier Tribunal (TC00691): *Furniture Finders of Winsford Ltd*

2.4.4 Books etc.

HMRC have published a revised version of Notice 701/10 on zero-rating of books etc. The main change is the removal of a requirement to obtain a ruling from HMRC on the status of certain printed items which have a detachable form for completion (which could therefore constitute stationery).

Notice 701/10

2.4.5 Changing planes

HMRC have published a paper explaining the changes to import duty and import VAT arising from the changes to the definition of "qualifying aircraft" which took effect on 1 January 2011. It should be read by "*importers and owners of aircraft and aircraft parts who use or hold an End Use authorisation*".

JCCC CIP (10) 91

2.4.6 Concession withdrawn

As part of the ongoing review of extra-statutory concessions following the *Wilkinson* decision in the House of Lords, HMRC have announced the withdrawal of several concessionary treatments for payments by caravan owners and occupiers to caravan site owners. With effect from 1 January 2012, it will no longer be possible for caravan site customers to receive:

- the recharge of business rates as outside the scope of VAT
- zero-rated water and sewerage charges where actual consumption cannot be identified; and
- first time connection to utilities as zero-rated for VAT.

12 months' notice has been given to allow site owners to plan for any required adjustments to charges.

HMRC Press release 14 December 2010

2.5 Lower rate

Nothing to report.

2.6 Computational matters

2.6.1 Rate change

HMRC have published a research report which explains the compliance burden and commercial impact of the temporary reduction of the standard rate of VAT to 15% for the 13 months from 1 December 2008 to 31 December 2009.

HMRC Research Report 103; http://www.hmrc.gov.uk/research/comp-costs-comm.pdf

HMRC have also issued a Brief to remind traders of some of the main issues arising from the rate change on 4 January 2011, and to direct traders to the more detailed guidance available.

Payments on Account Regime

The VAT rate increase means that there will be consequential changes to the VAT Payment on Account (POA) thresholds. Under the POA, certain businesses are required to make monthly VAT payments. Since the VAT rate change will increase the VAT liabilities of businesses, the POA entry and exit thresholds will go up from £1.6m and £2m to £1.8m and £2.3m. The thresholds will change on 1 June 2011 for quarterly reviews and on 1 December 2011 for annual reviews. For further information on the POA see Notice 700/60 Payments on account on our website, go to www.hmrc.gov.uk.

Businesses – what you must do when the standard VAT rate changes

For any sales of standard-rated goods or services that you make on or after 4 January 2011, you must charge VAT at the 20 per cent rate. The special arrangements for businesses trading on 31 December 2009 (when the standard rate reverted to 17.5 per cent) will not apply to this rate change.

If you have a cash business and calculate your VAT using the VAT fraction you must use the VAT fraction of 1/6 on your standard-rated VAT inclusive sales from 4 January 2011.

If your business issues VAT invoices, the normal rule is that you must use the new 20 per cent rate for all VAT invoices you issue on or after 4 January, which are issued within 14 days (or longer period that has been agreed with HMRC) of you providing the goods or services.

Supplies that span the rate change

If you supply goods or services before 4 January 2011, but issue a VAT invoice on or after that date, you can choose to charge VAT at 17.5 per cent.

For continuous supplies of services where a contract started before 4 January, you can choose to charge the old rate, 17.5 per cent, on services actually performed before 4 January, and the new rate of 20 per cent on the value of services actually performed on or after.

Businesses reclaiming VAT

From 4 January 2011, you may receive VAT invoices with the new 20 per cent rate, as well as VAT invoices with the old 17.5 per cent rate for goods or services you bought before the rate changed. In such cases, you should claim back VAT at the rate shown on the invoice.

Completing a VAT return

The deadlines for submitting VAT returns remain the same, so you should continue to submit VAT returns in the usual way - whether you send them monthly, quarterly or annually. For returns that span the change in rate, you will need to add together both the VAT on sales charged at 17.5 per cent and those charged at 20 per cent. You then put this total in box 1 of your VAT return.

Countering arrangements designed to take advantage of the VAT rate change

In order to counter arrangements where businesses aim to take advantage of the VAT rate change by applying the 17.5 per cent VAT rate to goods or services to be delivered or performed on or after 4 January 2011, anti-forestalling legislation has been introduced. Further details can be found in the web link below.

R & C Brief 52/2010

www.businesslink.gov.uk/bdotg/action/layer?topicId=1085334907&furlname=vatratechange&furlparam=vatratechange&ref=&domain=www.businesslink.gov.uk

Apparently some commentators and consumers had hoped that the VAT increase was "temporary", just as the VAT decrease in December 2008 was for 13 months only. George Osborne has confirmed that it is as permanent as any tax policy can be – it is built into the Treasury's calculations until the end of the current Parliament in 2015.

Financial Times 17 December 2010

2.7 Discounts, rebates and gifts

2.7.1 Consideration and discounts

A company paid "cashbacks" to customers who entered into agreements to carry out home improvements using a loan facility. The company argued that the cashbacks reduced the VATable consideration for the supplies of the taxable home improvements. HMRC argued that the cashback was rather an inducement to borrow the money from a particular source and to keep that loan agreement open for a particular period, and it would therefore not reduce the taxable consideration.

The company offered cash or credit terms to its customers. If the customers took the credit option, the company earned commission from its chosen finance provider, Clydesdale Bank. This commission was clawed back if the loan was terminated by the customer within 120 days. The amount of the commission varied between 12.4% and 22.5% of the loan amount. One of a variety of promotional offers by the company was a cashback amounting to 10% of the loan amount if the customer took the loan and kept it open for at least 180 days.

It was agreed that there were three distinct supplies:

- *First, there is a home improvement supply from the Appellant to the customer. The consideration for this supply is the payment by the customer to the Appellant.*
- *Secondly, there is the exempt supply of credit by Clydesdale to the customer. The consideration for this supply is the payment of interest from the customer to Clydesdale.*
- *Thirdly, there is the supply of introduction services from the Appellant to Clydesdale, i.e. the introduction of the Appellant's customer by the Appellant to Clydesdale. The consideration for this supply is the payment of commission from Clydesdale to the Appellant.*

In 2006 HMRC formed the view that the cashback was an inducement which was related to earning the introductory commission, rather than to making the home improvement supply.

The company argued that orders using finance were generally higher than orders paid for in cash. The cashback offer encouraged people not just to take out a loan, but to buy more home improvements. That was the business strategy of the company, and it was the rationale behind this promotional scheme.

The Tribunal examined the precedent cases on consideration in detail. It decided that the payment by the company to the customer was not for a supply of services by the customer (i.e. the fulfilment of certain conditions that would generate income for the company) but was in reality a discount that was payable if the customer satisfied a contingency. Its economic purpose was identical to other incentives offered by the company, and it should be treated for VAT as a discount.

The Tribunal commented on the decision in *Jag Communications Ltd* (VTD 20,002) in which a company selling mobile phones gave customers a cashback that was higher than the whole value of the phone. It enjoyed a significant payment from a telecom provider if it signed customers up to an airtime contract, and it rebated some of this to the customer. There is an implied disagreement with the conclusion of the Tribunal in that case that the customer provided a service rather than merely satisfying a contingency; however, the result there was made more difficult by the possibility of a rebate creating a negative sale price for the phone.

As the appeal had been commenced before 1 April 2009 (the Trib 1 was submitted in August 2006), the appellant applied for costs. However, it had not applied for the 1986 rules to be followed at the right time. The Tribunal considered the question in some detail and also queried why the appeal had not been categorised as complex. The question of costs was remitted to a different judge who will consider that issue in isolation.

First Tier Tribunal (TC00863): *Everest Ltd*

2.7.2 Samples

HMRC have confirmed that they will change their policy in respect of VAT and samples following the ECJ decision in *EMI Group plc* (Case C-581/08). There will be no change to the policy on small gifts for business purposes, because the court approved the UK position.

The Court disagreed with UK policy and law concerning VAT and samples. It stated that the UK's blanket restriction of relief to the first sample given away was not compatible with the EU Principal VAT Directive. It also stated that the criteria should not be restricted to samples given to existing, or potential customers, and may cover supplies to other parties who have an ability to influence future sales of that product (for example, through scientific testing/analysis, marketing activity, or via media reviews etc). However, the Court accepted that the rules on samples need to be construed narrowly, and defined them as follows:

Definition of a sample

The Court defined a sample as 'a specimen of a product which is intended to promote the sales of that product and which allows the characteristics and qualities of that product to be assessed without resulting in final consumption, other than where final consumption is inherent in such promotional transactions'. HMRC will apply this definition.

Examples that would not qualify as samples

An example of an item that would not qualify as a sample is a finished item taken from a discontinued line. Although intended to demonstrate the type and standard of a particular range, it could not promote sales of that product line since it was no longer available.

Another example would be a product provided in quantities greater than necessary for its characteristics and qualities to be assessed. If a waiter in a restaurant pours a small glass of wine as a 'taster', this would qualify as a sample, but if the restaurant provides a regular customer with a bottle of wine, this would not meet the 'samples' criteria.

HMRC Position and prospective changes

Following the decision in the ECJ, HMRC policy concerning VAT and samples has changed. Where businesses provide samples (as defined above) of their products free of charge to individuals for marketing purposes, none of the samples are liable to VAT.

The Finance Bill 2011 will contain a clause to remove the restriction that only one 'sample' of each product supplied to another person can be disregarded for VAT purposes.

Claims for repayment may be made in respect of past samples as newly defined, subject to the normal warnings about capping and unjust enrichment (although it is hard to see how unjust enrichment could apply where the customer has not paid for the item).

Draft clauses for the Finance Bill 2011, published for consultation, include a provision to remove the "one sample only" rule.

R & C Brief 51/2010; http://www.hmrc.gov.uk/budget-updates/autumn-tax/tiin1765.pdf

In an article in *Tax Adviser*, Jaysson Palmer analyses the *EMI* decision and its implications.

Tax Adviser November 2010

2.8 Compound and multiple

2.8.1 Printed matter

Draft clauses for the Finance Bill 2011 have been published. One of them proposes to remove zero-rating from printed matter which is supplied with a differently rated service, where the supply has been separated from that service by the use of a different supplier, and if supplied together the printed matter would be regarded as ancillary or incidental to the service. This reverses the effect of the decision in the *Telewest Communications* case that HMRC could not compound together supplies made by two different legal entities.

http://www.hmrc.gov.uk/budget-updates/autumn-tax/tiin510.pdf

2.9 Agency

2.9.1 Client account

The Tribunal has reconsidered its earlier decision in a case about a company which appeared to have set up its whole business structure based on VAT advice. In its earlier decision (VTD 20,888), the Tribunal confirmed assessments for more than £1.2m covering the periods July 2002 to November 2004. However, the High Court remitted the case to the Tribunal for reconsideration.

It was common ground that a company which supplies "loft conversion services" to a customer must charge VAT on the whole of what the customer pays, when the customer pays it. The companies in this case argued that they provided "project management services". They received money from the customer and put it in a client account. It would then be taken out of the client account:

- to pay the project manager's fees, which were included in the companies' VAT returns, company accounts and corporation tax computations;
- to pay the costs of the project, which were regarded as disbursements of the client's money and therefore not part of the companies' accounts at all.

At the end of a project, some money was retained within the client account to cover the possible cost of claims under a ten-year guarantee. That part of the client's payment would not be subject to VAT until much later when it was released to the project manager.

The company director claimed that the company's contracts reflected the intended arrangements. The company arranged contracts between the various suppliers – designers, plumbers, electricians, plasterers, and so on – and the clients. The contracts should determine the nature of the supply unless they were a sham, which they were not.

The Tribunal took evidence from a number of witnesses, including a client and some tradesmen. Although the fine print attempted to create the contracts that the director contended for, it seemed unlikely that anyone else understood that to be the case. In particular, the client – who was a friend of the director and presumably was trying to support his case – did not believe that he had a contract with each of the individual tradesmen. If there had been a problem, he would have expected the company to put it right.

As a result, the Tribunal concluded that the company itself supplied the loft conversion service, and it was liable to output tax on all its receipts.

The company appealed to the High Court. Lewison J remitted the case for a rehearing by the Tribunal, holding that it had misdirected itself in law. It had considered that the precedent cases presented inconsistent approaches to the question of determining the VAT treatment of agency arrangements, and also that the present situation should be approached differently because the principal in the alleged agency was the consumer and not the supplier. The judge said that the Tribunal had adopted an "unstructured approach" and had "neither construed the contract, nor squarely addressed the question whether the contract, as construed, represented the real bargain between the parties".

The Tribunal directed that the new hearing should be confined to the issues identified by the judge:

(a) How should the contract(s) be construed?

(b) Was the written contract, as construed, the true contract between the parties, or was it a sham, or was it otherwise superseded by some different contract?

(c) Having determined the parties' rights and obligations, to whom did the contractors supply their services and what services did A1 Lofts supply to the client?

The new decision quotes extensively from the analysis of the contracts by the judge, presumably to demonstrate that the High Court's view is being carefully applied. This is important because the Tribunal comes to exactly the same conclusion as it did before: that the contracts are inconsistent with the principles of agency, and therefore the supplies of loft conversion services are made by the company rather than by the sub-contractors.

Important in this construction of the contracts is the setting of the price by the owner of the company. He does not attempt to obtain quotes in order to get the best price for his clients. This places the company potentially in a position of conflict of interest, which is incompatible with agency. There is also no breakdown of amounts paid to the various parties – this could be obtained by the client if requested, but it was not provided as a matter of course.

Construing the contract in conjunction with other documents which were provided to the client, the Tribunal concluded that the company agreed to "build your loft conversion", and that involved a supply for the total consideration paid by the customer. The sub-contractors made their supplies to the company. The original decision, and HMRC's assessments, were upheld.

First Tier Tribunal (TC00831): *A1 Lofts Ltd & A1 Loft Conversions Ltd (no.2)*

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Vouchers

An article in *Taxation* considers the implications of the ECJ decision in *AstraZeneca* (Case C-40/09). Malcolm Nichols points out that it raises questions about HMRC's future attitude to other salary sacrifice schemes and a possible review of their policy about the impact on the employer's transaction of the liability of the supply for which the voucher is redeemed (i.e. if it is known that the eventual redemption will be exempt, does that make the supply of the voucher exempt?).

Taxation 9 December 2010

2.12.2 Emissions allowances

The last update included several of the statutory instruments which give effect to the change to the treatment of emissions allowances from 1 November 2010. The last of these removes the zero-rating which was brought in as an emergency measure during 2009. Emissions allowances will therefore once again be subject to the standard rate of VAT, but in most cases the liability will be transferred to the recipient of the supply.

SI 2010/2549

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Change in use

HMRC announced a consultation – to run for only a month, from early December 2010 to 3 January 2011 – on proposals to simplify the "change in use" of buildings charge under Sch.10 paras 35 – 37 VATA 1994. The proposal is to change from two separate mechanisms for imposing a charge to only one, which will be applied in all circumstances. This will be based on:

- the amount of VAT that would have been chargeable on the original supply (or supplies) had the building in question not been eligible for the zero rate;
- the proportion of the building that is affected by the change in use;
- the number of complete years that the building has been used solely for a qualifying purpose prior to the change in use.

A Brief explains the consultation, the reasons behind it, and a number of examples of the way in which the charge is currently calculated. Draft legislation is included, and the intention is for the new rules to apply to changes in use from early 2011 onwards.

Examples (based on a standard VAT rate of 20 per cent) of how the current 'change in use' provisions work and how the proposed simplified provisions will impact

A £5 million new zero-rated building, consisting of five floors, was occupied by a charity for its own use. During the first five years it was used by them wholly for its non-business activities.

After five years it decides to change how it uses 20 per cent of the building.

The VAT consequences under current legislation will vary depending on the circumstances.

Used by that charity for business purposes

If one floor of the building is put to a business use by the charity, then a one-off self-supply charge of VAT of £100,000 will be due.

This has been calculated under the current provisions as follows:

The value of the original zero-rated supply (£5 million) multiplied by the part of the building that has ceased to be used for a qualifying purpose (20 per cent) multiplied by the remaining years left in the ten year period after the change (5 or 50 per cent) multiplied by the standard rate of VAT (20 per cent).

That is (£5m x 20% x 50% x 20%) = £100,000 VAT.

NB The charity can also recover the VAT charged, provided the business activity carried out in this area is fully taxable.

Impact of proposed change - none - charge would be calculated on the same basis as at present, resulting in a one-off self-supply charge of £100,000 VAT.

Rented to another charity for its non-business activities

Providing the rental to the other charity is non-business and the charity tenant uses the part rented to them solely for a relevant charitable use, then there is no change in use because the property is still used wholly for a non-business purpose. The owner of the building does not suffer a VAT cost.

Rented to a tenant who uses it for business purposes

If the property is let for five years to a tenant (including another charity) who does not use that part solely for a relevant charitable use, a change in use charge arises.

The charge is calculated by reference to any premium and rent charged.

Assuming a £200,000 premium, and an annual rent of £60,000, the change of use charge is £52,000 in the first year and £12,000 per annum in successive years (that is 20 per cent of £60,000 per annum) for a total of five years.

In total, the cost will be £100,000 VAT.

Different tax results are likely depending upon the length of the lease, whether there is a premium and the value of the rent.

Impact of proposed change - the annual charge based on rent charged is replaced by one-off liability based on 20 per cent overall changed use of the building, that is £5m x 20% x 50% x 20% = £100,000 VAT.

NB The charity can recover the VAT charged if it opts to tax the rent charged and that option is not disapplied.

R & C Brief 49/2010

3.2 Option to tax

3.2.1 Occupancy and disapplication

HMRC announced a second consultation – also to run for only a month, from early December 2010 to 3 January 2011 – on proposals to simplify the disapplication of the option to tax under Sch.10 paras 12 – 17 VATA 1994. The proposal is to restrict the circumstances in which trivial use of the land by the grantor of an interest will lead to disapplication of the grantor's option.

The disapplication rule is explained as follows:

- if the grantor is a developer of the land...
- ...and the grantor or development financier intend or expect that the land will become 'exempt land'...
- ...which means that it is to be used or occupied by the grantor or development financier or a connected person...

- ...not "wholly or substantially for eligible purposes"...
- ...which means making 80% taxable supplies...
- ...then the grantor's option will be disapplied and all input tax will become irrecoverable.

In April 2010 a new "10% occupation test" was introduced to reduce the number of occasions when minor occupation of an opted property would not lead to disapplication. HMRC have become aware of further problems even with this rule, and now propose to introduce an additional "2% occupation test" to apply from early 2011. A draft SI amends the building occupation conditions to introduce a "maximum allowable percentage" that a person may occupy in order to be treated as not in occupation of the land. If the person is a grantor or a person connected to the grantor, the maximum allowable percentage is 2%. If the person is a development financier or person connected to a development financier, the maximum allowable percentage is 10%.

Occupation of any part of a building by the grantor (even a very small proportion) normally counts as occupation for the purposes of the anti-avoidance test and can result in the option to tax being disapplied. Under the proposed change a grantor is not treated as in occupation where the conditions of the '2% occupation rule' are met (the conditions largely mirror those of the existing 10% rule). The rule works as follows:

- *There must be no intention or expectation at the time of the grant that the grantor or a person connected with the grantor will occupy more than 2% of any building (or part of a building) included in the grant at any time during the grantor's CGS adjustment period. Where the grantor is in occupation together with a person connected to them, it is the combined occupation that counts towards the 2% threshold, unless the occupation by either person meets the eligible purposes test in Schedule 10 paragraph 16.*
- *The proportion of the building occupied is to be calculated in relation to the whole of the single building or, where the grantor holds an interest in only part of the building, that part in which an interest is held immediately prior to the grant being made (this includes any part of the building in which an interest is held by a person(s) connected to the grantor.*
- *Where a number of buildings are included in the same grant, the rule is applied to each building on an individual basis. Where the 2% threshold is exceeded in relation to any of the buildings, the conditions of the rule are not met. For the purpose of the rule a single building takes its meaning from VATA 1994 Schedule 10 sub-paragraphs 18(4) to (7).*
- *The rule is not satisfied where the person(s) occupy any land included in the grant which is not a building. However, occupation of land that falls within the curtilage of the building or is used for parking vehicles can be disregarded as long as such occupation is ancillary to the occupation of the building.*

- *For the purposes of calculating the percentage of the building occupied by a particular person the practices set out in the RICS 'Code of Measuring Practice' are to be used. Further details about how this is applied are set out in paragraph 13.8.6 of Notice 742A Opting to tax land and buildings. As with the 10% rule, HMRC will only require evidence of the calculation in cases where the area occupied is close to 2%.*

Occupation by reference to ATMs

The way that occupation by reference to Automatic Teller Machines (ATMs) is treated will also be changed. Currently, occupation which is solely in the form of ATMs can be disregarded as a result of Schedule 10 sub-paragraph 16(7). Under the proposed changes the reference to ATMs in sub-paragraph 16(7) will be replaced by new references in paragraph 15. In future, occupation of land which is solely by reference to ATMs will not be treated as occupation for the purposes of the anti-avoidance test. In addition, occupation of any building which is solely by way of ATMs will be ignored for the purposes of both the 2% and 10% rules.

R & C Brief 50/2010

3.2.2 Insurance?

A company let commercial properties to tenants. It had opted to tax the properties, but treated some of its receipts as exempt consideration for a "block insurance policy". The Tribunal did not agree: the terms of the policy did not allow the landlord to effectively insure the tenants, and there was no relationship between the insurer and the tenants. There was therefore no exempt supply of insurance to the tenants by either party, and the whole of the landlord's receipt was rent which should be VATable.

The Tribunal distinguished the circumstances of *Card Protection Plan*, where the trader passed on the insurance benefit as a principal element of the supply to the customer, and also *Global Self Drive Hire*, where there was a relationship between the insurer and the customer.

First Tier Tribunal (TC00752): *OM Properties Investment Co Ltd*

3.3 Developers and builders

3.3.1 Article

In an article in *Tax Adviser*, Neil Warren points out a number of opportunities and pitfalls for traders involved in property transactions and deals.

Tax Adviser October 2010

3.4 *Input tax claims on land*

3.4.1 Not business

A married couple operated a cattery business. They obtained planning permission for the construction of a house on the site and claimed DIY builders' relief. HMRC refused the claim on the grounds that the planning permission provided that "*the occupation of the dwelling shall be limited to a person solely or mainly employed or last employed in the cattery business or a widow or widower of such a person, or any resident dependants*" and the house was therefore constructed in the course or furtherance of the cattery business.

The Tribunal allowed the wife's appeal, holding that the planning condition did not amount to a prohibition on separate use or disposal. It was only an occupancy restriction, and it did not prevent the house from being a dwelling. Notice 719 (which has subsequently been replaced) accepted that occupancy restrictions might apply to homes for particular categories of workers such as those employed in agriculture or forestry, and such restrictions would not disallow a DIY claim. The planning policy behind the restriction was examined: isolated new houses in the countryside are not generally allowed unless there is a specific justification for them, and an association with a business is such a justification. The Tribunal did not think that the planning condition created an association for VAT purposes.

First Tier Tribunal (TC00737): *Mrs ME Wendels*

3.4.2 Apportionment

In TC00552, the First Tier Tribunal found that an individual should be allowed to claim for part of the VAT incurred on a DIY project where part of the building converted into a dwelling had previously been used as a garage but part had not. The parties could not agree the amount of the apportionment, so another hearing was required.

The Tribunal agreed with HMRC that it was necessary to consider the extent to which the original building had been residential and non-residential, not the extent to which the space was incorporated in the converted building. The legislation was concerned with the extent of prior residential use, not the result of the conversion.

The Tribunal also accepted HMRC's contention that the apportionment should be based on volume, rather than floor area, but commented that floor area could usually be used as a reasonable approximation unless there was something unusual about the layout of the building.

The appellant's contention that the roof space above the garage was not part of the garage because it was "used for storage" was rejected. Use as a garage included use for purposes that were ancillary and incidental to use as a garage: storage of old furniture and possessions was not an independent non-residential use. The roof space should be apportioned on the same basis as the rest of the building.

The appellant's percentage of 81% was reduced to just over 51%.

First Tier Tribunal (TC00723): *John Clark (no.2)*

3.4.3 Pontoon

An architect built a prototype home which was intended as a flood plain solution: it was constructed on a floating pontoon which was attached to the land by large steel piles so it could fall and rise with variable water levels. The VAT Helpline had suggested that this could be the subject of a DIY builders' claim, but HMRC did not stand by that advice.

The Tribunal examined the facts and the law and agreed with HMRC (with some reluctance – the appellant "has every right to feel aggrieved"). Houseboats are not eligible for a s.35 claim, and this was too similar to a houseboat.

First Tier Tribunal (TC00727): *Dunster*

3.4.4 Wrong rate

A familiar story unfolded in unusual circumstances in a case where a DIY claim included conversion expenses that should have been charged by the builders at 5% but were actually charged at 17.5%. The DIY claim failed and it was too late to recover the difference from the builders because the invoices were over 3 years old.

The unusual aspect was that the claimant was a director of a building company. The company had initially claimed the VAT on the project on its VAT returns, but this had been disallowed as the director had carried this development out personally for non-business reasons. The VAT had therefore been assessed on the company and reclaimed by the director under the DIY scheme. The Tribunal confirmed that there was no reason for HMRC to repay something that had been charged as VAT but was not VAT.

First Tier Tribunal (TC00701): *CAM Anderson*

3.4.5 Building materials

A DIY claimant tried to recover VAT on the purchase of an electric Aga cooker on the basis that it heated the kitchen and was therefore a "space heater" within the legislation. The Tribunal agreed with HMRC that it was excluded from Note 22 Group 5 Sch.8. It incidentally heated the kitchen, but that was not its main purpose.

First Tier Tribunal (TC00695): *Richard Sidgwick*

A DIY builder claimed £17,393, of which £774 was refused in respect of sundry items which HMRC did not believe qualified under s.35. The Tribunal reviewed the list and held:

- plastering and applying screed to a floor: should have been zero-rated, and were services rather than goods – dismissed;
- commissioning a boiler and plant hire: services, not goods – dismissed;
- roller blinds: were similar to curtain rails, which are accepted as building materials – allowed.

The Tribunal recorded HMRC's agreement that the supplier of the services in the first item could refund the VAT to the claimant and adjust its VAT account accordingly. It was also noted that the decision in

relation to the second item shows that a DIY builder is not in an equivalent position to a developer, even if that is the intention of the law. A developer would be able to recover such VAT.

First Tier Tribunal (TC00873): *John Price*

3.4.6 Change of plans

An individual was granted planning permission to construct an annex to an existing building, which would not have qualified for a DIY claim. Building Control then required him to carry out further works on the basis that the result would be a new dwelling, and planning permission was given for this. However, the planning department refused to make the planning permission retrospective to a time before the work commenced, which meant that the development failed to meet the conditions for a DIY claim.

The Tribunal chairman commented that it was disturbing that Building Control could apparently misunderstand the Planning Department's requirements and so impose extra conditions on an individual which made further expenditure necessary, while effectively breaching the original intention of the planning permission, and all without anyone considering the impact of the VAT rules. The appeal was dismissed.

First Tier Tribunal (TC00780): *Michael James Watson*

A Reader's Query in *Taxation* deals with a similar problem – a change of plans from an extension to demolition and reconstruction. The answers suggest that the conditions for zero-rating the work are unlikely to have been met in the circumstances described.

Taxation, 11 November 2010

3.4.7 Planning conditions

A DIY builder appealed against the refusal of £25,000 claimed on works which created a new substantial dwelling house on the site of a small bungalow. The local planning rules apparently required an application for permission to extend the bungalow rather than to demolish and replace it: permission for a new replacement building would have had to require something on the same scale as the former bungalow. In order to meet this peculiar planning condition for an extension, it was required that two existing walls were retained.

The claimant entered into detailed discussions with the planning authority over how this could sensibly be complied with, and it appeared to the Tribunal that the planning consent was confused and confusing. Nevertheless, it did appear to require the retention of the two walls. Unfortunately, that was not enough. In spite of failing to raise this condition in earlier discussions about the claim, HMRC pointed out for the first time in their skeleton argument for the hearing that the retention of two walls was only permitted if the building was a "corner site". The Tribunal could not interpret the legislation in this way, even though the judge considered the denial of the claim to be wholly unfair. This was the conclusion:

54. The consequence of this is that technically this appeal must fail and be dismissed.

55. We do however add a plea that those responsible for this case within HMRC should consider whether the plainly just result should not be that the Appellant's claim should be accepted. In this context, we would hope that the reasonable discretion and latitude that HMRC has in administering the tax system might justify the refund of the claimed VAT.

56. The reasons why we advance this somewhat unusual request are that:-

- *for anyone who has seen the photographs of the concrete site of the new building and the preservation of the two small and ridiculous bits of wall, it seems offensive to deal with this case on the basis that the new building was anything but a completely new building;*
- *it is only by one extraordinary quirk of planning law that the Appellant has been put to the trouble and expense of having to retain two poor walls, that in building terms should unquestionably have been demolished;*
- *HMRC challenged this case in the initial decision, a further consideration of the decision, and in an independent review, without raising the only point on which we now reach a decision in favour of HMRC;*
- *we note that in the only passage of the HMRC letter of 9 January 2008 in which any actual guidance was given to the Appellant, HMRC managed to misquote Note 18(b) and ignore the corner site requirement that we now consider to be crucial; and*
- *most vital of all, if HMRC had not omitted the reference to the corner site requirement in that letter of 9 January it is possible that, had the Appellant gone back to the local planning authority and explained that in order to preserve his deserved entitlement to a VAT refund, the local authority would need to amend the requirement and require him just to retain the North wall, it is possible that the local authority would have acceded to that request. Since the retention of the two walls was a technical fiction to support the "enlargement" argument, and there was not the faintest merit in the walls themselves, if the local authority had been able to adopt a sensible modification to its requirement to enable the Appellant to achieve a clearly deserved result, they might have seen the sense of the request and granted it. Since however it was only in the preparation of documentation for the hearing before us, and thus well after the building had been completed, that HMRC lighted on the significance of the corner site point, countless months after the time at which the Appellant might have been able to do something to modify the retention requirement, the Appellant never had the opportunity to try to modify those requirements.*

First Tier Tribunal (TC00872): *Martin Samuel*

3.5 Other land problems

3.5.1 Stamp Duty Land Tax

SDLT is calculated on the gross consideration for a transfer or lease of land, including VAT. Where SDLT is charged on future rent, it must be calculated on the assumption that the highest possible consideration will be payable. This means that a lease which does not rule out the option to tax will be charged on the assumption that VAT will be added to future rent.

HMRC have clarified the impact of the forthcoming VAT rate increase on SDLT charges on rent. HMRC's view is that the amount to be brought into the chargeable consideration should reflect the VAT rate position known at the effective date of the transaction. On that basis, subsequently legislated changes to the rate of VAT do not affect the computation of SDLT liability or create the need for a further return.

A technical note explains the detailed consequences of transactions entered into before and after the enactment of the VAT increase in the Finance (no.2) Act 2010 on 27 July 2010.

HMRC Release 11 October 2010

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Information sheets

HMRC have issued the usual Information Sheet setting out the exchange rates to be used by registered e-traders in the quarter to September 2010.

Information Sheet 19/2010

HMRC have also published an Information Sheet to remind e-traders about the impending rate change on 4 January 2011.

Information Sheet 20/2010

4.2 Where is a supply of services?

4.2.1 Phonecards

A retailer failed to account for output tax on the sale of phonecards. When HMRC assessed him, he argued that the place of supply of some of the phonecards was outside the UK, because the underlying service was supplied by a telecoms provider outside the UK. The Tribunal upheld his appeal, but the High Court overturned the decision. This was partly based on the principle of the avoidance of non-taxation – if the retailer did not charge VAT, then there would be no VAT anywhere in the EU on what was almost certainly consumption of services in the EU.

The judge also concluded that art.21 SI 1992/3121 provided that the supply of the phonecards could be located in the UK because it was a right to services and the underlying services were supplied in the UK. The Court of Appeal disagreed with this, holding that art.21 did not mean that the place of supply of a right to services was automatically the same as the place of supply of the underlying services.

However, the Court of Appeal upheld the judge's overall decision, ruling that the sale of the phonecard is a supply of services which is distinct from the underlying supply. It therefore does not have to follow the same place of supply rules, and this trader's supplies all took place in the UK.

Court of Appeal: *PKS Arachchige v HMRC*

4.2.2 Sponsorship or sporting?

A company ran a Grand Prix racing team, sponsored by Toyota. The question before the Tribunal was whether the sponsorship supply was a sporting service (supplied where the services took place, which was partly in the UK) or an advertising service (supplied where the recipient belonged, outside the EU).

While sponsorship is normally related to advertising, in this case the payments were linked to a "driver development agreement". Toyota were paying Williams for giving their nominated drivers experience in driving

racing cars, with the long-term objective of using those drivers for another team under Toyota's control.

The Tribunal considered that the services could be categorised as one thing or the other, but the parties had agreed that they could not be both: they were a single supply. The appellant relied on the *Kronospan* case (C-222/09 – see below), in which a Polish business was held to be providing an intellectual service rather than a scientific one to a Cyprus customer largely because the "supplied where performed" services are typically provided to many different people at once, rather than to a single recipient. As Toyota was the sole customer, this favoured the "supplied where received" argument.

The Tribunal considered that *Kronospan* was even more finely balanced than the current case. Because the agreement was described as relating to driver development, and the payments under the agreement varied according to the amounts of driver experience obtained, the supply was "by a small margin predominantly" a supply of sporting services. The appeal was dismissed.

First Tier Tribunal (TC00848): *Williams Grand Prix Engineering Ltd*

4.2.3 Holiday club points

The ECJ has confirmed the overall conclusion of the Advocate-General's opinion in the *Macdonald Resorts* case, but has made an important change of detail in how the transactions should be treated for VAT.

The company operated a "club" which enabled the owners of timeshares to obtain "points" which could be exchanged for hotel accommodation or the use of other timeshare properties. The company owns a number of properties in the UK and in Spain, and provides property maintenance and related services as well as the sale of timeshares. It argued that the supply of the points amounted to a supply of an interest in or right over land and was therefore exempt, but HMRC and the Tribunal disagreed.

The Tribunal expressly disapproved of the earlier Tribunal decision in *Finest Golf Clubs of the World* (19,347). In that case, it was held that the company could estimate the proportion of golf games that would be supplied outside the UK (about 90%) based on past experience; so, when it received subscriptions for future golf games, it was reasonable to suppose that 90% of them would also be outside the scope of UK VAT. This Tribunal held that the same principle could not be applied to this situation. At the time of supply, there was nothing that constituted a right over land under EU law. In particular, rights over land have to related to particular land. That was definitely not the case with these points. As exemptions must be strictly construed, these supplies had to be standard rated.

The Advocate-General took a different line: although the overall result on liability may be similar (all taxable), the place of supply will be different if the ECJ follows the opinion. The acquisition of points, and payments to enhance the value of points (e.g. to be able to exchange them for a more attractive property or week than the purchaser's own timeshare right), should both be regarded as supplies connected with immoveable property. They would therefore be supplied where the land was situated and would qualify for exemption under basic principles. However, it was open for

member states to exclude them from exemption because they were likely to be related to holiday or hotel accommodation.

The Advocate-General considered that the points were the subject of a supply, and therefore the place of supply of points rights had to be determined. In the opinion, this would be situated where the property relating to those points was situated. Enhancement rights would not be associated with any particular property but with the range of properties for which the rights could be exchanged. The Advocate-General therefore believed that these rights should be apportioned between the member states in which the supplier owned properties.

The answers given by the full court are:

(1) Supplies of services effected by an operator such as the applicant in the main proceedings under a scheme such as the 'Options Scheme' at issue in the main proceedings should be classified at the time when the customer participating in such a scheme converted the rights he had initially acquired into a service offered by that operator. Where those rights were converted into hotel accommodation or into a right to temporarily use a property, those supplies were supplies of services connected with immovable property within the meaning of art.9(2)(a) of the Sixth Directive which were performed at the place where the hotel or that property was situated (see [42] of the judgment).

(2) Under a scheme such as the 'Options Scheme' at issue in the main proceedings, when the customer converted the rights he had initially acquired into a right to temporarily use a property, the supply of services concerned constituted the letting of immovable property within the meaning of art 13B(b) of the Sixth Directive. However, that provision did not prevent member states from excluding that supply from exemption (see [53] of the judgment).

It therefore appears that such a business suffers from the complication that the TOMS was designed to prevent (the requirement to register in many member states) without being able to use the TOMS to avoid that complication.

However, the answers given by the Court appear to take a significantly different line from the Advocate-General, and this may have much wider implications. The Court held that the initial acquisition of points – whether for timeshare rights or for cash – was not an “aim in itself” for the club member. The intention was to acquire the right to a temporary stay in accommodation; the acquirer of points therefore did not receive the consideration in return for the transfer of timeshare of rights or of money until the reciprocal supply of specific accommodation was effected. This means that the ECJ did not regard the supply of the points themselves as VATable at the time. There would only be a supply when the accommodation was provided, which at least means that the place and liability of that supply can be determined.

However, this raises a number of questions about vouchers and voucher schemes. In the UK, the supply of a voucher is regarded as potentially a VATable transaction in its own right; it may now be necessary to consider why it is different from the supply of points in this case.

ECJ (Case C-270/09): *Macdonald Resorts Ltd v HMRC*

4.2.4 VAT package postscript

HMRC have issued a Brief to remind traders that the VAT package included one change to place of supply that took effect on 1 January 2011 rather than 1 January 2010. Business to business supplies of cultural, artistic, sporting, scientific, educational, entertainment or similar activities are now "supplied where the customer belongs", unless the supply constitutes admission to an event (or a service ancillary to that, such as the provision of cloakroom facilities).

The Brief clarifies what is covered by "admission":

Admission will cover any payment that gives the right to attend an event even if it is covered by a season ticket or subscription. This includes payment to attend conferences, exhibitions and seminars even if they are of an educational nature. In-house events will fall within this rule as well as those open to the general public.

R & C Brief 52/2010

4.2.5 New old Notice

HMRC have issued a revised (October 2010) version of Notice 741 on the place of supply of services. This was replaced by Notice 741A for supplies from 1 January 2010 onwards, so the updated Notice 741 deals only with the rules up to 31 December 2009. The Notice explains that it has been amended to improve readability and to incorporate some previous updates, but does not explain why it was thought appropriate to issue a new Notice which is no longer applicable to current supplies.

Notice 741

4.2.6 Engineering

A Polish company carried out work for a Cyprus company which was described as "research and development work relating to the environment and technology, carried out by engineers". The Polish tax authority issued a ruling that the work involved "scientific activities", for which the place of supply was Poland. The company appealed and questions were referred to the ECJ, where the court ruled that these supplies were "services of engineers" which fell within art.9(2)(e). The place of supply was therefore where the customer belonged.

The court considered that research and development fell within the normal and habitual activities of engineers. It was also more normal for art.9(2)(c) services to be supplied to many customers, rather than one customer as in this case.

ECJ (Case C-222/09): *Kronospan Mielec sp zoo v Dyrektor Izby Skarbowej w Rzeszowie*

4.2.7 Article

In an article in *Taxation*, Neil Warren discusses the current state of the place of supply rules, including the changes to B2B supplies of education etc. which will come into force on 1 January 2011.

Taxation, 11 November 2010

4.3 International supplies of goods

4.3.1 Zero-rating conditions

A jeweller made items which he claimed had been exported to customers in Jersey and Australia. HMRC decided that the conditions for zero-rating exports in Notice 703 had not been satisfied. The jeweller said that he had provided sufficient proof of export in the form of letters from customers and banking of sales proceeds; HMRC ruled that this was not sufficient.

The Tribunal noted that there was medical evidence of the appellant suffering from a condition which made it difficult to organise his paperwork, a factor which HMRC were unaware of when they raised the assessment. HMRC's counsel commented that HMRC were not casting any doubts on the Appellant's integrity. She said that she accepted that the Appellant had made the exports: her case was that he had not retained the paper evidence necessary for zero-rating.

In respect of one invoice, HMRC accepted that a late-produced postal receipt could satisfy the conditions. In respect of another, the Tribunal was satisfied (even if the officer was not) that the copy postal receipt provided was legible and adequate to prove export in the absence of any suggestion of dishonesty. In respect of the other transactions, the letters from customers fell short of the standard required by Notice 703; those provisions had the force of law, and it was therefore mandatory to obey them or to suffer the consequences. The appeal was allowed only in respect of the two transactions, and the remainder of the sales were standard rated.

First Tier Tribunal (TC00870): *Michael Cohen*

The same law was examined in different circumstances in a case which was anonymised because the principal of the appellant was in the midst of criminal proceedings arising from related transactions. "Mr Acting Representative" had failed to provide adequate evidence that certain indirect exports of electronic goods to Nigeria had taken place, and HMRC had ruled that they were standard rated.

The Tribunal examined the evidence that the trader had produced after the event, and was not entirely satisfied with it either. However, the main problem was that the company had not met the basic rule in Notice 703 for indirect exports – the evidence of export must be obtained by the exporter within 3 months of making the supply. This was not an incidental or unimportant requirement, and failure could not be rectified by producing better documentation later. It was reasonable for HMRC to enforce the rule to prevent avoidance, evasion and abuse, and the trader was fairly assessed.

First Tier Tribunal (TC00871): *Traderco Ltd*

4.3.2 Diversion fraud

A company dispatched 119 lorry loads of beer and cider from an approved customs warehouse near Norwich to a customs warehouse in Calais. HMRC suspected that the beer which arrived was not the beer which left. The UK beer could have been diverted into the UK market, while identical beer already in France could have been delivered instead –

because the duty rates are much lower in France, this would create an advantage.

HMRC produced a considerable amount of evidence to back up the speculation that such a fraud had taken place, including the scanning of 16 of the loads as they crossed the channel which disclosed that they were in fact empty.

The chairman makes the following preliminary remarks about the performance of each side:

"*...we consider that when the Appellant contended that HMRC's case was based on unfounded speculation, we consider that in this regard the boot was on the wrong foot. The reality was that the Appellant's suggested explanations for damaging evidence were the unfounded speculation.. We might perhaps also observe that, either through lack of staff or to some extent through incompetence and change of personnel, HMRC has hardly acquitted itself in a very favourable light in this case.*"

The chairman also lamented the absence of direct evidence about what had happened. Potential witnesses had gone missing, emigrated, and had died, and the primary HMRC officer who had raised the assessments was no longer working for HMRC.

The decision goes into detailed examination of the evidence for the facts, and the explanations given for those facts by the two sides. While not being able directly to find that the managing director of the appellant, or one of the trailer drivers, were lying in their statements, the Tribunal rejected their version of events as contradicted by other stronger evidence. At the very least, the managing director had presided over very poor due diligence procedures, or else had been a knowing participant in the fraud.

The appeal was dismissed and costs were awarded to HMRC.

First Tier Tribunal (TC00865): *Checkprice (UK) Ltd (in administration)*

4.3.3 New Notice

Notice 725 (The Single Market) has been updated again, replacing the December 2009 edition. Changes include detail on adjustments for the new VAT rate from January 2011 (paragraph 16.12) and penalties for late submission of EC Sales Lists (paragraph 17.12).

Notice 725

4.3.4 Intrastat thresholds

The Intrastat thresholds for 2011 remain unchanged from their 2010 levels:

- dispatches £250,000;
- arrivals £600,000;
- delivery terms £16,000,000.

R&C Brief 48/10

4.3.5 Guarantee levels

HMRC have issued a reminder to traders with a customs and VAT deferment guarantee that they must increase the amount to reflect the increase in the standard rate of VAT. It is the account holder's responsibility to ensure that, at all times, the outstanding amount does not exceed the guarantee limit.

JCCC CIP (10) 83 13 December 2010

4.3.6 New rules on gas, electricity and cooling

A series of statutory instruments has implemented the VAT Technical Directive provisions with effect from 1 January 2011. The purpose of the amendments is to make sure that supplies of natural gas, electricity and cooling supplied between member states through a network is subject to tax where the customer belongs rather than where the subject of the supply is located or supplied. The explanatory notes to the statutory instruments explain the point as follows:

What is being done and why

7.1 Supplies of natural gas and electricity are treated as supplies of goods for the purposes of VAT. However, their intangible nature makes it difficult to apply some of the normal VAT rules and so they are subject to special arrangements.

7.2 A key element of the special arrangements are place of supply rules under which supplies of natural gas and electricity for resale take place where the customer belongs, rather than where the gas or electricity is located. Hand in hand with this are provisions disapplying the normal VAT consequences that would arise through movement of gas or electricity either in the course of being imported into the EU or transferred to another EU Member State.

7.3 The VAT Technical Directive corrects unintended restrictions in the scope of the existing arrangements (insofar as they apply to natural gas) and makes other technical changes to adjust the scope of the rules. This includes extending the application of the special rules applicable to gas and electricity to supplies of heat and cooling.

7.4 The Orders make the necessary changes for each of these key elements by altering their scope in relation to natural gas and extending them to heat and cooling.

SI 2010/2923, 2924, 2925; SI 2010/3017

4.3.7 Movement of boats

The ECJ has given a ruling concerning the exemption of a despatch of a boat from one member state to another (art.138 VAT Directive) and liability for acquisition tax in the destination state (art.20). This should not depend on a rigid time-limit but on a number of factors which evidence the buyer's intention regarding consumption, including where the boat is registered, where the owner has a permanent mooring for it, and the time taken for the journey relative to the distance between the member state of origin and the member state of destination.

The individual argued that he should only pay VAT in the UK, not in Sweden, because by the time he moved the boat to Sweden he had already owned it for three months and had sailed it for 100 hours. The ECJ agreed with the Swedish tax authorities that this was not sufficient to deny them their revenue.

The question of whether a means of transport is "new" should be considered at the time of supply and not on arrival at the final destination.

ECJ (Case C-84/09): *X v Skatterverket*

Meanwhile, HMRC have announced the withdrawal of a concession on "sailaway boats" with effect from 1 January 2012. This is part of the general review of ESCs following the House of Lords decision in the *Wilkinson* case. From 1 January 2012, VAT registered businesses will no longer be able to zero-rate the supply of a sailaway boat to a UK resident who intends to keep it outside the EC.

Businesses can continue to zero-rate the supply of a boat to a UK resident provided they either undertake to export the boat themselves or make all the arrangements for the export.

A year's notice has been given so that traders can adjust their procedures accordingly.

HMRC Press release 14 December 2010

4.4 European rules

4.4.1 Minimum standard rate confirmed

The Commission has confirmed that the minimum standard rate of VAT throughout the EU will remain 15% until 2015.

http://register.consilium.europa.eu/pdf/en/10/st15/st15495-re02.en10.pdf

4.4.2 Action against fraud

The Commission has adopted a regulation to strengthen cross-border administrative co-operation and action against fraud. It specifies the cases in which member states must exchange information spontaneously, the procedures for providing feedback on such information and situations in which member states must conduct multilateral controls.

The regulation also creates Eurofisc, a network of national officials to detect and combat new cases of cross-border VAT fraud.

http://register.consilium.europa.eu/pdf/en/10/st12/st12193.en10.pdf; http://register.consilium.europa.eu/pdf/en/10/st13/st13994-ad01.en10.pdf

On 7 December, the Council reached political agreement on a draft directive on administrative cooperation in direct taxation to combat tax evasion and fraud. Although it directly applies to direct taxes, the directive also refers to extending cooperation between member states to cover taxes of any kind.

http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/118257.pdf

4.4.3 New invoicing Directive

The Council has adopted a new Directive which makes a significant number of amendments to the 2006 VAT Directive in respect of the issue of invoices and the consequences of issuing invoices for tax points and liability. This is in response to a report produced by the Commission in accordance with art.237 VAT Directive which identified, in the light of technological developments, certain difficulties with regard to electronic invoicing and which, in addition, identified certain other areas in which the VAT rules should be simplified with a view to improving the functioning of the internal market.

Council Directive 2010/45/EU; http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:189:0001:0008:EN:PDF

4.4.4 Streamlining the market

A newspaper report stated that the Commission intends to propose a raft of 172 measures to improve the workings of the single market and prevent the financial crisis leading to economic protectionism. The proposals will include an overhaul of VAT systems and corporate tax bases across the EU as well as regulation of cross-border transactions and improved controls to prevent abuse of intellectual property.

The Guardian, 27 October 2010

Further details were announced on 20 December in respect of a number of barriers to the efficient working of the market. These include direct tax difficulties as well as indirect charges such as those on car registration. The main VAT issue (barriers to e-commerce) will be dealt with as part of the general consultation about the VAT system which is discussed below.

IP/10/1751

On 1 December, the Commission launched a wide-ranging consultation on the future of the VAT system. This is explained as follows:

"*VAT was introduced in the EU more than 40 years ago, at a time when the marketplace looked very different from today. Despite efforts over the years to modernise and simplify the VAT system bit by bit, it is clear that the regime no longer fits the needs of a service-driven, technology-based, modern economy. The complexity of the current VAT system creates unnecessary costs and burdens for taxpayers and administrations, and obstacles to the Internal Market. Moreover, certain weaknesses within the VAT system leave it vulnerable to fraud and evasion. Therefore, a fundamental review of the VAT system is needed.*"

The Green Paper sets out the following questions:

- whether the fundamentals of the current VAT system should be overhauled;
- whether goods and services should be taxed in the Member State of origin or where they are sold;
- whether reduced VAT rates are still relevant today;
- whether the rules on deductions are neutral enough;
- whether and how the system can be made more fraud-proof;
- how red tape can be cut in VAT transactions;
- whether and how the collection of VAT could be improved in order to close the €100 billion VAT gap that currently exists in the EU.

Comments are invited by 31 May 2011.

http://ec.europa.eu/taxation_customs/common/consultations/tax/2010_11_future_vat_en.htm; IP/10/1633

4.4.5 Small businesses

Austria does not require businesses with a turnover below a set threshold to register for VAT. However, this is restricted to persons established in Austria. A German resident, who generated income from letting an apartment in Austria, was refused the exemption. Questions were referred to the ECJ about whether this complied with EU law (art.283 2006 VAT Directive).

The Advocate-General gave an opinion that the restriction was contrary to EU law because it is based on place of establishment and favours those based in the member state over outsiders. The Austrian government's argument that the distinction was necessary for good fiscal supervision was rejected.

However, the full court has upheld the Austrian provisions. The judgment states that "*at this stage in the evolution of the VAT system, the objective which consists in guaranteeing the effectiveness of fiscal supervision in order to combat fraud, tax evasion and possible abuse and the objective of the scheme for small undertakings, which is to support the competitiveness of such undertakings, justify, first, limiting the applicability of the VAT exemption to the activities of small undertakings established in the territory of the Member State in which the VAT is due and, second, the annual turnover generated to be taken into account being that generated in the Member State in which the undertaking is established*".

It is interesting to note the exposition of the purpose of the small undertakings exception which is included in the judgment: "*The VAT scheme for small undertakings provided for administrative simplifications intended to support the creation, activities and competitiveness of small undertakings, and to retain a reasonable relationship between the administrative charges connected with fiscal supervision and the very small amounts of tax to be reckoned with.*"

Note that the second part of the decision means that a business which is "large" in its home state cannot take the benefit of the small undertakings exception in another member state. This is a point which is often considered by a business which has occasional transactions in other countries – it appears that such transactions are automatically subject to VAT if the place of supply is in the other country, regardless of any registration threshold that may exist.

ECJ (Case C-97/09): *Ingrid Schmelz v Finanzamt Waldviertel*

4.4.6 Criminal intent

The ECJ has overruled the Advocate-General on the consequences of an intra-community VAT fraud.

A Portuguese national who managed a German company falsified invoices to conceal the identities of the purchasers. The effect was that the sales of luxury cars were treated as intra-community despatches of goods which were exempt from VAT in Germany, but no VAT was accounted for in Portugal. Some of the customers apparently colluded in this fraud, while others were victims of identity theft.

The German court referred questions to the ECJ to determine whether the exemption for intra-community despatches could be denied to someone who admitted attempting to abuse the system for fraudulent purposes. The defendant in the case claimed that there really were despatches, so no German law had been broken (presumably this meant that the problem would arise in Portugal).

The Advocate-General's opinion was that the exemption should not be denied where all the other conditions are met. Even in circumstances of bad faith, the requirements of fiscal neutrality overrode other considerations. There were other remedies which could be applied to recover the lost tax, and denial of exemption was a disproportionate response.

The full court disagreed. Where an intra-community supply had actually taken place, but the supplier had concealed the true identity of the

purchaser in order to facilitate the evasion of VAT, it was acceptable for the member state of departure to deny exemption to the despatch.

ECJ (Case C-285/09): *R v Generalbundesanwalt beim Bundesgerichtshof*

Meanwhile, the French courts have referred a question to the ECJ to determine whether the repayment of import VAT can be made conditional under rules aimed at restricting the possibility of tax evasion. The question is:

"*Does Article 17(2)(b) of the Sixth Directive permit a Member State to make the right to deduct value added tax on importation conditional, regard being had in particular to the risk of tax evasion, upon the actual payment of that tax by the taxable person, where the taxable person for the purposes of value added tax on importation and the holder of the corresponding right to deduction are, as in France, the same person?*"

ECJ (reference) (Case C-414/10): *Société Veleclair v Ministre du budget des comptes publics et de la réforme de l'État*

4.4.7 Not a tour

A German company carried on business as a travel agent. It also sold opera tickets, and accounted for them within TOMS in line with the rest of the business. The tax authority ruled that TOMS should not be applied where no travel services were supplied with the tickets. Questions were referred to the ECJ, which agreed with the tax authority. The company argued that the sale of tickets on their own should be treated as part of a portfolio of alternatives that it offered and all taxed in the same way; the ECJ considered that this would distort competition, because it would treat sales of the same item differently depending on who sold them, and precedent cases had held that a travel service must relate to a journey to be included in the margin scheme.

ECJ (Case C-31/10): *Minerva KulturreisenGmbH v Finanzamt Freital*

4.4.8 Horses for courses

The Advocate-General's opinion favours the Commission in the first case about lower-rating of horses which are not "intended for the preparation or production of foodstuffs for human or animal consumption". The lower rate should not be available unless a particular horse was expected to be eaten. The Advocate-General did not consider it unacceptable to impose a different treatment based on the subjective view of the destination of individual horses.

ECJ (A-G) (Case C-41/09): *Commission v Netherlands*

Meanwhile, the Commission has decided to refer Ireland to the ECJ over the application of a lower rate to horses and greyhounds. Presumably this is not based on an intention to eat either type of animal.

http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/1576&format=HTML&aged=0&language=EN&gu

4.4.9 Polish rules unacceptable

The Commission applied to the ECJ for a declaration that Poland's application of a reduced 7% VAT rate to supplies of babies' clothing and children's footwear contravened art.98 of the 2006 VAT Directive. The court granted the declaration.

Poland argued that it should have the benefit of art.115, which allows the retention of certain reduced rates if they were in force in the member state on 1 January 1991. The Advocate-General's opinion accepted this argument. However, the full court ruled that the system of taxation in force in Poland in 1991 was not sufficiently similar to VAT (being based on gross turnover without deduction of input tax) for the transitional provision to apply. As it was a derogation from the normal rules of VAT, it had to be strictly interpreted.

Poland also argued that its rules were intended to encourage a higher birth rate in the country which is an objective within the spirit of the Lisbon Treaty. However, the ECJ ruled that this was a socio-political objective which could not justify a departure from the VAT Directive.

ECJ (Case C-49/09): *Commission v Poland*

4.4.10 Pre-registration tax

A Lithuanian trader appealed against a refusal of credit for VAT incurred on expenditure before he registered for VAT. The ECJ considered the general EU right of "effectiveness", which means that traders must be given the opportunity to exercise their rights without the imposition of excessively difficult conditions. The ruling was that the Lithuanian refusal of a repayment breached this condition.

"*Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as precluding a taxable person for VAT purposes who meets the substantive conditions for the right of deduction, in accordance with the provisions of that directive, and who identifies himself as a taxable person for VAT purposes within a reasonable period following the completion of transactions giving rise to that right of deduction, from being denied the possibility of exercising that right by national legislation which prohibits the deduction of VAT paid on the purchase of goods if the taxpayer was not identified as a taxable person for VAT purposes before using those goods in his taxable activity.*"

ECJ (Case C-385/09): *Nidera Handelscompagnie BV v Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos*

4.4.11 Reverse charges

A Hungarian law allowed all parties to agree that VAT should be accounted for using a variation of the reverse charge mechanism. A dispute arose where a building project had been partly completed before the new law came into effect. When the rules had changed, the traders attempted to apply them, and were told by the authorities that they could not deduct input tax because the invoices issued by subcontractors did not comply with the new law.

The ECJ ruled that imposing these administrative conditions after the right to deduction had arisen was not in compliance with the VAT Directive, violating as it did the principles of proportionality and legal certainty.

ECJ (Case C-392/09): *Uszodaépíto Kft. v APEH Központi Hivatal Hatósági Foosztály*

A Polish law, in force before Poland joined the EU, restricted the right to deduct input tax on certain services provided by counterparties established in territories which were classified as "tax havens". Even though a transitional blocking order may be permitted, this cannot go against the general principles of the VAT Directive to the extent of a general blocking on business services of whatever description, just because they originate in a tax haven. The ECJ ruled that the blocking of input tax in these terms was contrary to the Directive.

ECJ (Case C-395/09): *Oasis East sp. z o.o. v Minister Finansów*

4.4.12 Italian reference

The Italian court has referred questions on whether the principles of effectiveness, non-discrimination and tax neutrality rule out a legal framework which gives a right to a customer to apply for a court order for reimbursement of VAT from a supplier if the VAT was paid in error, but the supplier is given a significantly shorter time limit to claim back that amount from the tax authorities. This is an issue that has arisen several times recently in the UK in respect of DIY builders' claims for VAT which was overcharged to them by builders – in general, a customer has 6 years to make a claim against a trader, but the trader only has 4 years to make a claim from HMRC.

In a second question the referring court asks whether the EU legal principles are compatible with a practice that allows a reimbursement order to be made by a court in favour of the customer against a supplier, where the supplier has not had the technical issue determined by its own appeal to a tax court, but the reimbursing court is relying on a judicial interpretation or administrative practice that the underlying transaction is subject to VAT.

ECJ (Reference) (Case C-427/10): *Banca Antoniana Popolare Veneta SPA v Ministero dell'Economia e delle Finanze*

4.4.13 Spanish practices

The European Commission has formally requested Spain to amend its legislation which allows a reduced VAT rate for general medical equipment, appliances to alleviate animals' physical disabilities and substances used in the production of medicines. The Directive allows a reduced rate to be applied to some medical products and to aids for disability, but the Commission believes that the Spanish relief is too general in that it extends the reduced rate to:

- materials used in the production of medicines;
- equipment to help disabled animals as well as humans.

IP/10/1572

4.4.14 Self supply?

The French court has referred a question to the ECJ about the scope of the self-supply charges allowed by art.5 6th Directive.

Does Article 5 of the 6th Directive allow a Member State to maintain in force or establish a provision imposing value added tax on the supply by a taxable person to itself of property for the use of its business, although that supply gives rise to a right to deduct the value added tax thereby levied immediately and in full?

Articles 5(6) and 5(7) allow for self-supply charges on use of goods for non-business purposes, but apparently only where the result would be irrecoverable input tax.

ECJ (reference) (Case C-487/10): *L'Océane Immobilière SAS v Direction de contrôle fiscal Ouest*

4.4.15 Exemption for own use of property?

The Belgian courts have referred a question to the ECJ to determine whether the repayment of import VAT can be made conditional under rules aimed at restricting the possibility of tax evasion. The question is:

"*Must Articles 6(2)(a) and 13B(b) of the 6th Directive be interpreted as precluding national legislation which treats as an exempt supply of services, on the basis that it constitutes a leasing or letting of immovable property within the meaning of Article 13B(b), the private use by a director and his family of part of a building constructed or owned under a right in rem in that property by a taxable legal person, where the input tax on that asset is deductible?*"

This appears to be similar to the issue in the *Seeling* case, in which German rules which deemed private use of a business property to be exempt (thereby denying input tax recovery) were held to be unacceptable. Even though the purpose of the law was to prevent a VAT advantage on private use, the ECJ ruled that exemptions have to be construed narrowly – something could not be deemed to be exempt without actually being the leasing or letting of immoveable property referred to in the legislation.

ECJ (reference) (Case C-414/10): *Belgian State - SPF Finances v BLM SA*

4.5 Eighth Directive reclaims

4.5.1 Extended deadline

In accordance with the intention reported in the last update, the Council has now adopted a Directive which defers the deadline for filing 2009 8th Directive reclaims until 31 March 2011.

Council Directive 2010/66/EU

Amendments have been made to reg.173P SI 1995/2518 to give effect to this extended deadline in the UK.

SI 2010/2940

5. INPUTS

5.1 Economic activity

5.1.1 Abuse?

The last update reported the Advocate-General's opinion in the *RBS Deutschland* case. The full court has now issued its judgment, which agrees with the opinion and with the UK Tribunal: the company's arrangements created a VAT advantage, but in the circumstances there was nothing that the authorities could do about it.

The answers to the questions raised were:

"*The answer to the first question is that, in circumstances such as those of the main proceedings, Article 17(3)(a) of the directive must be interpreted as meaning that a Member State cannot refuse to allow a taxable person to deduct input VAT paid on the acquisition of goods in that Member State, where those goods have been used for the purposes of leasing transactions carried out in another Member State, solely on the ground that the output transactions have not given rise to the payment of VAT in the second Member State.*

The answer to the second, third and fourth questions is that the principle of prohibiting abusive practices does not preclude the right to deduct VAT, recognised in Article 17(3)(a) of the directive, in circumstances such as those of the main proceedings, in which a company established in one Member State elects to have its subsidiary, established in another Member State, carry out transactions for the leasing of goods to a third company established in the first Member State, in order to avoid a situation in which VAT is payable on the sums paid as consideration for those transactions, the transactions having been categorised in the first Member State as supplies of rental services carried out in the second Member State, and in that second Member State as supplies of goods carried out in the first Member State."

The judgment makes the point that RBS Deutschland is a company which carries on a genuine financial business in Germany, and the transactions concerned were genuine and effected at arm's length with unconnected suppliers and customers. The fact that the RBS group had chosen to carry out these transactions using a German subsidiary rather than a UK company could not be attacked using the abuse of rights doctrine.

ECJ (Case C-277/09): *HMRC v RBS Deutschland GmbH*

The use of "artificial leasing" to exploit differences of treatment between different member states is included in "Avoidance Spotlights", a publication which sets out schemes which HMRC are aware of and wish to warn people off.

http://www.hmrc.gov.uk/avoidance/spotlights.htm

Peter Mason examines the concept of abuse of rights following this decision in an article in *Tax Adviser*.

Tax Adviser, January 2011

5.1.2 More abuse

CM and CA were two companies in the Churchill Insurance group. They made mainly exempt supplies of insurance, and they recovered only 1% of input tax on assets purchased. A subsidiary of CM, W, was not part of the same VAT group. The following chain of transactions was undertaken:

- companies in the C group lent W money interest-free;
- it used the money to purchase assets which it leased to S, a company that was established by a VAT consultant to the C group, at rentals which were less than 10% of the cost of the assets each year (even though they were treated as having a useful life of 4 years for accounting purposes);
- on the strength of these leases W reclaimed the input tax on the purchases;
- S leased the assets to CM and CA, making a small profit and charging VAT which the C group could only recover to the extent of 1%;
- W made losses on the transactions for corporation tax purposes (partly because of capital allowances on the purchased assets, but its accounts showed losses as well), and it surrendered those losses to other group companies.

Following the Tribunal's decision in *Halifax plc*, HMRC raised assessments disallowing the input tax claimed by W (totalling over £1.75m) on the basis that the transactions were not proper economic activity; alternative protective assessments were raised on the basis that the scheme constituted an abuse of rights.

The Tribunal examined the arrangements in considerable detail, taking evidence from finance personnel in W, the C group and S, and also from a solicitor who gave expert evidence to support the contention that W and S were both carrying on "normal" leasing activities.

HMRC argued that the overall effect of the arrangements was that the C group were "really" buying the assets that were supplied to W, and the recovery of input tax by W was an abuse of rights under the principles set out in the *Halifax plc* ECJ judgment because an insurance group should not be able to recover input tax on the assets purchased for its business. The abusive features of the scheme were:

- the use of a company outside the VAT group (W) to make the purchases;
- the use of a legally unconnected company (S) to avoid a direction under Sch.6 para.1 to account for output tax on the leasing transactions at open market value.

As a result, the C group was able to substantially reduce the amount of irrecoverable VAT, as well as improving its cash flow. HMRC's representative "said that none of the Appellant's explanations for the transactions was credible. Abuse could be inferred from the almost total disregard of the provisions in the leases, from the connection between the parties, from the lack of negotiations or legal advice and from the artificiality of the arrangements which could be collapsed at any time without any penalty."

The taxpayer's representative pointed out that "*Halifax* shows that the concept of abuse of rights is very limited; at [69] the Court said that the transactions must not be 'in the context of normal commercial operations' and must be 'solely for the purpose of wrongfully obtaining advantages.'" She argued that the arrangements were far more commercial and genuine than the *Halifax* scheme (W had carried on a substantial taxable trade for 8 years and had made a profit in 2005).

She also contended that HMRC's attempt to disallow the input tax in W was wrong. If HMRC wanted to recharacterise the transactions in a "non-abusive" way, they would have to assess output tax on the rentals from W to the C group ignoring S, presumably at a market value. This was not what they had done, and the Tribunal could not substitute a different (correct) assessment or allow HMRC to regard an input tax assessment as "the same as" an output tax assessment (following the principles established in the *Ridgeons Bulk Ltd* case in 1994 – although that has now been disapproved by the Court of Appeal in the recent *BUPA Purchasing Ltd* case).

The Tribunal considered that there was nothing abusive in an exempt trader leasing an asset. The resultant spreading of the VAT cost of the asset over a period is not contrary to the purpose of the VAT Directive. The only element of the arrangement that created a tax advantage in the *Halifax* sense was the low level of rentals; but no evidence had been brought forward by HMRC about the level of rentals, because their attack was on the whole arrangement rather than this particular aspect of them. It seems that the Tribunal might have found for HMRC if HMRC had chosen to pursue this line; but it appeared to the Tribunal that HMRC had deliberately not used this argument, and as a result it could not be considered.

The Tribunal did find that the essential aim of the transactions was the obtaining of the VAT advantage that accrued. Other explanations put forward by the witnesses (solvency benefits, control over capital expenditure) were unconvincing. If the Tribunal was wrong and the scheme did circumvent the purpose of the legislation, it was satisfied that the scheme was solely implemented to obtain a tax advantage.

In case the first conclusion was wrong, and the scheme was therefore regarded as abusive under *Halifax*, the Tribunal then considered what the appropriate assessment would be. The ECJ had said "It follows that transactions involved in an abusive practice must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice." The redefinition would have to be by substituting arm's length leases – that would involve assessing W on underdeclared output tax, not disallowing input tax. The assessments raised by HMRC therefore could not stand.

HMRC appealed to the High Court, where the judge started from the conclusion of the Tribunal that the transactions were artificial, not at arm's length and outside the normal commercial operations of the companies concerned, and were only undertaken in order to obtain the tax advantages described. However, he did not consider this enough to make them abusive within the strict conditions imposed by the ECJ in the *Halifax* case. It would be necessary to show that they were also contrary to the purpose of the VAT Directive: in this case, the spreading of the

VAT cost over a period by means of claiming input tax on purchases and accounting for it on lease rentals could not be said to be contrary to that purpose. HMRC's appeal was dismissed.

The Court of Appeal referred the following questions to the ECJ:

1. In circumstances such as those that exist in the present case, where a largely exempt trader adopts an asset leasing structure involving an intermediate third party, instead of purchasing assets outright, does the asset leasing structure or any part of it give rise to a tax advantage which is contrary to the purpose of the Sixth Directive1 within the meaning of paragraph 74 of the Judgment in Case C-255/02 Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v. CCE ("Halifax")?

2. Having regard to the fact that the Sixth VAT Directive contemplates the leasing of assets by exempt or partly exempt traders, and having regard to the Court's reference to "normal commercial operations" in paragraphs 69 and 80 of the Judgment in Halifax and 27 of Case C-162/07 Ampliscientifica and also to the absence of any such reference in the Judgment in Case C-425/06 Part Service, is it an abusive practice for an exempt, or partly exempt, trader to do so even though in the context of its normal commercial operations it does not engage in leasing transactions?

3. If the answer to question 2 is yes:

(a) what is the relevance of "normal commercial operations" in the context of paragraphs 74 and 75 of the Judgment in Halifax: is it relevant to paragraph 74 or to paragraph 75 or to both;

(b) is the reference to "normal commercial operations" a reference to:

(i) operations in which the taxpayer in question typically engages;

(ii) operations in which two or more parties engage at arm's length;

(iii) operations which are commercially viable;

(iv) operations which create the commercial burdens and risks typically associated with related commercial benefits;

(v) operations that are not artificial in that they have commercial substance; or

(vi) any other type or category of operations?

4. If the asset leasing structure or any part of it is found to constitute an abusive practice, what is the appropriate redefinition? In particular, should the national court or the tax collecting authority:

(a) ignore the existence of the intermediate third party and direct that VAT be paid on an open market value of the rentals;

(b) redefine the leasing structure as an outright purchase; or

(c) redefine the transactions in any other way which either the court or thetax collecting authority considers to be an appropriate means by which to re-establish the situation that would have prevailed in the absence of the transactions constituting the abusive practice?

The Advocate-General's opinion:

- agreed with the Tribunal and the High Court that a leasing arrangement is not in itself an abusive practice, so HMRC will not be able to recharacterise the transactions as direct purchases by the insurance company;
- agreed with HMRC that the use of an unconnected lessor in an artificial chain of transactions, with the clear aim of disapplying the connected party market value direction power in the UK legislation, is an abusive practice.

The full court has confirmed that the leasing arrangement on its own is not abusive. However, it includes conditions:

The tax advantage accruing from an undertaking's recourse to asset leasing transactions, such as those at issue in the main proceedings, instead of the outright purchase of those assets, does not constitute a tax advantage the grant of which would be contrary to the purpose of the relevant provisions of the 6th Directive ... and of the national legislation transposing it, provided that the contractual terms of those transactions, particularly those concerned with setting the level of rentals, correspond to arm's length terms and that the involvement of an intermediate third party company in those transactions is not such as to preclude the application of those provisions, a matter which it is for the national court to determine. The fact that the undertaking does not engage in leasing transactions in the context of its normal commercial operations is irrelevant in that regard.

If certain contractual terms of the leasing transactions at issue in the main proceedings, and/or the intervention of an intermediate third party company in those transactions, constituted an abusive practice, those transactions must be redefined so as to re-establish the situation that would have prevailed in the absence of the elements of those contractual terms which were abusive and/or in the absence of the intervention of that company.

It therefore appears to support the view that the inclusion of the outside intermediary leasing company is an abusive practice because it prevents the imposition of arm's length rates. However, it is not clear how the recharacterisation of the transactions should be carried out; it seems clear that the assessments raised by HMRC (denying input tax credit to Weald) cannot be sustained. The redefinition could involve ignoring the intermediary, so that Weald is treated as leasing directly to Churchill, or ignoring the fact that the intermediary is outside the group, making a Sch.6 para.1 direction possible.

ECJ (Case C-103/09): *HMRC v Weald Leasing Ltd*

5.1.3 Yet more abuse

A company entered into a VAT planning arrangement using a wholly-owned subsidiary in order to secure a repayment of VAT in respect of some buildings it had constructed for exempt use in education. Following the ECJ decision in *Halifax plc*, HMRC issued a ruling that the scheme constituted an "abuse" and the input tax was not recoverable. The companies subsequently accepted this, but continued with an appeal about the correct way to recharacterise the transactions.

HMRC refused to give the company credit for output tax it had accounted for under the arrangements because it had not made a claim for repayment within the s.80 time limits. The First Tier Tribunal rejected this, holding that *Halifax* was authority for the proposition that the recharacterisation exercise should not impose a penalty on the taxpayer. To assess a liability without allowing compensating adjustments would effectively do that.

The Upper Tribunal upheld the decision. In recharacterising transactions under *Halifax*, HMRC were required to make compensating adjustments. The time limit in s.80 did not apply: the company was not making a repayment claim, and it had not lost the right to offset the tax it had paid against the tax that was now due.

Upper Tribunal: *HMRC v Moorbury Ltd*

5.2 Who receives the supply?

5.2.1 For the creditors?

A company was in financial difficulties and appointed an accountancy firm to liaise with its banks, bondholders and other creditors. It paid the fees and reclaimed input tax on them. HMRC assessed to disallow the tax, arguing that the firm's supplies were made to the creditors, not to the company.

The First Tier Tribunal examined the engagement letters, which appeared to support HMRC's position: they were addressed to the engaging institutions, and stated that the report was solely for the use of the engaging institutions. However, even HMRC accepted that the appellant was a party to the contracts – they were tripartite agreements. HMRC relied on the Tribunal decisions in *Telent plc* (19,967) and *Birmingham City Football Club* (20,151) to support the contention that the person who pays for services does not necessarily have the right to deduct the VAT.

The First Tier Tribunal quoted the *Redrow plc* decision of the House of Lords at length. It concluded that there was a supply made to the company as well as to the lenders; it was then obvious that the supply was used for the purposes of its business, and it was entitled to the deduction.

The Upper Tribunal has reversed this decision on appeal. The judges did not consider that Airtours received any benefit for its business in the same way that Redrow did. It did not start by needing PwC's report to place before the institutions; the institutions started by wanting the report for themselves, as the agreement states. The benefit to Airtours was that PwC's report might lead to continued finance from the institutions for which Airtours was willing (or was forced) to pay. In reality, the institutions were contracting with PwC for the provision of the services, and the involvement of the company in the agreement was only in order to make sure that it had to pay for those services.

Upper Tribunal: *HMRC v Airtours Holiday Transport Ltd*

5.2.2 Reader's Queries

A Reader's Query in *Taxation* considered a property developer who intended to purchase some land from a local authority. The authority had asked the developer to pay for certain professional services which had been supplied to the authority. The answers did not hold out much hope for any recovery of the VAT on these recharges.

Taxation, 21 October 2010

Another Reader's Query asks about the cost of installation of a security screen in a sub-post office. The answers refer to a precedent in which the Tribunal held the expenditure was not incurred in the course or furtherance of the business (a convenience store) but in relation to activities which were outside the scope of VAT (employment by the Post Office). The VAT would therefore not be input tax and could not be recovered.

Taxation, 18 November 2010

5.2.3 Article

Neil Warren considers various problems of three-way contracts, including place and nature of supply as well as input tax deduction, in an article in *Tax Adviser*.

Tax Adviser, December 2010

5.3 Partial exemption

5.3.1 Proposed special method upheld in Tribunal

A company engaged in the casino, restaurant, bar and entertainment business proposed a floor-area based special method for partial exemption. HMRC rejected it and the company appealed to the Tribunal.

The First Tier Tribunal examined the way in which the business was organised at the several different locations operated by the company. It noted that a significant amount of food (taxable) was in fact given away to gamblers. In addition, significant areas of the properties were not used to make any supplies, but were communal areas, passageways, reception etc. Some 71% of residual input tax was argued to be property-related, which the company contended made the use of floor areas a reasonable proxy for "use" of inputs.

The proposed special method took the floor areas that were used to make supplies and ignored the rest. It was proposed that residual input tax should be recovered using a calculation as follows:

- the "T" part would include the whole of the area given over to taxable gaming and entertainments, but only a proportion of the areas of bars and restaurants – that would be reduced to reflect the proportion of food and drink that was given away free;
- the "E" part would include the remainder of the bar and catering areas and the exempt gaming areas as well.

HMRC used their normal arguments against floor-based methods, citing the Tribunal's decision in *Vision Express* in support. They also argued that treating all the residual input tax as property-related was not likely to produce a fair result.

The First Tier Tribunal disagreed. The situation was quite different from that in the opticians' cases. Allowance had been made for the cross-subsidisation of food and gaming by removing the "free food and drink" from the "T" part of the calculation. The case was different from that of *Aspinalls*, in which most of the food and drink was given away; here, the catering was a genuine business activity which made a significant contribution to overheads. Overall, the Tribunal was satisfied that the proposed method would produce a fair result.

It was then necessary to consider whether it gave a fairer result than the existing special method (which dated from 1993). That was turnover-based, and the company's counsel had several criticisms of it. The two significant ones were that:

- it was wrong to use turnover as a proxy for use in this case because there were more costs incurred in earning £1 of catering income than there were in earning £1 of gaming income;
- a turnover-based method would produce unpredictably fluctuating results depending on how lucky the customers were, and this was clearly unfair and unreasonable when the costs did not vary at all.

The First Tier Tribunal accepted these arguments and allowed the appeal. The proposed method was fair and reasonable, and more so than the existing method.

HMRC appealed to the Upper Tribunal, which upheld the decision as a reasonable one on the basis of the evidence. The judge started by commenting on the principle that the appellate court should not normally interfere with a finding of fact, but he still examined the decision in detail and agreed with its reasoning at each level.

Upper Tribunal: *London Clubs Management Ltd v HMRC*

5.3.2 Pitched battle

A rugby club paid for the construction of a new pitch. HMRC ruled that the costs were entirely attributable to making exempt supplies and were therefore not recoverable. The Tribunal accepted the club's appeal on the grounds that the costs were residual.

The chairman raised an interesting point about the HMRC review process. It was clear that the officer who raised the assessment understood that the pitch was a new one, constructed where there previously had not been one at all. However, the reviewing officers (and HMRC's skeleton argument for the hearing) referred to the project as "pitch renewal", i.e. renovating a pitch that already existed. The chairman commented that this misunderstanding of the facts created uncertainty about the reasonableness of HMRC's decisions – it was not certain that they would have come to the same conclusion had they properly understood the situation.

The club argued that it spent the money on the new pitch to reverse a decline in its fortunes. It was fundamental to the expenditure that it would

be able to earn more money in future from advertising boards around the pitch. Although there were no contracts in place to secure this revenue, the Tribunal accepted that this was the intention at the time the expenditure was incurred, and this was a sufficient link for input tax purposes.

At the hearing HMRC pointed out that the delay between the expenditure and the receipt of advertising board income meant that there was no income from the supposedly linked taxable supply during the period in which the input tax was claimed. As this had not previously been put forward as an argument by HMRC, the Tribunal declined to consider it at this hearing. Instead, the parties were invited to discuss the issue further in the next 28 days and return to the Tribunal if it was necessary to debate the point.

First Tier Tribunal (TC00718): *Cirencester Rugby Club*

5.3.3 Changes to capital goods scheme and PESMs

HMRC have issued a Brief containing a technical note and draft amending regulations to implement the EU VAT Technical Directive. This partly affects "*Lennartz* accounting" (see 5.6 below) but there are also more general changes to the CGS, including:

- the inclusion of ships and aircraft costing £50,000 or more;
- the simplification of reg.113, which used to contain a list of different types of expenditure on buildings but which now lists separately 6 classes of asset then describes the capital expenditure that will be covered by the scheme;
- the removal of reg.115(3), which restricted a sale adjustment in the taxpayer's favour to the amount of output tax charged on the sale – HMRC regard this as unnecessary because regs.115(3A) and (3B) give them the power to restrict the total input tax recovered on the item to that amount anyway;
- enactment of the concession which allows a trader who becomes registrable because of an option to tax to recover VAT in accordance with a calculation similar to the CGS;
- clarification of the interaction between grouping and the CGS (the representative member is treated as owning all the CGS items in the group).

HMRC are also proposing to finish the project on simplification of the partial exemption rules which has been in progress for the last three years. The last phase includes:

- introduction of a new right of taxpayers to agree a single method which will deal with taxable, exempt and non-business VAT in one calculation (currently a special method is strictly only permitted once the non-business VAT has been extracted);
- introducing a de minimis limit below which changes in the use of a CGS asset will be ignored.

The de minimis limits are as follows:

(a) the adjustment percentage is 1% or less, or

(b) the total VAT bearing capital expenditure on a capital item of a description falling within regulation 113 is £1,000,000 or less and the adjustment percentage is 10% or less, or

(c) the total VAT bearing capital expenditure on a capital item of a description falling within regulation 113 is £10,000,000 or less and the adjustment percentage is 5% or less.

R&C Brief 47/10; SI 2010/3022

5.4 Cars

Nothing to report.

5.5 Business entertainment

5.5.1 HMRC accept foreign customers

HMRC have accepted that the *Danfoss/AstraZeneca* decisions of the ECJ (Case C-371/07) have shown that the UK cannot maintain an input tax block on genuine business expenditure involving entertainment of foreign customers. This is because such expenditure was allowed when the 6th Directive came into force in the UK in 1978, and member states are not allowed to extend blocking orders on expenditure which is allowable under general principles (as the UK did for both VAT and corporation tax in this area in 1988).

HMRC will accept new claims subject to the four-year cap. The Brief points out that HMRC announced in March 2009 that it invited *Fleming* claims for the period 1 August 1988 to 30 April 1997 pending its review of the policy, but it will no longer accept such claims.

The Brief sets out the standard for a “claim” to be accepted:

- details of the overseas customers
- the type of expenditure, for example, meals to support business meetings, etc.
- the amount of VAT claimed
- evidence that VAT has been incurred and not previously been deducted
- if required for historical claims, evidence of the type of business entertainment the business normally excludes from recovery by reference to recently rendered tax periods.

The Brief also comments that in some circumstances a private use charge should cancel out the input tax recovery. HMRC consider that the ECJ cases of *Julius Fillibeck Sohne* (C-258/95) and *Danfoss and AstraZeneca*

(C-371/07) provide two tests of when it will not be necessary to account for private use:

- the "necessity" test – in *Fillibeck*, it was practically impossible for employees to travel to a building site unless the employer provided transport;
- the "strict business purpose" test – in *Danfoss*, the provision of meals was simply to enable the smooth running of meetings.

The Brief comments on the different considerations which may apply to in-house meetings, external meetings and corporate entertainment events.

R&C Brief 44/10

5.6 Non-business use of supplies

5.6.1 Changes to the law

The last Finance Bill of 2010, published on 1 October, contains provisions to amend the *Lennartz* rules. Clause 19 introduces Schedule 8, which amends the *Lennartz* procedure, under which a business may initially recover VAT in full on the purchase of an asset even where there is an element of non-business use, is to be changed. Amendments to VATA 1994 will:

- distinguish between business input tax and non-business VAT;
- ensure that VAT is not recoverable on the private or non-business use of specified assets;
- provide a power to treat non-business VAT as input tax;
- ensure that VAT on the private use of directors' accommodation is not recoverable.

The capital goods scheme will be amended by regulations to take into account changes in the business/private use of an asset (see below).

As a revenue protection measure, output tax will continue to be due in respect of supplies for which credit was allowed under the *Lennartz* mechanism (assuming that the trader does not choose to reverse the *Lennartz* accounting that has been commenced under the old rules).

http://www.publications.parliament.uk/pa/cm201011/cmbills/072/11072.i-iii.html

HMRC have now issued a Brief containing a technical note and amending regulations to implement the new rules in accordance with the EU VAT Technical Directive. To deal with the issue of private use:

- the capital goods scheme is amended to include "VAT-bearing capital expenditure", so it is no longer dependent on the VAT incurred being input tax at the point of acquisition;
- it is extended to include ships and aircraft costing £50,000 or more, but land and buildings still have to cost at least £250,000;

- "the adjustment percentage" is redefined to mean the difference (if any) between the extent, expressed as a percentage, to which the whole or part as appropriate of the capital item was used or to be used for the making of taxable supplies at the time the original entitlement to deduction of the input tax was determined and the extent to which the whole or part of it as appropriate is so used in a subsequent interval;
- a capital item that is purchased before the person is registered will be considered to have started an adjustment period when first used, and adjustments will be made for any intervals which finish after the trader is registered – at the same time, it is clarified that expenditure on capital items cannot qualify as pre-registration expenditure under reg.111, because it will only give rise to entitlement under this new provision;
- "the original entitlement to deduction" is redefined to mean the entitlement to deduction under sections 24 to 26 of the Act and regulations made under those sections.

The regulations on *Lennartz* accounting (reg.116B) are amended to exclude any expenditure incurred on or after 1 January 2011.

Regs. 108 and 109 are also amended to allow a payback or clawback to occur where there is a change from a taxable intention to non-business use or vice versa (by defining "exempt supplies" for the purposes of those regulations as including a reference to non-business activities that give rise to an amount of non-business VAT).

R&C Brief 47/10; SI 2010/3022

5.6.2 Article

In an article in *Taxation*, Mike Thexton considers the history of the "*Lennartz* approach" and its eventual withdrawal in 2011.

Taxation, 7 October 2010

5.7 Bad debt relief

Nothing to report.

5.8 Other input tax problems

5.8.1 Carousels

Blue Sphere Global is one of the rare traders which has succeeded on a carousel fraud appeal. In the Tribunal it had lost, but the High Court found in 2009 that it had no means of knowing about fraud carried out in a different deal chain. In the course of that appeal, the company had made an offer to settle the litigation, which HMRC had refused. The Court of Appeal agreed with the trader that it was entitled to the benefit of Rule 36 of the Civil Procedure Rules, which provide for awards of costs and interest where a party insists on going through with litigation and ends up with a result that is not as good as the offer the other party made. The fact that HMRC were pursuing the litigation in the public interest was no reason to deny the company the benefit of the CPR.

Court of Appeal: *Blue Sphere Global Ltd v HMRC*

The Tribunal examined the transactions of a company which had been refused a payment of £394,450 of input tax in respect of various transactions in 2006. Applying the *Kittel* test as interpreted in the *Mobilx* case, the Tribunal concluded that the appellant "knew or ought to have known" (indeed, in this case actually knew) that the transactions were connected with fraud. Even if the trader did not, as a matter of fact, know about the connection with fraud, there was no other reasonable explanation for the way the deals were carried out.

The appeal was dismissed with costs.

First Tier Tribunal (TC00746): *3rd Generation Communication Ltd*

A similar decision was reached in another case concerning input tax disallowed of just over £70,000 in the 03/06 quarter.

First Tier Tribunal (TC00732): *Telement Ltd*

A similar decision was reached in another case concerning input tax disallowed of just under £740,000 in the 06/06 and 07/06 periods. The director was described as "an intelligent man" who must have known what he was involved in.

First Tier Tribunal (TC00717): *Phonepoint Communications Ltd*

A different argument was raised in a case about the set-off of over £6m by two contra-traders where the subject matter was urine testing strips. The trader pleaded "legitimate expectations" and accused HMRC of an abuse of power. The decision was the same: the Tribunal was satisfied that the director actually knew that the orchestrated transactions had to be fraudulent; and if he did not actually know, fraud was still the only reasonable explanation, so he ought to have known.

First Tier Tribunal (TC00716): *Eurosel Ltd*

Another contra-trading case involved about £5m of VAT over three months in 2006. Once again, the Tribunal was satisfied that the appellant's director knew what was going on; or, if he did not, he ought to have done. In this case, there was clear evidence of a link between the clean and dirty chains, so the defence that has sometimes succeeded in contra-trading cases was no help.

First Tier Tribunal (TC00699): *Radarbeam Ltd*

Yet another MTIC case involved a company which had traded honestly for many years and had a substantial warehouse full of genuine goods. Nevertheless it became caught up in a carousel fraud in 2006 and was denied input tax of £300,000 in respect of its 08/06 period. The due diligence undertaken was considered to be a "low hurdle to be jumped" rather than a genuine commercial exercise. There were also references in recorded MSN messages that suggested the appellant knew the trade was fraudulent.

First Tier Tribunal (TC00704): *A One Distribution (UK) Ltd*

In a rare success, one company persuaded the Tribunal that HMRC had failed to prove that fraud was "the only reasonable explanation" for its transactions and it therefore did not have the means of knowing that it was involved in a MTIC fraud. Its appeal against the refusal of an £8.8m repayment was allowed.

This was a relatively unusual MTIC case in that the claimant and its supplier were both established businesses within the mobile phone industry and there was no evidence of circularity of goods or payments. The claimant did not use the First Curacao International Bank that is a feature of many carousel deals. The director was cross-examined for a day and a half and maintained his innocence and honesty in the face of "robust" questioning. The Tribunal decided that HMRC had not made out their case.

First Tier Tribunal (TC00680): *Emblaze Mobility Solutions Ltd*

Another company also succeeded with the same argument and secured a repayment of £176,000. It appears to have been able to rely on the principle that a trader in a clean chain is less likely to have the means of knowledge of a fraud in a connected, but separated, dirty chain.

First Tier Tribunal (TC00682): *Greener Solutions Ltd*

Another company was unsuccessful with an appeal against the denial of nearly £1.5m relating to 03/06 and 06/06. In this case the Tribunal did not consider that there was any direct evidence that the director had known that the transactions were fraudulent, but the lack of adequate due diligence procedures meant that he had failed to protect himself: if he had asked the proper questions, he would have realised what was happening, so he "had the means of knowing".

First Tier Tribunal (TC00687): *Ng International Ltd*

Another trader conceded that there had been a fraud, but argued that the company neither knew nor had the means of knowing about it. The Tribunal did not accept this: once again, the checks carried out were inadequate. HMRC were correct in disallowing £900,000 of input tax for the period 04/06.

The Tribunal thanked the accountant who represented the appellant for providing USB sticks with all the documents in scanned and searchable form. This made wading through reams of paper much easier than using ring binders.

First Tier Tribunal (TC00772): *Gillex (UK) Ltd (in liquidation)*

Another trader was found to be involved in circular payments through the First Curacao International Bank with no credible explanation other than a knowing involvement in fraud. Input tax of £3.3m was properly denied.

First Tier Tribunal (TC00774): *Extel RTI Solutions Ltd (in administration)*

The Tribunal found against a trader who had claimed repayments of £3m in 03/06 and 05/06. The trader had been involved in the mobile phone business since 2000 and had discussed the problems of MTIC fraud with HMRC several times. Earlier periods had led to enquiries which were inconclusive, so payments had been made on a "without prejudice" basis.

The Tribunal described the principal as an "incompetent businessman" and an unreliable witness, and concluded that the deal chains were clearly artificial. HMRC were correct to hold that the trader either knew, or ought to have known, that they were fraudulent.

First Tier Tribunal (TC00812): *Procomm Consultancy Ltd*

The Tribunal found against another trader who had claimed repayments of £5m in 04/06 and 05/06. This company had only commenced trading in April 2005. Unusually, it was a dealer in CPUs rather than mobile phones. Officers of HMRC met with the owner of the company before agreeing to register it and gave him a copy of Notice 726. Although confidentiality apparently prevented them being more explicit when talking to the trader, one of the officers noted after the meeting that "*I will be amazed if Xentric, as a broker, do not get involved in a supply chain with a defaulter in the UK.*"

The appellant argued that everything described in Notice 726 had been done, and HMRC ought to be satisfied with this due diligence. The Tribunal did not believe that the due diligence could have been adequate and at the same time completely inadequate: it had failed to detect any of the many fraudulent transactions in which the company was involved. The Tribunal concluded from observing the principal's 3 days of cross-examination that he was someone who was likely to know exactly what was going on around him. The decision was that he knew – and certainly ought to have known – about the fraud, and the appeal was dismissed with costs.

First Tier Tribunal (TC00862): *Xentric Ltd*

Another company was denied £2.2m of input tax on 18 deals in period 04/06. Many of the features of the trade were inexplicable unless they were fraudulent, and the Tribunal concluded that the company ought to have known that.

First Tier Tribunal (TC00846): *G Comms Ltd*

In a case management dispute, HMRC applied to bring in two witness statements. The trader successfully argued that the statements were generic rather than relevant to the specific case – "Officer Stone's manual

on MTIC fraud" – and the Tribunal decided that it would unnecessarily drive up costs to admit them. They also included material which would be prejudicial if admitted as fact without cross-examination, and the preparation of cross-examination would also involve considerable time and cost for the defence team.

First Tier Tribunal (TC00808): *Globalbis Distribution Ltd*

The mastermind of a £54m MTIC fraud was imprisoned for 15 years in December 2006. On 18 November 2010 his sentence was extended by a further 9 years because he has failed to repay £40m of his criminal profits. This is the longest sentence ever handed down by a UK court for this type of crime, and the confiscation order was one of the largest ever made.

HMRC Release 22 November 2010

5.8.2 A different carousel

HMRC report the successful prosecution of a gang involved in the importation of cars which were passed through a chain of companies which disappeared without paying the VAT. The cars ended up being sold by genuine car dealerships or car supermarkets in the UK. The ringleader was sentenced to 10 years in jail.

The turnover of the fraud was some £80m over two years, and the total VAT loss was £12m.

HMRC Release 26 November 2010

5.8.3 Fuel advisory rates

The twice-yearly change of the HMRC approved "fuel-only mileage rates" takes effect on 1 December and 1 June. For one month from the date of change, employers can use either the old or the new rates as they choose.

The rates can be used for two purposes for VAT:

- if the employee buys fuel, the employer can pay the mileage rate for business miles and HMRC will still accept an input tax claim based on 7/47 of the amount paid (as it is all for fuel) – 1/6 from 4 January 2011;
- if the employer buys fuel, and the employee reimburses this mileage rate for private miles and HMRC will accept that the output tax scale rates do not apply. However, the employer will have to account for output tax on the amount received, as it is an actual supply of fuel to the employee for consideration.

The rates have been adjusted slightly (upwards, where there is a change) from 1 December 2010 as follows:

Engine size	Petrol	Diesel	LPG
1400cc or less	13p (12p)	12p (11p)	9p (8p)
1401cc – 2000cc	15p (15p)	12p (11p)	10p (10p)
Over 2000cc	21p (21p)	15p (16p)	15p (14p)

These figures are also an acceptable basis for estimating the fuel element of a mileage allowance paid to someone for use of their own car. HMRC will still allow an input tax claim based on mileage allowances, so if the

employer pays 40p a mile to someone with a 2100cc car, it appears that 1/6 x 21p ought to be an acceptable basis for the input tax claim. It is a requirement that the employer holds input tax invoices which show at least the amount of the VAT that is being claimed on a mileage basis.

It is still open to all drivers, whether of their own cars or company cars, to make a claim based on actual costs. However, these mileage rates are likely to be a worthwhile simplification of that.

The Press Release contains a summary of the fuel consumption figures used to generate the above mileage rates, which may provide some indication of whether a particular car is likely to give a lower or higher "actual" figure.

Revenue & Customs Press Release 1 December 2010

5.8.4 On your bike

A Reader's Query in Taxation asked for the tax and VAT implications of the costs of a "Boris bike" – the bicycle rental scheme currently being run by the Mayor of London. The answers suggested that VAT relief was unlikely, given that no VAT invoice was issued. There was the additional problem that the user had three possible reasons for using a bike – a sole trade, an employment and social life – and only one of these was taxable for VAT purposes.

Taxation 16 December 2010

5.8.5 Article

In an article in *Tax Adviser*, David Coleman considers the decision on pre-registration input tax in *Crazy Farm Golf Course Ltd* (TC00594).

Tax Adviser November 2010

5.8.6 Academies

VAT incurred by state schools is usually recovered by the local authority which funds them. As part of the development of more independent academies, a new measure in Finance Bill 2011 will allow them to recover VAT on their expenditure directly insofar as it relates to non-business activities (i.e. the provision of free education).

http://www.hmrc.gov.uk/budget-updates/autumn-tax/tiin1615.pdf

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

6.2.1 Cancellation of registration

A company was incorporated and registered for VAT in 2007. It had only apparently made one supply, in the amount of £180,000 plus VAT, to an associated company which had the same directors and shareholders. The invoice described services which had taken place in 2005/06, i.e. before the company was incorporated. After considering the evidence, HMRC issued a direction that the registration should be cancelled retrospectively under Sch.1 para.13(3) VATA 1994 as there was no evidence that a trade was being carried on.

The company was not represented at the hearing, so it was hard to establish exactly what the directors had intended by using it. HMRC's counsel suggested that the single transaction appeared to be a recharging of income that perhaps should have been subject to income tax and NIC, and was therefore "suspicious". The Tribunal agreed that the decision to cancel the registration from the outset was a reasonable one.

First Tier Tribunal (TC00729): *Shadow Photographic Ltd*

An individual was involved in a long-running dispute over whether she was properly registered for VAT and therefore entitled to recover input tax. This appears to have originated in connection with a property transaction which may have involved a sale of land to the local authority (potentially a business transaction), or may have involved the individual receiving compensation following a lawsuit against the previous owners of the property (outside the scope).

The Tribunal examined the history of the dispute and the activities put forward by the individual in support of her claim for input tax. Applying the "Lord Fisher" tests, the chairman concluded that she was not in business and HMRC were correct to cancel her registration.

First Tier Tribunal (TC00775): *Priti Lee*

6.2.2 One person partnership

A catering business was registered as a partnership of husband and wife in 2001. On a control visit in 2007, the officer discovered that the wife had ceased to be a partner. He therefore directed that the partnership should be deregistered and the husband reregistered as a sole trader. The husband appealed, contending that the firm's registration should continue unchanged pending the introduction of a new partner.

The appellant was not represented at the hearing, where the Tribunal agreed with HMRC that the officer had followed the correct course of action. The deeming provision of s.45 VATA 1994 could not apply to a sole trader.

First Tier Tribunal (TC00782): *Thomas Maryam*

6.2.3 Failure to register

A sole trader commenced a trade of property development and renovation. He submitted a VAT 1 form in September 2009. On being alerted to his existence, HMRC examined his self-assessment income tax returns, and decided that he had been liable to be registered before, exceeding the threshold at the end of December 2007. His turnover had then dipped, so they issued a notice of compulsory registration to cover the period 1 February 2008 to 31 January 2009, together with an assessment for VAT calculated using the flat rate scheme percentage, and a belated notification penalty.

The trader's defence amounted to ignorance of the legal requirements and reliance on an accountant to deal with these matters. The Tribunal noted that HMRC had accepted that they had used the wrong FRS percentage, which reduced the assessment slightly, but it was confirmed in principle. HMRC's counsel pointed out that HMRC had been relatively generous in using the FRS and in allowing deregistration with effect from January 2009; for reasons which are not explained, HMRC also appear to have consented to waive the penalty. Even so, the trader would have to find £5,700 which he had not collected from his customers.

First Tier Tribunal (TC00856): *Jarvis Ellis t/a Ellis Construction*

6.2.4 Reader's Query

A Reader's Query in *Taxation* considered a problem arising from the registration of "the wrong group company" – a dormant company had been registered, and the trading company had used its VAT number for several years. The right amount of VAT had been accounted for throughout, but by the wrong company. The answers suggested that something had to be done, and the client would have to rely on HMRC being merciful.

Taxation, 7 October 2010

6.3 Payments and returns

6.3.1 FRS percentages

The new FRS percentages to apply from 4 January 2011 were confirmed by Statutory Instrument. They have not been changed from the announcement at the time of the June Budget.

Category of business	2011	2010	2009	2008
Retailing food, confectionery, tobacco, newspapers or children's clothing	4	3.5	2	2
Post offices	5	4.5	2	2
Farming or agriculture that is not listed elsewhere	6.5	6	5.5	6
Pubs	6.5	6	5.5	5.5
Retailing vehicles or fuel	6.5	6	5.5	7
Wholesaling food	7.5	6.5	5	5.5
Retailing that is not listed elsewhere	7.5	6.5	5.5	6
Membership organisation	8	7	5.5	5.5
Wholesaling agricultural products	8	7	5.5	6
Retailing pharmaceuticals, medical goods, cosmetics or toiletries	8	7	6	7
Sport or recreation	8.5	7.5	6	7
Wholesaling that is not listed elsewhere	8.5	7.5	6	7
Printing	8.5	7.5	6.5	7.5
Repairing vehicles	8.5	7.5	6.5	7.5
Manufacturing food	9	8	7	7.5
Manufacturing yarn, textiles or clothing	9	8	7.5	8.5
Packaging	9	8	7.5	8.5
General building or construction services*	9.5	8.5	7.5	8.5
Hiring or renting goods	9.5	8.5	7.5	8.5
Library, archive, museum or other cultural activity	9.5	8.5	7.5	7.5
Manufacturing that is not listed elsewhere	9.5	8.5	7.5	8.5
Repairing personal or household goods	10	9	7.5	8.5
Mining or quarrying	10	9	8	9
Transport or storage, including couriers, freight, removals and taxis	10	9	8	9
Forestry or fishing	10.5	9.5	8	9
Travel agency	10.5	9.5	8	9
Dealing in waste or scrap	10.5	9.5	8.5	9.5
Hotel or accommodation	10.5	9.5	8.5	9.5
Manufacturing fabricated metal products	10.5	9.5	8.5	10
Computer repair services	10.5	9.5	10	11
Agricultural services	11	10	7	7.5
Social work	11	10	8	8.5
Veterinary medicine	11	10	8	9.5
Advertising	11	10	8.5	9.5
Photography	11	10	8.5	9.5
Publishing	11	10	8.5	9.5

Any other activity not listed elsewhere	12	10.5	9	10
Investigation or security	12	10.5	9	10
Boarding or care of animals	12	10.5	9.5	10.5
Business services that are not listed elsewhere	12	10.5	9.5	11
Estate agency or property management services	12	10.5	9.5	11
Laundry or dry-cleaning services	12	10.5	9.5	11
Entertainment or journalism	12.5	11	9.5	11
Catering services including restaurants and takeaways	12.5	11	10.5	12
Film, radio, television or video production	13	11.5	9.5	10.5
Secretarial services	13	11.5	9.5	11
Hairdressing or other beauty treatment services	13	11.5	10.5	12
Financial services	13.5	12	10.5	11.5
Management consultancy	14	12.5	11	12.5
Real estate activity not listed elsewhere	14	12.5	11	12
Architect, civil and structural engineer or surveyor	14.5	13	11	12.5
Accountancy or book-keeping	14.5	13	11.5	13
Computer and IT consultancy or data processing	14.5	13	11.5	13
Labour-only building or construction services*	14.5	13	11.5	13.5
Lawyer or legal services	14.5	13	12	13

Because the increase in the standard rate will tend to increase gross receipts or turnover, the level at which a trader must leave the scheme is also raised from £225,000 to £230,000 with effect from 4 January 2011. The business may remain in the scheme if it expects its turnover in the following year not to exceed £191,500 (rather than £187,500).

SI 2010/2940

6.3.2 Reader's Queries

A Reader's Query in *Taxation* considered a trader who was registered under the Flat Rate Scheme. Turnover exceeded the exit threshold in one year, but HMRC had apparently accepted that this was likely to be a "one-off" occurrence and had allowed the trader to remain within the scheme. However, a year later the turnover was too high again. The answers examine the law and suggest that the trader should have been allowed to stay in the scheme for the intervening year as long as there were reasonable grounds for expecting the turnover to fall again – hindsight should not be taken into account.

Taxation, 18 November 2010

Another Reader's Query considers an assessment raised by an officer apparently based only on a discrepancy between the turnover disclosed in the self-assessment tax returns and that shown on the VAT returns. The answers consider possible reasons for such a discrepancy that might amount to a defence against the assessment.

Taxation, 2 December 2010

6.3.3 Manual update

HMRC have published a new online manual on default interest. It explains when interest will not be charged as there is no need for "commercial restitution" to the Exchequer.

www.hmrc.gov.uk/manuals/vdimanual/VDIM1000.htm

6.4 Repayment claims

6.4.1 Compound interest

The High Court has decided to refer questions to the ECJ on the issue of whether VAT repayments should carry compound or simple interest:

(1) where a taxable person had overpaid VAT which was collected by the member state contrary to the requirements of European Union VAT legislation, did the remedy provided by a member state accord with EU law if that remedy provided only for

> *(a) reimbursement of the principal sums overpaid, and*
>
> *(b) simple interest on those sums in accordance with national legislation, such as s 78 of the Value Added Tax Act 1994 (the 1994 Act);*

(2) if not, did EU law require that the remedy provided by a member state should provide for

> *(a) reimbursement of the principal sums overpaid, and*
>
> *(b) payment of compound interest as the measure of the use value of the sums overpaid in the hands of the member state and/or the loss of the use value of the money in the hands of the taxpayer;*

(3) if the answer to both questions 1 and 2 was in the negative, what should the remedy that EU law required the member state to provide include, in addition to reimbursement of the principal sums overpaid, in respect of the use value of the overpayment and/or interest; and

(4) if the answer to question 1 was in the negative, did the EU law principle of effectiveness require a member state to disapply national law restrictions (such as ss 78 and 80 of the 1994 Act) on any domestic claims or remedies that would otherwise be available to the taxable person to vindicate the EU law right established in the ECJ's answer to the first three questions, or could the principle of effectiveness be satisfied if the national court disapplied such restrictions only in respect of one of those domestic claims or remedies. What other principles should guide the national court in giving effect to that EU law right so as to accord with the EU law principle of effectiveness?

High Court: *Littlewoods Retail Ltd and others v HMRC*

6.4.2 Italian claims

The last update included the announcement from HMRC that they are suspending payments in respect of "Italian case" claims (concerning sales of ex-demonstrator vehicles which should have been treated as exempt rather than subject to a margin scheme). The suspension relates to a review of their policy following the ECJ decision in *Nordania Finans* (Case C-98/07), in which the court held that sales of leased cars were not "capital assets used in the business" to be excluded from the partial exemption fraction. The UK High Court had previously decided in *JDL Ltd* that the sale of ex-demonstrators should be so excluded, with the result that a claim for repayment of the output tax did not lead to any corresponding reduction in input tax entitlement.

Further detail has been given in *Revenue & Customs Brief 43/10*. This explicitly states HMRC's view that *Nordania Finans* overturns the *JDL Ltd* decision and that partial exemption should therefore have been taken into account in all *Italian Republic* claims.

HMRC will review claims that have been paid and will issue recovery assessments on a best judgement basis where they are in time to do so. They expect all outstanding claims to be revised by the claimant to take into account partial exemption adjustments to input tax.

Revenue & Customs Brief 43/10

6.4.3 No claim made

A firm of solicitors received income from the Legal Services Commission. At a control visit in 2002, it became apparent that it was accounting for VAT on receipts rather than on amounts billed, and an overpayment of some £30,000 had probably resulted. The solicitors were advised that they had to make a claim for repayment. They sent a letter in late 2003, but it appears that it did not contain details of the amount claimed. A dispute about whether a claim had been properly made or not ended up in the Tribunal, where the chairman tried to establish what had happened and when.

This proved to be a difficult exercise, but the conclusion was that the solicitors had failed to establish on the balance of probabilities that they had made a detailed claim in 2003. The claim was only specified at a much later date, by which time it was too late.

First Tier Tribunal (TC00734): *Nathaniel & Co Solicitors*

6.4.4 Unjust enrichment

A company sought to register for VAT in order to take advantage of the *Kingscrest* decision in 2005 which established that residential care homes could charge VAT to local authorities (which the authorities could recover under s.33 VATA 1994) and therefore recover their own input tax. It made a "long registration period return" covering some 28 years and claiming input tax of nearly £67,000. This information had been extracted from the annual accounts, and adjustments had been made in respect of the proportion of residents who were paid for by the local authority and who were private payers.

HMRC reduced the returns to nil, arguing that the company could not claim the input tax in isolation. It would have to account for output tax as well. The company contended that the local authorities could recover the output tax so there was no need to charge it. The Tribunal agreed with HMRC: it was not permissible to claim the input tax without accounting for the output tax. If the annual accounts could produce one figure they could be used to produce the other. The company would be better off leaving the matter as it had originally been treated by HMRC – exempt.

First Tier Tribunal (TC00751): *Benridge Care Homes Ltd*

6.4.5 Offsetting

In TC00121, the Tribunal dismissed a trader's appeal against an assessment on certain receipts of his taxi business. He subsequently claimed that the Tribunal had failed to address his complaint that HMRC had unfairly retained input tax that he had claimed on three returns. HMRC said that they had been entitled to offset these amounts against VAT owed to them by the trader. The trader applied to the Upper Tribunal for an appeal against the earlier decision, but was advised to go back to the First-Tier Tribunal instead with a separate appeal about the retention.

The decision is a little hard to follow. If the amounts were retained against the output tax liability, it seems that repaying them would only increase a liability to settle the assessments in cash; if on the other hand the assessments had been settled in full by other means, it seems surprising that HMRC should have continued to retain these amounts that had been offset. The Tribunal considered the arguments put forward by the trader and concluded that there was no reason to revisit the decision made in 2009. The offsets had been properly made and could not be reversed.

The Tribunal did, however, apologise to both parties for failing to deal with this explicitly in the previous decision, and therefore causing further work to be undertaken in settling the issue.

First Tier Tribunal (TC00759): *Mark Lancaster t/a Airport Cars*

6.4.6 Reader's Query

A Reader's Query in *Taxation* considered whether there was any redress for a trader who had been assessed by HMRC in 2005 in circumstances which were subsequently shown by the *Insurancewide* decision to have been wrong. The answers confirmed that the three-year (now four-year) cap would apply and there was nothing the trader could do about it.

Taxation, 7 October 2010

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Consultation on checks

HMRC have announced a programme of Business Records Checks that is intended to improve record-keeping across the SME sector. They issued a consultation document on 17 December 2010, to run to 28 February 2011, to gather views on how best to do this. No new legislation will be required, but the impact of penalties for failing to keep proper records will be relevant.

The background to the project is explained as follows:

2.2 Whilst the need to keep proper records in order to comply with tax obligations is widely acknowledged, HMRC's random enquiry programme indicates that poor record keeping is a problem in around 40% of all of SME cases (circa 5 million). Research by the Organisation for Economic Cooperation and Development (OECD) indicates that poor business record keeping generally leads to an underassessment of tax even where there is an audit-type check into a return for the period covered by such records. On this basis, poor business record keeping is responsible for a loss of tax in up to 2 million SME cases annually.

2.3 Tax agents tell us that whilst they advise clients on what records to keep and how to keep them, many do not follow the advice given. This causes additional unnecessary work for those agents who have no way of enforcing the standards that they think necessary

2.4 The loss of tax through poor record keeping, particularly in the current economic climate, cannot continue and HMRC is, therefore, determined to use the powers at its disposal to improve business record keeping and so reduce the loss to the Exchequer that stems from poor business records.

HMRC set out the potential benefits of Business Records Checks both for themselves and their "customers":

HMRC benefits

Improved record keeping leading to a reduction of tax lost.

A greater degree of assurance as to the likely accuracy of returns in cases where there has been a Business Records Check.

Customer benefits

Opportunity during a Business Records Check for business customers to ask questions and seek clarity if needed about their record keeping obligations and compliance with those obligations.

A reduced likelihood of a subsequent compliance intervention (such as a full enquiry into their returns) for those who are seen to be fulfilling their record keeping obligations.

Improved financial management (for example, keeping better track of debts and debtors); leading to

Improved chances of business success. A business that has an adequate and running record of its trading position and profitability has more information available to be able to make the necessary business decisions and adjustments to ensure survival and success.

The consultation document also includes a summary of the existing law in respect of a business' obligations to keep adequate records, and the sanctions available to HMRC to punish those who do not.

http://tinyurl.com/hsa4x

6.6.2 Article

In the Halloween edition of *Taxation*, Neil Warren describes a number of horror-stories which might give any practitioner nightmares. These include the capital goods scheme, registration problems, the flat rate scheme and the place of supply rules for land-related transactions.

Taxation, 28 October 2010

6.6.3 Manual update

HMRC have updated their online guidance on assessment procedures and how they interact with inaccuracy penalties.

www.hmrc.gov.uk/manuals/vaecmanual/updates/updateindex.htm

6.7 Assessments

6.7.1 Time limits

A trader failed to register for VAT. HMRC assessed periods covering a total of 9 years, and the trader appealed on the grounds that some of the assessments were invalid because they were out of time. The Tribunal confirmed that HMRC had 20 years to raise an assessment in the circumstances of the case. VATA 1994 s.77(4) extends the normal 4 year (then 3 year) deadline to 20 years where a penalty under s.67 (belated notification) could be issued. Here, HMRC had decided not to levy such a penalty, but it would certainly have been possible so the extended deadline applied.

The trader also argued that HMRC had had all the information required to raise the assessment for more than a year, because he had submitted SA income tax returns showing turnover above the registration thresholds throughout the period since 1999. The Tribunal agreed with HMRC's argument that this on its own was not "sufficient knowledge". The significant events were notes between investigating officers in the Hidden Economy Team confirming that the trader had not registered for VAT and had reported turnover above the limit. These dated from 2008, not 1999.

A further hearing will consider the amount of the assessments now that their validity in principle has been established.

First Tier Tribunal (TC00733): *MR Rastegar (t/a Mo's Restaurant)*

6.7.2 Best judgement

A food distribution business underwent an inspection after input tax claims had increased. The company was asked to produce various documentary evidence relating to sales, day books, and sales to EU countries, and was unable to comply. An officer carried out a credibility exercise and found that input tax claimed appeared to exceed output tax charged on standard rated food and drink items. The director's explanations did not appear credible and an estimated assessment was raised for some £18,500.

The dispute centred on the allowance for wastage, which the officer set at 2% in an old warehouse and 1% in a new warehouse. The appellant argued that these figures were too low and unrealistic, but the Tribunal did not think that sufficient evidence had been produced to undermine them. The assessment appeared to have been made to best judgement and was reasonable.

First Tier Tribunal (TC00705): *M S Foods Ltd*

In TC00051, the First Tier Tribunal had to consider the case of a company operating two wine bars and several delicatessens. It was assessed following a dispute on the split between zero and standard rated sales. The First-Tier Tribunal examined the evidence in detail and concluded that HMRC had agreed that 3 of the delis could use a fixed 30/70 split between standard and zero-rated supplies, and this overrode any factual findings by HMRC. The appeal was allowed to that extent. However, in respect of the other outlets, there was no such agreement and HMRC's assessments had been made to best judgement.

The trader appealed to the Upper Tribunal, arguing that the FTT had applied the wrong test. It had restricted itself to considering only whether the assessments had been made to best judgement, when it should also have considered whether the amounts themselves were appropriate. It had effectively restricted its jurisdiction to a supervisory one instead of the full appellate role it held in respect of an assessment.

The Upper Tribunal decided that the FTT did appear to have restricted its decision incorrectly. It was possible that its conclusions were in fact based on the correct test, but if so they had not been adequately described. The case should be referred back to the same panel of the FTT in order to consider further submissions to the extent it felt necessary to reach a conclusion about the quantum of the assessments, rather than just asking itself whether the amounts of the assessments were reasonable.

The First-Tier Tribunal has reconsidered the case, including further submissions by the appellant emphasising its arguments put forward at the first hearing. It has come to the same decision, but has spelled its findings out in terms that should satisfy the Upper Tribunal that it has applied the right test: it is satisfied that the amounts of the assessments are correct, as well as the procedure which was undertaken to raise them.

First Tier Tribunal (TC00864): *Mithras (Wine Bars) Ltd*

A publican registered late for VAT, and his first return for a long registration period showed a repayment due of £11,800. HMRC investigated and found that he had rudimentary cash control, but had claimed input tax on all items of expenditure, whether VATable or not. n

They raised an assessment for £9,160. This was later reduced to £3,438 after further and better explanations from the trader. He continued to appeal, arguing as follows:

Basically I filled in a VAT Returns form and I worked out by adding up my takings working out how much VAT I owed. Then working out my expenses then working out how much VAT was owed to me. The office assigned to my case looked at my papers and said that I owed VAT because basically Pubs do not get a refund on VAT. I am sorry but I am using basic mathematics adding up and taking away and after working out several times it still totals that VAT owe me.

The appellant had been to several previous case management hearings, but at this late stage asked for an adjournment so he could obtain legal representation. HMRC objected, arguing that he had had plenty of opportunity to appreciate what would be involved and had continued to represent himself. The Tribunal agreed, and proceeded to dismiss the appeal on the grounds that the assessment was raised to best judgement.

Costs of an earlier hearing were awarded against the appellant. The Tribunal was satisfied that, on the balance of probabilities, notice of the hearing had been delivered to the appellant, and that therefore his failure to attend the hearing justified an award of costs to HMRC.

First Tier Tribunal (TC00855): *David Dean t/a The George & Dragon*

A long and detailed Tribunal decision concluded a long-running argument between a takeaway owner and HMRC. The trader argued that successive reductions in the amount assessed during the course of the argument showed that HMRC's approach was fundamentally flawed, and no assessment should be raised at all: the remaining amount claimed by HMRC was "within the margin for error" of a business such as his. The Tribunal did not agree. The record keeping was poor and the discrepancies were too large to be explained away. There was strong evidence that sales had been suppressed, and the assessments had been raised to best judgement. The reductions in the amounts assessed were a perfectly proper part of the assessment process, as the officers communicated their conclusions to the trader and took into account further and better particulars.

Nevertheless, some further reductions in the assessments and associated misdeclaration penalties were allowed by the Tribunal. The appellant had reserved its position on an award of costs, but the Tribunal commented that it would be unlikely to award any if asked.

First Tier Tribunal (TC00842): *Arash Pouladdej*

A firm of chartered accountants was assessed in respect of discrepancies between the sales invoices included on VAT returns and the amounts shown as receipts in its bank records. The assessments were reduced by some "innocent explanations", but about £15,000 remained. The grounds of appeal were not clear, and the appellants did not appear at the hearing: it seemed that they thought "it has all been settled and agreed" was enough. It was not – the assessments were confirmed by HMRC.

First Tier Tribunal (TC00840): *Rehncy Shaheen & Co*

6.8 Penalties and appeals

6.8.1 New penalties tested...

One of the first cases on the FA 2007 regime for penalties has come before the Tribunal. A trader submitted a VAT repayment claim for over £21,000. When HMRC queried it, the trader's accountant confirmed that the true repayment should have been just over £1,000. A penalty at 15% was imposed under the post-1 April 2009 rules.

The trader's plea of "reasonable excuse" was based on the attribution of the error to the work of a temporary employee. The Tribunal rejected this, holding that the trader had shown a "lack of reasonable care". The penalty was confirmed.

First Tier Tribunal (TC00728): *NA Al-Faham (t/a Express Food Supplies)*

A company deregistered for VAT in April 2009. In July 2005, it had opted to tax a building it owned, and had recovered input tax of £42,875. It failed to declare output tax on the deemed supply of the building under Sch.4 para.8 VATA 1994: this should have been accounted for on the final return to 2 May 2009. It seems that someone must have realised that this was a mistake, because the company tried to re-register in October 2009, and rang the Advice Line to discuss the possibility of reinstating the original registration. It was told that this would not be possible.

HMRC assessed the deregistration charge at £30,000 in January 2010, and imposed a 15% penalty for a careless error that had not been disclosed. The maximum penalty would be 30% of the potentially lost revenue, and HMRC contended that the maximum mitigation had been allowed.

The trader argued that it had disclosed the problem to HMRC when it tried to reinstate the registration in October 2009. The Tribunal examined the correspondence and representations from the taxpayer and disagreed: at no point had the error been explained by the trader. HMRC had identified it from information supplied, but it had not been voluntarily disclosed. The penalty was confirmed at 15%.

First Tier Tribunal (TC00828): *Mollan & Co Ltd*

A members' club in Southend claimed input tax of £28,287 in respect of a water bill which was in fact zero-rated. The club had taken 3/23 of the gross amount paid. HMRC levied a penalty at 15%.

The club had received a statement from the supplier but not an invoice. The accountant had tried to clarify whether the supply was VATable and had received conflicting advice; it had also paid VAT on other water supplies in relation to other premises. The invoice for this supply was only produced when HMRC investigated the input tax on the return, and it was discovered that it did not show any VAT.

HMRC said at the hearing that they had offered to suspend the penalty, but the club declined to accept the conditions which would have been imposed. The chairman noted that contradictory advice had been given on this as well, but that the reviewing officer had clearly stated that the penalty would not be suspended "because it is unlikely that it will happen again". That seemed to go against the policy underlying suspension of penalties.

The Tribunal was satisfied that the trader had exercised reasonable care and the penalty was therefore cancelled altogether.

First Tier Tribunal (TC00833): *The Athenaeum Club*

6.8.2 ...and clarified

HMRC have updated their "FAQs" on the inaccuracy, failure to notify and wrongdoing penalties. The FAQs were first issued in March 2009 before the beginning of the changeover to the new penalty regime in April 2009. The update follows the implementation of the whole of the new penalty regime from April 2010. There are 53 Q&A in all.

http://www.hmrc.gov.uk/about/new-penalties/faqs.htm

6.8.3 Old penalties updated

HMRC have issued an updated version of Notice 700/42 *Misdeclaration penalty and repeated misdeclaration*. It explains how HMRC calculate and notify the penalties under s.63 and s.64 VATA 1994. Even though these penalties no longer apply to current periods, they can still be levied while periods before 1 April 2009 are "in time" for enquiry and assessment. The new penalties apply to periods which commenced from 1 April 2008 onwards, where the filing date fell after 1 April 2009. In practice, this is likely to mean that quarters to 28 February 2009 are the last to which the old penalties apply.

Notice 700/42

6.8.4 Categorisation

The Tribunals Rules require cases to be allocated into one of four categories: default paper, basic, standard and complex. A major difference between complex and other cases is that different costs rules apply (see reg.23 The Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009).

An appellant applied to have the case categorised as complex. It concerned the recovery of input tax on the purchase of a helicopter for leasing out. The "business" had input tax of £550,000 and annual turnover of £120,000 a year. The First Tier Tribunal did not agree that there was anything particularly complex about the law or the evidence, and the possibility of a three-day hearing did not raise it from the standard run of First Tier Tribunal cases. The application was refused.

The Upper Tribunal reversed this decision, holding that the judge at first instance has applied the wrong test. A case which was capable of being categorised as complex should normally be so categorised; the criteria in rule 23(4) should be interpreted according to their normal meanings without stretching or restricting those meanings. There was no requirement for the case to be exceptional or particularly difficult to resolve.

The possibility of a transfer to the Upper Tribunal, and the availability of a costs order in relation to a complex appeal, were not determinative of the issue. However, these factors could be taken into account in a rounded decision on what should be categorised as complex.

Upper Tribunal: *Capital Air Services Ltd v HMRC*

6.8.5 Not out of time

A council accounted for output tax on its car parking receipts and subsequently claimed a repayment. It failed to appeal within the statutory time limits, but later applied to the Tribunal for leave to appeal out of time. The Tribunal allowed this application, noting that there was little prejudice to HMRC because the arguments were already fully rehearsed in the *Isle of Wight Council* case, and the council's appeal had a strong chance of success. Even though the failure to appeal in time was "seriously culpable", it seems that the council would be allowed to jump on the other councils' bandwagon.

The Tribunal considered the history of the council's dispute in detail. The council appeared to be operating entirely without professional advice, using instead a general guide to the issue published by PwC. The council claimed that they had understood the correct procedure to be the regular submission of voluntary disclosures and waiting for the resolution of the *Isle of Wight Council* case. Their officers had failed to appreciate the nature of decision letters and the need to do something about them within 30 days. The Tribunal appeared to accept some of these points as mitigating the culpability of the delay, but overall the decision was taken on the need to balance fairness to both parties rather than on any individual factor.

First Tier Tribunal (TC00714): *North Wiltshire District Council*

6.8.6 Out of time

A trader appealed in 2009 against an assessment for just under £5,000 that was raised on him in 1980 in respect of a period in 1978. He applied to the Tribunal for leave to appeal out of time, and HMRC objected. This application was rejected in TC00442, but he returned for a further attempt.

A different Tribunal judge considered the arguments again and came to the same conclusion. The trader had not given convincing reasons for his failure to appeal at the time; given the long delay, it would be almost impossible for him to provide enough evidence to succeed in a substantive hearing. The application was dismissed.

First Tier Tribunal (TC00748): *D A Gardner t/a Gardners Transport Co*

6.8.7 Struck out

A trader reclaimed input tax on petrol purchases by individuals. Because it had never accounted for any output tax, HMRC took the view that there was no trade and the input tax was disallowed. The company appealed, arguing that the individuals were its agents, engaged to look for business. When it was pointed out at a pre-trial review that this would surely mean that the input tax did not in any case belong to the company, the explanation was changed to an argument based on the individuals being employees. The Tribunal chairman issued an "unless" order requiring production of evidence to support this new contention.

The company failed to comply with this direction by the stated date. HMRC applied to have the appeal struck out. Documents were then produced which HMRC claimed were obviously false. On hearing the application to reinstate the appeal, the chairman commented that the

documents, if false, would constitute forgeries: presenting a forgery would be a serious matter, and he was not prepared to give a view on the status of the documents without taking witness evidence. However, it was clear that the company had not been straightforward in its dealings either with HMRC or with the Tribunal, and it had failed to comply with an "unless" order. The appeal was properly struck out.

First Tier Tribunal (TC00768): *Janice Traders Ltd*

6.8.8 New evidence

On the 9th day of an expected 12 day hearing in a MTIC fraud case, HMRC asked the First Tier Tribunal for permission to introduce new evidence. This was granted by the Tribunal, which allowed the appellant a day's grace to examine and respond to the new material. The trader appealed against the decision to allow the new evidence to be considered.

The Upper Tribunal considered the background to this appeal and the principles underlying the admission of evidence at a late stage. The judge concluded that the First Tier Tribunal had adopted the correct approach and had not reached an unreasonable decision, so the appeal was dismissed.

Upper Tribunal: *Connect Global Ltd v HMRC*

6.8.9 Surcharge appeals

A trader appealed against a 15% surcharge on the basis that it had agreed a "time to pay" arrangement with which it had complied. However, the Tribunal found that the agreement had been entered into only after the due date for payment, which meant that surcharges would not be suspended. Nevertheless, the Tribunal accepted that non-receipt of a particularly large debt which was being chased at the due date constituted a reasonable excuse within *Steptoe*. The appeal against the surcharge was allowed.

First Tier Tribunal (TC00703): *TGS Construction Services*

A company's main business was the transport of livestock. It was badly affected by a foot and mouth disease outbreak in its region in August 2007. It was paid compensation by DEFRA, but the payments were delayed and as a result it was late settling its VAT liability for the 03/08 quarter. The Tribunal held that the late payment by DEFRA was a reasonable excuse.

The company was next late in 09/08, by which time DEFRA had paid a substantial amount of money. The Tribunal dismissed the appeal in respect of this quarter, but reduced the percentage from 5% to 2%.

There were also defaults in 03/09, 06/09 and 09/09. Here, the Tribunal accepted that the directors held a reasonable belief that they had a time-to-pay agreement in force and that default surcharges would not be levied as long as they kept up with the instalments. This view had been strengthened by the withdrawal of a surcharge for the 12/08 period. The Tribunal decided that the company had a reasonable excuse for these periods as well.

First Tier Tribunal (TC00703): *Gilders Transport Ltd*

A company appealed against a string of default surcharges, arguing that they were draconian in the harshest economic circumstances since 1929. The Tribunal dismissed the appeal, holding that "disproportionality" and "lack of funds" were not adequate defences.

First Tier Tribunal (TC00759): *Scotpackaging Ltd*

A company was £18,000 in credit with HMRC when its VAT fell due for the period to 30 November 2008. It was due to receive a large amount (£368,000) from a customer; it had included this amount on the VAT return, which it subsequently realised was a mistake as it should have been subject to the reverse charge procedure (i.e. it was outside the scope). Until the amount was received just before midnight on 7 January 2009, it did not attempt to pay any of the VAT shown on the return. HMRC subsequently received the payment on 9 January and levied a 10% surcharge on £428,000.

The surcharge was successively reduced by the amount in credit and the correction of the error. What remained was some £59,950 that had been due on 7 January and was not received until 9 January. The trader argued that he had been told by HMRC that the surcharge would be levied in full even if he had paid some of the outstanding amount, and that was why he did not make a part payment in time to meet the 7 January deadline. The Tribunal did not believe that this statement, if made at all, had been made before 7 January. The trader did not have a reasonable excuse, and was liable for a surcharge on the late payment of £59,950.

First Tier Tribunal (TC00840): *Finch & Partners Ltd*

A London club was in default for the period ended 31 December 2008, and was issued with a surcharge liability notice on 13 February 2009. The accounts manager phoned HMRC on 30 April to say that the payment for the quarter to 31 March would be a few days late, and was told (according to his evidence) that there would be no problem with this. HMRC did not have a record of this call, although they did have records of an enquiry on 25 February asking why a surcharge liability notice had been issued, and another on 21 May to indicate that an appeal would be made against the surcharge.

A cheque of the size of the VAT liability (over £100,000) required 3 signatures, and one of them had been suffering ill-health. This led to the delay both in January and in April. The Tribunal accepted that the ill-health was a fact, even though no medical evidence was put before it, but nevertheless did not accept that there was a reasonable excuse. The surcharge liability notice should have warned the club's staff that it was essential to take the appropriate steps to ensure that the next return and payment went in on time. The appeal was dismissed.

First Tier Tribunal (TC00866): *East India Devonshire Sports and Public Schools Club Ltd*

A trader appealed against a default surcharge, pleading "the complete ineptitude and unprofessionalism of my previous accountant", who had been provided with information in good time but had not filed returns as expected. This could not constitute a reasonable excuse, and the appeal was dismissed.

First Tier Tribunal (TC00876): *Tekniko Ltd*

6.8.10 Costs

A company was involved in a dispute over input tax on mobile phones. Following the ECJ decision in *Optigen Ltd*, HMRC settled the claim, and the company applied for costs. HMRC resisted the application on the basis that the solicitor was working on a contingency fee basis. HMRC argued that this constituted “champerty” – the encouragement of litigation by an outsider who acquires a financial interest in the outcome. This is illegal in the UK.

The High Court refused HMRC’s application, holding that the VAT Tribunal was not a “court” for the purposes of the Solicitors Act 1974 (which made provisions against contingency fees). The arrangement was lawful. The judge declined to follow principles laid down by precedent cases that HMRC cited in which the courts had disapproved of contingency fees (*Wallersteiner v Moir* and *Trendtex Trading Corporation v Credit Suisse*).

High Court: *Tel-Ka Talk Ltd v HMRC*

An appeal in respect of an alleged MTIC fraud commenced before April 2009 and would continue afterwards. HMRC had indicated in their original statement of case (in 2008) that they would seek costs if they won. As the appeal was “current proceedings” on the change of rules at 1 April 2009, it was up to the Tribunal to decide whether to exercise a discretion to apply the new or the old costs basis to the appeal. HMRC wanted to do so, on the basis that it was always their understanding that costs would be available to them; the appellant resisted the application, on the basis that the default position since April 2009 is that costs should not be awarded.

The Tribunal considered the arguments and the underlying law in detail, and decided that it was entirely up to the discretion of the Tribunal to choose which set of rules to apply. The facts that the appeal concerned an alleged MTIC fraud, or might have been categorised as “complex” if it had commenced under the new rules, were not conclusive. In the circumstances of the case, the judge considered that the 2009 rules, rather than the 1986 rules, would better serve the interests of fairness and justice.

First Tier Tribunal (TC00875): *Hawkeye Communications Ltd*

6.8.11 Director’s liability

A company was liquidated owing £220,000 in VAT after failing to make returns. A penalty of nearly £93,000 was charged on the director under s.61 VATA 1994. He did not appear before the Tribunal and it was said he had already been made bankrupt. The Tribunal was satisfied that his conduct – allowing the company to pay very small centrally issued assessments while fully aware that the true level of business was much higher – was dishonest. The penalty was therefore properly raised, and the appeal was dismissed.

First Tier Tribunal (TC00858): *Rod Littley*

6.8.12 Procedure

Minor changes have been made to the First-Tier Tribunal and Upper Tribunal Rules to reflect the addition of MP expenses cases to the Tax Chamber, amend the definition of HMRC to reflect the functions of the recently established Director of Border Revenue, and provide that a preliminary issue may be transferred to the Upper Tribunal.

SI 2010/2653

A new Order has been made to replace the 2008 First-tier Tribunal and Upper Tribunal (Chambers) Order. As before, this Order organises the First Tier and Upper Tribunals into chambers and provides for the allocation of those Tribunals' functions between the chambers. It provides a power for the Senior President of Tribunals to allocate a case to the most appropriate chamber in the event of doubt or dispute, and for a Chamber President to re-allocate a case to another chamber.

SI 2010/2653

6.9 Other administration issues

6.9.1 Spending review

In the spending review, HMRC are set to make savings to reduce resource spending by 15% in real terms and capital spending by 44% in real terms. £900m of savings are supposed to be "recycled back" into additional work against tax avoidance, evasion and criminal attack. The Department's administration budget will be reduced by 33%.

The Treasury explains the way in which these targets will affect HMRC's work as follows:

The department will manage these reductions by reducing the costs of administering tax, targeting customer services more effectively and collecting the right amount of revenue, including:

- *Restructuring HMRC's Enquiry Centre network so that face to face service is provided to those that need it most*
- *Improving on-line support to reduce the need for manual processing.*
- *Applying benchmarks to reduce administration costs by 33% by 2014-15.*

In addition, the department will be adopting the following ideas, suggested through the Spending Challenge process:

- *Replacing National Insurance Number (NINO) cards with letters, saving up to £1million a year.*
- *Exploring increased use of Magistrates Courts for recovering uncollected debts, freeing up resources.*

By taking these very tough decisions the department is able to focus on reducing the tax gap while modernising and improving services for customers, including:

- *Investing £900million over the Spending Review period to transform HMRC's work against avoidance, evasion and criminal attack to bring in extra tax revenue of £7billion a year by 2014/15. This includes a more robust criminal deterrent against tax evasion - HMRC will increase the number of criminal prosecutions fivefold - and a crackdown on offshore evasion with the creation of a new dedicated team of investigators to catch those hiding money offshore.*
- *Initiating a joint HMRC and DWP strategy for fraud and error, setting out that over the Spending Review period HMRC will reduce fraud and error within the tax credit system by £2billion a year by 2014/15.*
- *Improving capacity and skills in key areas to offer improved services to customers and redesigning education products and processes that cause the most error and rework such as VAT registrations.*
- *Clearing the backlog of PAYE cases by 2012 and stabilising the PAYE service in order to recover and improve customer service;*
- *Undertaking the next stage of consultation on improving PAYE through the use of real time information which will bring improvements to employers and taxpayers.*

HM Treasury Release 21 October 2010

HMRC have published their latest business plan for delivering the coalition government's objectives for the tax system over the next 5 years. These include improved collection of debts (£7bn a year by 2014/15) and the reduction of losses through fraud and error (to 5% by 2011). HMRC and Companies House systems should be aligned by 2012; PAYE should operate in "real time" by 2014; and all tax reliefs should be reviewed by 2011.

One interesting objective is the intention to publish in April 2011 the unit cost of collecting income tax, corporation tax, NICs and VAT, and the unit cost of administering payments of child benefit and tax credits.

www.number10.gov.uk/wp-content/uploads/HMRC-FINAL-Business-Plan.pdf

6.9.2 Tax avoidance

In December HMRC issued new guidance about the operation of the Disclosure of Tax Avoidance Schemes rules, which are subject to a number of changes coming into force on 1 January 2011. However, this guidance does not deal with the VAT rules, which are still found in Notice 700/8.

HMRC Press Release 1 December 2010

Meanwhile, the government has asked Graham Aaronson QC to carry out a study into the feasibility of a General Anti-Avoidance Rule (GAAR) in the UK. The study is to be completed by 31 October 2011. We are promised that a GAAR will not be implemented without a further public consultation following the completion of this preliminary study.

HMRC Press Release 1 December 2010

In Avoidance Spotlights, HMRC say that "*Taxpayers have been conceding and paying the disputed tax in ... VAT avoidance on promotional vouchers issued with sales of services or goods*". No further detail is given.

http://www.hmrc.gov.uk/avoidance/spotlights.htm

6.9.3 Tax simplification

The new government established the Office of Tax Simplification to look at ways of improving the tax system. Its first review is an examination of the huge number of tax reliefs that exist – the intention is to assess which fail to achieve their objectives, encourage the wrong behaviour, are too complex, or apply so rarely that they are not worth keeping. Several hundred direct tax reliefs have been selected for consideration in advance of the March 2011 Budget. However, VAT reliefs have not been included in the preliminary review.

http://www.hm-treasury.gov.uk/ots_taxreliefsreview.htm

6.9.4 Engaging with agents

In a report to Parliament, the National Audit Office comments that HMRC might be able to increase tax revenues by offering more support to tax agents and targeting poorer ones. The report is mainly concerned with direct taxes, but it also notes that 43% of VAT returns are submitted via agents.

NAO Report: HMRC – engaging with tax agents

6.9.5 HMRC website

In an article in *Taxation*, Neil Warren comments on the significance of the "button" marked "view change history" on HMRC's website. In some cases, the current state of the law is not reflected in the text unless this button is clicked. HMRC's policy of not giving rulings where the subject is covered in published guidance, combined with the possibility that the most accessible guidance may be misleading, is called into question.

Taxation, 14 October 2010

6.9.6 Withdrawal of ESCs

HMRC have issued a technical note identifying further concessions which are to be withdrawn as part of the review following the House of Lords' decision in the *Wilkinson* case. The VAT concessions to go are:

- ESC 3.4 – Misunderstanding by a VAT trader (also applies to IPT)
- ESC 3.16 – Connection to the gas or electricity mains supply
- ESC 8.1 – Sailaway boats (see section 4.3.7 above)
- Recharge of non-domestic (business) rates at caravan sites
- Zero-rating of motor vehicles adapted after initial supply
- Zero-rating of parts and accessories for boats supplied for disabled people

http://www.hmrc.gov.uk/menus/extra-stat-con-tn.pdf

At the same time, HMRC have published for comment draft legislation which will enact some concessions, including one that allows seasonal pitches to be treated as exempt in certain circumstances. The concessionary treatment is set out in paragraph 4.1 of Notice 701/20 *Caravans and houseboats*. The draft legislation will amend the notes to Sch.9 Group 1 VATA 1994 to redefine "seasonal pitch".

http://tinyurl.com/38pvkae

6.9.7 Manual update

HMRC have updated their online compliance manual in relation to inaccuracy penalties. There are also new sections on VAT underassessments, the interaction of inaccuracy penalties with default surcharge, and revised guidance on suspending penalties.

http://www.hmrc.gov.uk/manuals/ch2manual//ch410000.htm

6.9.8 Tax policy review

The Institute for Fiscal Studies has published a review of tax policy prepared by Sir James Mirrlees. His conclusions on VAT are that zero-rating is an expensive and inefficient tool of social policy, and it would be better to extend VAT to nearly all spending. In that conclusion he is probably close to the European Commission, but it seems unlikely that such a change would be politically acceptable in the UK.

http://www.ifs.org.uk/mirrleesReview

6.9.9 Investigations

HMRC have issued an updated version of Notice 160 *Compliance checks into indirect tax matters*. It explains what happens if HMRC are investigating dishonest conduct, including suspected missing trader fraud.

Notice 160

HMRC have also issued COP8 *Specialist Investigations (Fraud and Avoidance)*. This Code of Practice explains how the Fraud and Avoidance section of the Specialist Investigations directorate of HM Revenue & Customs (HMRC) carry out investigations. It applies to all

investigations where the Civil Investigation of Fraud procedures (Code of Practice 9) are not used.

http://www.hmrc.gov.uk/pdfs/cop8.pdf

6.9.10 Prosecutions

HMRC announced on 2 December 2010 that 5 members of a mobile phone fraud gang had been sentenced to a total of 15 years in jail. The VAT stolen amounted to £17m. Over £8m in assets had been subjected to restraining orders and HMRC have undertaken confiscation proceedings. A sixth man was later sentenced to a 3-year community order and disqualified from being a company director for 4 years.

http://nds.coi.gov.uk/Content/detail.aspx?NewsAreaId=2&ReleaseID=416867&SubjectId=15&DepartmentMode=true

The following day HMRC announced that four members of a gang who used a network of connected companies to steal VAT on imported cars had been jailed. The ringleader received a sentence of 10 years. The total VAT involved was £12m. The succession of transactions followed by the disappearance of the person who owed VAT appears to be yet another variation on missing trader fraud.

http://nds.coi.gov.uk/Content/detail.aspx?NewsAreaId=2&ReleaseID=416907&SubjectId=15&DepartmentMode=true

On 9 December, HMRC announced a series of 6 arrests in relation to another £1m fraud involving fake trading in textiles and associated machinery.

http://nds.coi.gov.uk/Content/detail.aspx?NewsAreaId=2&ReleaseID=416990&SubjectId=15&DepartmentMode=true

6.9.11 Freezing order

HMRC have been investigating an alleged VAT fraud amounting to some £95m since 2001. One of the accused died in 2006. In April 2002, HMRC had obtained a worldwide freezing order against the assets of a Gibraltar trust which they alleged had received the proceeds of the fraud. Now the deceased's sister wished to carry on the defence of the legal action – presumably in the hope of demonstrating that the money was clean and could therefore be left to her brother's family – but did not have enough resources to pursue the legal action without recourse to the frozen funds. She applied for a variation of the freezing order to allow her to use the money to cover reasonable legal costs. HMRC sought to put a cap of £2.5m on such payments, but the High Court did not agree that this was appropriate. She was granted the order she sought.

High Court: HMRC v Begum

6.9.12 Information powers

The Autumn Statement included an announcement that legislation will be introduced in Finance Bill 2011 to modernise HMRC's information powers by updating the legislation for:

- bulk information powers that are used by HMRC to gather specific pieces of information about a group of taxpayers, for use in risk analysis; and
- specialist "unnamed taxpayer" powers that are narrowly defined in law to be used in very specific circumstances during a compliance check, for example where it is not clear who the taxpayer is.

The legislation will also:

- allow HMRC to apply to the tribunal for increased daily penalties where data is not supplied;
- cover data about certain foreign taxes;
- update Schedule 36 to Finance Act (FA) 2008 to mirror these two provisions; and
- amend Schedule 36 to FA 2008 to provide a penalty if a person is aware of an inaccuracy when providing information or documents and to correct a minor error in the legislation..

http://www.hmrc.gov.uk/budget-updates/autumn-tax/tiin910.pdf

http://www.hmrc.gov.uk/budget-updates/autumn-tax/data-gathering-0910.pdf

6.9.13 Security

The last update noted the peculiar issue of the April 2009 – a year and a half after its cover date – version of Notice 700/52 on the requirement to deposit security. Now HMRC have issued a December 2010 version. Under "What's changed" it states:

This notice has been rewritten to take account of changes to our strategy in tackling VAT fraud.

Section(s):

- *2 - 3 of the notice explain in detail, for each type of security listed above, the circumstances in which we may issue a Notice of Requirement to give security*
- *2.4 and 3.5 explain the accepted forms of security*
- *4 explains what you can do if you do not accept the decision to require security*

However, it is still entitled "*Notice of requirement to give security to Customs and Excise*".

Notice 700/52

HMRC prosecuted a trader for continuing to trade after a notice to deposit security had been issued (and not complied with). A fine of £16,500 was imposed, representing 11 separate charges of £750 under s.72(11) VATA 1994, and 11 more of the same amount under s.171(4) CEMA 1979.

http://nds.coi.gov.uk/Content/detail.aspx?NewsAreaId=2&ReleaseID=416966&SubjectId=15&DepartmentMode=true