VAT UPDATE
JANUARY 2012

Covering material from October – December 2011

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VAT Update January 2012

Contents

1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The HMRC website section which reports the progress of appeals reappeared on 21 January 2011 after lying dormant for some time. It says that it will be updated monthly, but the first update to appear arrived on 23 May. The next update was dated 14 July, and the latest (in early January 2012) is 14 October.

Several of the "appeal will be dropped" items are still on the website list, but where they have already been reported in the update they are not reproduced below.

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

Awaiting the CJEU:

- *Littlewoods/Grattan*: the entitlement of traders to interest on VAT overpayments (questions described in the last update and in this).

UK appeals awaiting hearing:

- *Bridport & West Dorset Golf Club Ltd*: HMRC are seeking leave to appeal to the Upper Tribunal against the FTT decision that the UK's exemption for sporting services was not in compliance with the Directive
- *David Finnamore t/a Hanbridge Storage Services*: HMRC have applied for leave to appeal to Upper Tribunal after First-Tier decided that a trader was supplying a licence to occupy land rather than storage services
- *DCM (Optical Holdings) Ltd*: HMRC have appealed to the Upper Tribunal after the FTT accepted that a floor-area based special

method could be appropriate (Upper Tribunal hearing 20 – 23 September 2011)

- *GMAC UK plc*: HMRC appealed to the Upper Tribunal after the First Tier Tribunal held that the company was entitled to go back for many years in a bad debt relief claim because the UK rules were too restrictive – the last update included a preliminary UT decision, which was not to refer questions to the CJEU but to proceed with a substantive hearing (full hearing later 14 – 15 February 2012)
- *Greener Solutions Ltd*: HMRC have appealed to Upper Tribunal after First-Tier decided that a trader did not have the means of knowing about a carousel fraud (Upper Tribunal hearing 26 – 27 September 2011)
- *Honourable Society of Middle Temple*: HMRC are seeking leave to appeal to the Upper Tribunal against the FTT decision that the Society was making separate zero-rated supplies of water as well as taxable land
- *John Wilkins Ltd and others*: Supreme Court refused HMRC permission to appeal one aspect of the case, in which the Court of Appeal decided that motor dealers were entitled in principle to claim compound interest on VAT repayments. Substantive issue stayed until 2012 pending the *Littlewoods* decision in the CJEU.
- *Newey (t/a Ocean Finance)*: HMRC have appealed to the Upper Tribunal after the First Tier Tribunal held that a scheme was effective in reducing irrecoverable VAT on advertising costs by moving a loan broking business to the Channel Islands (Upper Tribunal hearing December 2011)
- *SecretHotels2 Ltd*: HMRC are seeking leave to appeal against the Upper Tribunal decision that a website operator was acting as an agent, not as a principal, in selling hotel accommodation to tourists

In this update from previous lists:

- *London Clubs Management Ltd*: HMRC unsuccessfully appealed to the Court of Appeal after the FTT and Upper Tribunal accepted that a floor-area based special method could be appropriate
- *Rank Group plc*: CJEU decision about applying the principles of fiscal neutrality to gambling transactions.

Gone from the list without explanation:

- *Isle of Wight Council and others*: remitted to Tribunal to consider evidence again in light of CJEU's ruling on how "risk of distortion of competition" is to be applied
- *Pendragon plc*: HMRC stated an intention to appeal to the Upper Tribunal after the First Tier Tribunal found a scheme "not abusive"

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Compensation or membership fees?

A company operated a chain of 63 commercial fitness clubs. Some new members were required to sign up for twelve months, agreeing to make monthly payments with a three month notice period for termination. If they missed a payment, they were barred from using the facilities after five days, and the company engaged debt collectors to enforce the debt. When the money was collected, the company accounted for output tax on the basis that it remained a taxable membership subscription. It then claimed the VAT back (some £1.3m) on the basis that the fees were not consideration for a taxable supply but rather compensation for breach of contract. 99% of those who missed a payment chose never to re-start their membership, so they never received any further services in exchange for any payment obtained by the debt collectors.

HMRC argued that “the supply” was simply “membership”, and the payment was for that, whether enforced by debt collectors or paid voluntarily. The club did not terminate membership on non-payment – it only denied use of the facilities. The facilities were still effectively available to the non-paying member if the contract was complied with, so the money once collected was simply that contractual payment. The solicitors enforcing debts in the county court referred to “the balance of consideration outstanding ... in respect of services rendered”.

The Tribunal was more persuaded that the real supply was “the use of the facilities of the gym”, and without access to the gym there was no supply. It accepted that the solicitors’ claim forms were not correctly completed and had not been agreed by anyone at the company. The contracts with members (in three different versions) were examined in detail, and the Tribunal concluded that the company’s analysis was correct – a small proportion of the recovery was VATable (representing the five days before the member was barred), but the remainder was compensation for breach and was outside the scope.

In reaching this conclusion, the Tribunal considered that the CJEU decision in *RCI Europe* (Case C-37/07) and *MacDonald Resorts* (Case C-270/09). The court held in both cases that membership of a timeshare club was not an end in itself, but was rather a supply of services associated with land. For the same reasons, membership of a sports club was not “the supply” – it was the use of the facilities provided. By contrast, in *Kennemer Golf* (Case C-174/00), the supply was making the facilities available, regardless of whether the member used them.

The Tribunal commented that it was not necessary for a contract to be terminated for a payment to be taken outside the scope of VAT. The barring of access was enough to break the link between payment and the supply of any service. An innocent party such as the company was entitled not to terminate the contract which the customer had broken, but could still enforce payment in the nature of compensation for breach.

First Tier Tribunal (TC01475): *Esporta Ltd*

2.1.2 Transfer of bad debts

The CJEU has given judgment on the case about the transfer of 'non-performing loans'. One bank transferred 70 loans which had a face value of about €15.5m and was paid €8m by the transferee bank.

The tax authorities believed that the purchaser of the portfolio was providing a taxable service (debt collection) to the seller, following the decision in *MKG* (Case C-305/01).

The Court has agreed with the Advocate-General's opinion that this does not constitute a supply of services for consideration, because there is no direct consideration linked to anything done in return by the person alleged to be supplying the service (the transferee bank).

In *MKG*, the factor guaranteed that the transferor would receive payment for its debts by accepting the risk of default in return for a fee. The outcome of the transactions might have been similar, but the legal structure was quite different – there were factoring commissions and del credere fees explicitly linked to the service that the factor was providing to its customer. In this case, there was a simple assignment, with a payment by the assignee to the assignor.

Accordingly, the purchase of defaulted debts at below their face value did not constitute an economic activity and was outside the scope of VAT.

CJEU (Case C-93/10): *Finanzamt Essen-NordOst v GFKL Financial Services AG*

2.1.3 Treatment of public bodies

Art.13(1) of the Principal VAT Directive provides that public authorities are not taxable persons when carrying out their statutory functions, unless:

- they are making supplies within Annex 1 to a more than negligible extent; or
- treating them as non-taxable would lead to significant distortions of competition.

There is no explicit transposition of art.13(1) into UK legislation. HMRC say that they have given effect to the article by interpreting existing legislation in a way that achieves the correct result for the article's purposes. However, recent statements by the Courts have cast doubt on whether this approach amounts to an effective implementation of art.13(1).

The 2011 March Budget included an announcement that the UK law would be amended to make sure it explicitly complies with the Directive. Since the measure simply involves the technical implementation of EU law, which is already implemented in practice, there has not been a consultation period. HMRC believe that public bodies should see no change to their existing tax treatment as a result of the legislative changes.

VATA 1994 s.41(2) makes particular provision for treating supplies made by the Government departments and other central government bodies, which are not made in the course of furtherance of a business, as taxable where there are competing providers in the private sector. There is no equivalent to this provision in VATA for other public bodies such as local authorities nor is there any general exemption for public bodies (including the Crown) when engaged in making taxable supplies within an exclusive statutory legal framework. This subsection will be repealed.

A new s.41A VATA 1994 will be inserted. Where public bodies supply goods or services pursuant to public statute which is unique to them, they will not be regarded as doing so in the course or furtherance of a business carried on by them unless:

- the exemption would cause distortion of competition; or
- the supplies arise from activities described in Annex 1 of the Principal Directive which are engaged in to a degree which is more than merely negligible.

'Public body' is defined by reference to art.13(1). European case law has clarified what falls within this definition. A public body must be "part of the public administration"; or, to put it another way, "it must be identified as part of the public administration of the state".

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

2.1.4 HMRC manual

HMRC have updated their manual on *VAT Supply and Consideration* to expand the section on feed-in tariffs for electricity generation.

www.hmrc.gov.uk/manuals/vatscmanual/vatsc05220.htm

2.2 Disbursements

2.2.1 MOT query

A Reader's Query in *Taxation* asked whether a service garage had to identify the exact amount paid to a subcontractor garage for MOT tests. The answers pointed out that this has been HMRC's view since 1996, but has been criticised by a succession of Tribunal chairmen as inaccurate and misunderstood by the officers who try to apply it. The following cases support the view that the amount recharged can be treated as a disbursement even if it is not specifically identified:

- VTD 20,100: *Duncan (t/a G Duncan Motor Services)*;
- VTD 20,269: *Martin Peter Jamieson (T/A Martin Jamieson Motor Repairs)*;
- VTD 20,567: *Kevin John Lower & Mrs Suzanne Jane Lower*;
- VTD 20,627: *Carl John William Denton t/a Denton Auto Repairs*.

Taxation, 17 November 2011

2.3 Exemptions

2.3.1 Bingo!

The Rank appeal has been heard by the CJEU. The UK courts had agreed with the taxpayer that the principles of fiscal neutrality required that its games of bingo and slot machines should be treated as exempt because other, similar supplies were treated as exempt by HMRC. The UK law and practice attempted to draw a distinction between taxable and exempt supplies when they were practically indistinguishable and therefore competed against each other. The Court of Appeal (in relation to bingo) and the Upper Tribunal (in relation to slot machines) decided to refer questions on how the issue of distortion of competition should be determined.

The answers from the Court are as follows:

1. The principle of fiscal neutrality must be interpreted as meaning that a difference in treatment for the purposes of value added tax of two supplies of services which are identical or similar from the point of view of the consumer and meet the same needs of the consumer is sufficient to establish an infringement of that principle. Such an infringement thus does not require in addition that the actual existence of competition between the services in question or distortion of competition because of such difference in treatment be established.

2. Where there is a difference in treatment of two games of chance as regards the granting of an exemption from value added tax under Article 13B(f) [6th Directive], the principle of fiscal neutrality must be interpreted as meaning that no account should be taken of the fact that those two games fall into different licensing categories and are subject to different legal regimes relating to control and regulation.

3. In order to assess whether, in the light of the principle of fiscal neutrality, two types of slot machine are similar and require the same treatment for the purposes of value added tax it must be established whether the use of those types of machine is comparable from the point of view of the average consumer and meets the same needs of that consumer, and the matters to be taken into account in that connection are, inter alia, the minimum and maximum permitted stakes and prizes and the chances of winning.

4. The principle of fiscal neutrality must be interpreted as meaning that a taxable person cannot claim reimbursement of the value added tax paid on certain supplies of services in reliance on a breach of that principle, where the tax authorities of the Member State concerned have, in practice, treated similar services as exempt supplies, although they were not exempt from value added tax under the relevant national legislation.

5. The principle of fiscal neutrality must be interpreted as meaning that a Member State which has exercised its discretion under Article 13B(f) and has exempted from value added tax the provision of all facilities for playing games of chance, while excluding from that exemption a category of machines which meet certain criteria, may not contest a claim for reimbursement of VAT based on the breach of that principle by arguing that it responded with due diligence to the development of a new type of machine not meeting those criteria.

The judgment goes through a wide range of precedents and principles, including the earlier rulings that the legality or otherwise of gambling operations, and the holding of licences or the failure to hold licences, cannot affect the VAT treatment.

The Court also points out that it is permissible for a member state to exclude certain types of gambling from exemption while retaining the exemption for others, as long as the activities are objectively dissimilar (e.g. slot machines and lotteries as opposed to horse-race betting).

The only light for HMRC is in the fourth answer. Where the UK law regarded certain comparator machines as taxable, but HMRC failed to apply the law and effectively regarded them as exempt, it is not possible for someone else who paid output tax on similar machines to claim a repayment. This is to take fiscal neutrality too far. So a person who has suffered as a result of the incorrect application of the law can claim a repayment; but where someone else has benefited from HMRC's incorrect application of the law, that person's competitors cannot insist on receiving the same benefit.

The 'due diligence defence', which was roundly rejected by the UK Tribunal, is given much shorter consideration here. It is effectively dismissed in principle by the observation that Directives have direct effect, and this does not depend on the member state deliberately or negligently failing to implement the law – so correcting a defect with due diligence cannot make any difference to that direct effect. The Court also comments that it appears that the authorities knew about the existence of the problematic types of slot machine for long enough to make a due diligence defence hard to sustain on the facts.

CJEU (Case C-259/10): *HMRC v The Rank Group plc*

HMRC have responded to this decision in a Brief. They accept that the litigation is over with respect to bingo, and anyone who has made a valid claim in respect of bingo games which are similar to those in *Rank* will have received a repayment (in line with R&C Brief 75/2009) which will not now be subject to clawback.

HMRC believe that the judgment does not finally determine the litigation in relation to gaming machines, because it provides some criteria for determining whether gaming machines make similar supplies. HMRC will examine these and continue their appeals to the UK courts.

HMRC also believe that the judgment only affects supplies made between November 1998 and December 2005. Claims for periods before and after that window will not be paid.

R & C Brief 39/2011

2.3.2 Supplies to betting syndicate

A company placed bets for a syndicate of gamblers, many of whom owned shares in the company. HMRC issued an assessment for £38,500 covering a two and a half year period on the basis that its supplies to the gamblers were taxable. The Tribunal agreed. It took no risk; it provided a mere administrative service as agent of the syndicate, and was not supplying any service that could fall within Sch.9 Group 4. The company's attempts to distinguish its activities from those held to be taxable in the *United Utilities* case failed.

First Tier Tribunal (TC01558): *Rating Report Ltd*

2.3.3 Machine Games Duty

HMRC have announced that they will provide a series of updates on the transition from the current tax regime for gaming machines (Amusement Machine Licence Duty and VAT) to the new Machine Games Duty which is due to be implemented on 1 February 2013. A consultation document and a press release issued on 6 December 2011 give further information.

www.hm-treasury.gov.uk/d/consult_implementing_machine_games_duty.pdf; Excise Information Note 2/2011l; http://www.hm-treasury.gov.uk/d/machine_games_duty.pdf

2.3.4 Purpose of association

A trade association was established in 1938 to represent proprietors of amusement parks. It registered for VAT in 1982 but later submitted a "*Fleming* claim" in respect of its subscriptions, arguing that they should be exempt under Sch.9 Group 9.

The main question was whether the association fell within Item 1(d):

"an association, the primary purpose of which is to make representations to the Government on legislation and other public matters which affect the business or professional interests of its members."

The Tribunal examined the history of the association, its constitution and the information it sent to members about the services it provided. The chairman concluded that lobbying was not the primary purpose of the association, even if 70% of the chairman's time was now devoted to that activity.

In case he was wrong on that principal issue, Sir Stephen Oliver went on to consider whether Note 5 disqualified the association anyway. This requires that an organisation which satisfies Item 1(d) must restrict its membership wholly or mainly to individuals or corporate bodies whose business or professional interests are directly connected with the purpose of the association. About 31% of the members were agreed not to be in a kind of business that was concerned with the lobbying activities, and Sir Stephen ruled that this was too great to satisfy "wholly or mainly". In his view, that expression required "substantially all" rather than "a bare majority".

The Tribunal also concluded that HMRC could rely on the defence of unjust enrichment, even if it was wrong on the question of liability. The VAT had been passed on to the members, most of whom would have been able to recover it. Although the onus was on HMRC to demonstrate unjust enrichment, the burden was not excessive – it was not necessary for them to identify the status of every single member and show the extent to which the association would be enriched. In principle, it seemed more likely that the cost of the VAT had been passed on.

First Tier Tribunal (TC01504): *The British Association of Leisure Parks, Piers & Attractions Ltd*

2.3.5 Cost sharing exemption

The implementation of the exemption in art.132(1)(f) Principal VAT Directive draws closer. A summary of consultation responses is available on the HMRC website. The introduction highlights some important changes that have been made as a result of the consultation:

1.9 The main concern was that the cost sharing vehicle had to be a separate entity from its members and could not be controlled by one of them.

1.10 The Government have considered the responses and decided to allow one member to control the cost sharing vehicle but to maintain the requirement that there is a separate entity with no third party control or ownership.

1.11 Most respondents believed there was no requirement for minimum threshold of qualifying activity to be a member. If however a threshold was felt necessary there was significant support for every member of a Cost Sharing Group (CSG) to have at least 5% exempt and/or non-business activity. The Government have therefore decided to make this a requirement of CSG membership.

1.12 There was overwhelming support for the preferred approach to the definition of 'directly necessary' so this will be applied with a threshold of 85% exempt and/or non-business activity enabling all services received by members from the group to be covered by the exemption, subject to the other conditions being met.

1.13 In respect of the 'exact reimbursement of costs' and 'distortion of competition' conditions they will be applied broadly in line with what was described in the consultation document.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=HMCE_PROD1_031792

A new s.31(3) VATA 1994 will give HMRC power to make regulations in accordance with art.131 Principal VAT Directive. This will introduce a new Group 16 of Sch.9 VATA 1994 to cover "Supplies of services by groups involving cost sharing".

HMRC have set out the following principles that will apply to cost-sharing groups (CSGs) (subject to ongoing consultation with stakeholders about the detailed application of the new rules):

Independent groups of persons

A CSG will be a separate entity and will be owned and controlled by its members. If the members agree ownership and control would not have to be equal amongst all members. One member could have a majority interest and/or control the CSG.].

Exempt and Non-Business Supplies

To be eligible for membership of a CSG, members will have to make a minimum of 5% exempt and/or non-business supplies over a prescribed period of time. There will be provisions for an orderly discontinuance of membership should a member or members cease to qualify under this condition.

Directly Necessary

The preferred approach as described in the Consultation Document will apply. There will be provisions for an orderly process if a member or members cease to qualify to receive services under the exemption as a result of the application of this condition.

Exact Reimbursement of Costs

The general approach outlined in the Consultation Document will apply.

Distortion of Competition

The general approach, outlined in the Consultation Document will apply.

In an Information Note, HMRC recognise that the mandatory exemption may apply to a range of organisations including banks, charities, housing associations, insurance companies, residential care homes, universities and further education colleges. A number of frequently asked questions are given brief replies.

The Note agrees with commentators who have observed that the doctrine of direct effect means that organisations which already qualify for the cost sharing exemption can claim the benefit of art.135(1)(f) going back for four years. However, HMRC warn that anyone who does this but subsequently is found not to qualify will be subject to assessment and potentially penalties. Clearly HMRC believe that their implementation of the rules will define exactly what will qualify and only what will qualify, so anyone who claims exemption now without knowing what the rules are is taking a risk; however, it may still be open to dispute whether other activities or entities could qualify for exemption using direct effect.

http://www.hmrc.gov.uk/budget-updates/29nov11/vat-cost-sharing.pdf

2.3.6 Updated manuals

HMRC have updated their online manual on betting and gaming to assist in determining the VAT liabilities of gaming machines, bingo and lotteries. This predated the *Rank* decision and therefore may need to be revised further in due course.

www.hmrc.gov.uk/manuals/vbandguidance/VBANDG01100.htm

HMRC have updated their online "health" manual. It has been updated to include legislative changes as well as clarification on the VAT treatment of spectacles, cosmetic services, contact lenses, opticians, psychologists, and drugs supplied with dental care. The Tribunal decision in *Allen Carr's Easyway (International) Ltd* (TC00136) is included and the section on National Regulators have also been amended, and a new section on the storage of stem cells has been added (reflecting recent CJEU case law, in particular *Future Health Technology* Case C-86/09).

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

HMRC have updated their online manual on "welfare". It has been rewritten and restructured to improve readability.

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

HMRC have updated their online manual on burial and cremation to improve readability and generally update cross-references to legislation and VAT Notices.

http://www.hmrc.gov.uk/manuals/vburcmanual/Index.htm

HMRC have updated their online manual on Trade Unions and Professional Bodies, amending the section dealing with the treatment of public interest bodies falling within VAT Act 1994, Sch 9, Group 9, Item 1(e).

www.hmrc.gov.uk/manuals/vtupbmanual/vtupb6500.htm

2.3.7 Updated Notices

HMRC have issued a revised version of their notice on *Insurance*. It replaces the May 2002 version and the update issued in February 2004, but does not highlight any particular amendments made. The first section explains what is meant by "insurance", and sets out HMRC's attitude to block policies following *Card Protection Plan*.

Notice 701/36

HMRC have issued a revised version of their notice on *Finance*. It has been updated since the June 2009 edition to reflect changes in the sections on "Debts and related services" and "Securities and related services".

Notice 701/49

HMRC have issued a revised version of their notice on *Funded pension schemes*, which provides guidance about claiming input tax on funded pension scheme expenditure for both employers and trustees. It has been updated since the March 2002 edition largely to improve readability, and to make sure that the technical content is up-to-date and relevant. The new version retains the simplified approach of treating a third party manager's inclusive fees as 30% for managing the pension scheme (which is then deductible by the business for whose employees the scheme is run) and 70% for investment services (which is not deductible).

Notice 700/17

HMRC have issued a revised version of their notice on *Commodities and terminal markets*. It explains the VAT treatment of transactions in commodities and commodity derivatives, and on terminal markets. Although it says "Details of any changes to the previous versions can be found in paragraph 1.1 of this notice", it does not highlight what has changed since the withdrawn March 2002 version.

Notice 701/9

HMRC have issued a revised version of their notice on *Health Institutions*, which explains the VAT liability of goods and services supplied by hospitals, and other institutions that provide medical care or treatment; the VAT liability of goods and services supplied by third parties on the premises of a hospital or other institution that provides medical care or treatment; when drugs or medicines dispensed to in-patients, residents or other people attending the premises of a hospital or other institution may be relieved from VAT; and when institutions that provide medical care or treatment should register for VAT. It has been revised from the February 2007 and provides additional guidance on independent pharmacies operating within hospitals.

Notice 701/31

Associated with the above, there is also an updated version of the notice on *Health Professionals*, replacing the January 2007 edition. The main changes concern psychologists' services, supplies of drugs and other goods on prescription and the introduction of the Community Contractual framework for community pharmacy services in Scotland. Revenue & Customs Briefs 43/2009 (regulated psychologists added to the exempt medical professions), 12/2010 (difference between supply of services and supply of staff) and 40/2010 (revised concession on supply of nurses) have been incorporated into the notice.

Notice 701/57

HMRC have issued a revised version of their notice on *Gold*. It has been rewritten to improve readability, but the technical content has not changed since the February 2000 version. It was last updated in August 2011.

Notice 701/21

2.4 Zero-rating

2.4.1 Biscuits, not crisps

A company made savoury snack products called "Discos" and "new recipe Frisps". The question was whether they were excepted from zero-rating because they were "similar products" to potato crisps. Discos had been made of potato up till 2000, when some of the potato was replaced with wheat flour; Frisps are still currently made of potato, but a new recipe has been proposed which the company wanted to treat as zero-rated. Discos contain 27.87% potato; the new recipe for Frisps contains 22.56% potato.

The Tribunal considered the approach of the Court of Appeal in the case about regular Pringles. It concluded that "made from the potato" implied that potato had to be the largest single ingredient, which was not the case here. The texture, taste and packaging were inconclusive (as they were similar not only to crisps but to other zero-rated products as well, and the main taste was the flavouring). Overall, the presence and importance of the wheat starch and wheat flour meant that the products were neither "made of potato" within the meaning of the legislation, nor "similar to potato crisps". They were zero-rated.

First Tier Tribunal (TC01515): *United Biscuits (UK) Ltd*

2.4.2 Glaxo lose again

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 First Tier Tribunal (TC00688) 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.

The company appealed to the Upper Tribunal. The argument was considered again, but the judge found no reason to overturn the First Tier-s decision. The appeal was dismissed.

Lucozade Sport is sold both ready-mixed and in powder form. The conclusion that the ready-mixed version is a beverage means that the powder is also necessarily standard rated, because it falls within the exclusion for "powders ... for the preparation of beverages".

Upper Tribunal: *GlaxoSmithKline Services Unlimited v HMRC*

2.4.3 A win on drinks

By contrast, a company has won an appeal on the basis that its "iced tea concentrates" were within the definition of "tea" and were therefore within the "items overriding the exceptions" within Group 1 Sch.8. The company manufactured the concentrates for Whittards, a specialist tea supplier, from a range of their products (including fruit teas). The result was sweetened with syrup and 15 times as strong as normal tea, so that it could be diluted to make a cold drink.

HMRC argued that the addition of the syrup changed the product from "tea" to "syrup" and therefore clearly within the excepted items. HMRC argued that the appropriate test was to consider whether an average person would regard the product as "tea or similar".

The Tribunal considered previous cases including *Orchid Drinks* and *Snapple Beverage Corporation*, and distinguished the facts. In this case, the principal ingredient was undoubtedly tea (together with water), and the addition of the syrup did not change its nature. It tasted of tea, was sold as tea and would probably be regarded as a form of tea by the customer. It was properly zero-rated.

First Tier Tribunal (TC01536): *Thorncroft Ltd*

2.4.4 A win on books

An American company supplied "photobooks", which were digitally produced from a customer's own photographs to look like books. Initially it accounted for output tax but subsequently reclaimed this on the basis that its products ought to be zero-rated. HMRC argued that it was predominantly supplying a service which was standard rated.

The Tribunal considered the characteristics of "books and booklets" and a number of precedent cases. It upheld the appeal in part, holding that most of the company's products were clearly goods to which the production service was ancillary. They therefore qualified for zero-rating. However, two products did not qualify, because they did not look like books or leaflets – the leaves were simply sheets of photographic paper bound together with a spiral binding. They did not look like books.

This was a leading case which presumably will be applied to a number of similar operators in the same industry (for which reason HMRC may decide to appeal to the Upper Tribunal).

First Tier Tribunal (TC01562): *Harrier LLC*

2.4.5 For the disabled

A company supplied mattresses which were, according to its contention, designed solely for use by a handicapped person and were therefore zero-rated in accordance with Sch.8 Group 12 Item 2(g). The Tribunal examined the underlying law and the analysis in Notice 701/7, as well as the evidence about the facts and a number of previous decisions on the issue. The following general principles were drawn from the precedents:

The following, at least, should be considered in order to determine whether the equipment or appliance is designed solely for use by a handicapped person:

(i) the identification of the designer and his intention;

(ii) the function, purpose, possible and actual uses of the finished article;

(iii) any advertising and promotional literature and the market in which the product is supplied and its cost; and

(iv) the availability and use of similar products and their comparative cost.

The Tribunal decided that the products, which were individually made to meet the needs of specific customers, satisfied the conditions for zero-rating.

First Tier Tribunal (TC01454): *Pure Independence (UK) Ltd*

A registered charity was formed to offer disabled people "opportunities in aviation". It purchased two light aircraft and immediately arranged for them to be modified for use by disabled persons. HMRC ruled that the supplies did not qualify for zero-rating under Sch.8 Group 12 item 2(g). The Tribunal disagreed, holding that there was no reason in the legislation or in common sense to draw a distinction between something that was supplied already adapted and something that was so adapted before it was ever used. The chairman commented that item 2(g) should be interpreted as relating to "the quality of the item as used by the handicapped person, not the quality of that item when it left the factory".

The chairman commented that the vendor of one of the aircraft did not want the alterations to be carried out before a contract for sale was concluded "for rather obvious reasons". There was no doubt that the intention of the purchaser at all times was to acquire an aircraft that would be adapted and used only by disabled people.

HMRC tried to make something of the requirement of the legislation that the supply by the charity had to be for the "personal use" of the disabled person. The Tribunal considered that this only required that it was not business use, and did not imply exclusivity.

First Tier Tribunal (TC01580): *The British Disabled Flying Association*

2.4.6 Disabled ESCs

HMRC have issued a reminder of the withdrawal of two concessions relating to disabled people. The withdrawal of both was first announced in December 2010 and will apply from 1 January 2012.

- The first allows zero-rating for a motor vehicle supplied to a disabled wheelchair user if the vehicle was adapted shortly after it was supplied to the disabled person. Zero-rating continues to apply if the car is adapted before it is supplied.

  R&C Brief 44/2011

- The second allows zero-rating for parts and accessories designed solely for use with boats adapted for use by disabled persons. A Brief sets out a number of supplies which continue to be zero-rated after the change.

  R&C Brief 42/2011

2.4.7 Updated manuals

HMRC have published their online manual on protective equipment to assist in determining the VAT liabilities of protective boots and helmets for industrial use; motorcycle helmets; pedal cycle helmets; and children's car seats.

www.hmrc.gov.uk/manuals/vprotequipmanual/VPROTEQUIP1000.htm

HMRC have updated their online manual on clothing. It clarifies the VAT liability of particular types of clothing by reference to the scope and eligibility of zero-rating, body sizes in Notice 714, and the *Brays of Glastonbury* case in which size 5 moccasins were held to be "suitable for older persons" because they would fit a large part of the adult female population as well as the children for whom they were ostensibly designed.

www.hmrc.gov.uk/manuals/vclothingmanual/update/updateindex.htm

HMRC have updated their online manual on *VAT relief for books* to include reference to the new supply-splitting rules.

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

2.4.8 Updated Notices

HMRC have issued a revised version of their notice on *Food*, replacing the May 2002 edition. It states that it has simply been updated to improve readability.

Notice 701/14

HMRC have issued a revised version of their notice on *Animals and animal food*, replacing the March 2002 edition. It states that it has been updated to include the liability of livery packages provided by special purpose stables.

Notice 701/15

HMRC have issued a revised version of their notice on *Food Processing Services*. It replaces the January 2002. The main highlighted change is the replacement of the Meat and Livestock Commission by the Agriculture and Horticulture Development Board with effect from 1 April 2008.

The notice starts with the following statement of a general principle:

The processing of someone else's goods is a supply of services, and if that process produces new zero-rated goods it is zero-rated.

New goods are produced when a process alters the essential characteristics of the goods. Where the process does not produce new goods, or the goods are not zero-rated, then the process is standard-rated. In these cases VAT is due on the charge for providing the processing service.

It goes on to discuss how the trader can tell if new goods are produced.

Notice 701/40

HMRC have issued a revised version of their notice on *Seeds and Plants*, replacing the November 2003 edition. The notice explains when seeds and plants can be zero-rated on the basis that they are used for production of food for human consumption. The technical content has not changed, although there has been a minor amendment to the section which deals with "Ornamental herbs sometimes used for culinary purposes".

Notice 701/38

HMRC have issued a revised version of their notice on *Catering and takeaway food*. The notice has been updated to improve clarity.

Notice 709/1

HMRC have issued a revised version of their notice on *Zero-rating of books etc*. The notice has been updated from the October 2010 version, but no particular changes are specified in the introduction.

Notice 701/10

2.5 Lower rate

2.5.1 Withdrawal of ESCs

HMRC have issued a reminder that three extra-statutory concessions affecting caravan sites are being withdrawn with effect from 1 January 2012. The concessions allowed VAT not to be charged on:

- recharges of business rates at holiday/leisure caravan sites;
- recharges of non-metered water/sewerage rates at caravan sites;
- one off charges for the first time connection to gas, electricity, water and sewerage.

These will in future follow the liability of the pitch fee (generally standard rated on holiday sites, exempt on residential sites). Where individual consumption of utilities is metered and recharged exactly, it can be treated as a supply of the utility itself and will follow its liability (reduced rated for electricity and gas, zero rated for water and sewerage).

The Brief also comments on the effect of the tax point rules on the timing of the change, and sets out the treatment that it will accept (concession will still apply to bills issued before 1 January) – but reserves the right to disapply the concession if it is used for tax avoidance.

R&C Brief 37/2011

HMRC have issued a reminder that ESC 3.16 is being withdrawn with effect from 1 January 2012. The concession allowed the first time gas or electricity connection of a dwelling or relevant charitable/residential building could continue to be zero-rated even after the supply of power became subject to the reduced rate. HMRC now consider that this relief is not permitted under UK or EU law, so it is being withdrawn.

From 1 January 2012, where the connection is made by the same person that will supply the gas or electricity, it will be lower rated (effectively being ancillary to the main supply). If it is made by someone else (or the ultimate supplier of the power has not been determined), the connection charge will be standard rated.

It is possible for connections to qualify for zero-rating if they are part of the construction of a new dwelling within Sch.8 Group 5, or for lower-rating if they are part of a qualifying project within Group 6 or Group 7 of

Sch.7A. The lower rate may also be applied under Item 4 Group 3 Sch.7A (grant-funded energy saving supplies).

The Brief also comments on the effect of the tax point rules on the timing of the change, and sets out the treatment that it will accept (concession will still apply to bills issued before 1 January) – but reserves the right to disapply the concession if it is used for tax avoidance.

R&C Brief 43/2011

2.5.2 Updated Notice

HMRC have issued a revised version of their notice on *Energy-saving Materials*, replacing the August 2006 edition. It clarifies when the installation of energy-saving materials qualifies for the lower rate of VAT. The following amendments have been made:

- Paragraph 2.3 has been amended to clarify HMRC policy on energy-saving materials supplied or installed with other goods.
- Paragraph 2.16 gives new definitions of residential accommodation in caravans and student accommodation.
- Paragraph 3.5 has been updated in the light of the withdrawal of grants for the installation of security goods.
- Paragraph 3.8 clarifies the categories of persons qualifying for the reduced -rate under Schedule 7A Group 3.

Notice 708/6

2.5.3 Updated Manuals

HMRC have updated their online manual on *Fuel and power*. It now includes guidance on feed-in tariffs and the use of meters in universities, explains the roles of the new VAT policy and advisory teams, deals with how to determine the proportion of fuel which qualifies, covers wholesale supplies of gas for conversion in CHP systems, and explains the British Electricity Trading and Transmission Arrangements (BETTA).

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

2.6 Computational matters

Nothing to report.

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

Nothing to report.

2.9 Agency

Nothing to report.

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

2.11.1 Proceeds to charity

A company sold goods by mail order. The catalogue indicated that a proportion of the price would be given to charity. After initially accounting for output tax on the full sale prices, the company made a repayment claim, arguing that it should not have accounted for VAT on the amount that would be given away. It cited precedent decisions in *Patrick* (VTD 12,354) and *EMAP MacLaren Ltd* (High Court 1997). The total reclaimed included £1.7m for three years up to 2002 and a *Fleming* claim for £11m. The company also appealed against an assessment for £375,000 which related to the period after it had decided it should only be accounting for VAT on the net amount.

The company sold its products through agents to supporters. It was subject to an open market value direction under Sch.6 para.2. In 2002 it changed the terms of its business and claimed that it was now dealing directly with the supporters; it appears that HMRC accepted for a period that this meant that the OMV direction no longer applied, but they withdrew that decision in October 2004 and ruled that nothing significant had changed.

The Tribunal ruled that HMRC were correct: the full catalogue price was the consideration for the supplies. The chairman observed that the *EMAP McLaren* case had been decided on the basis of a Court of Appeal decision that had subsequently been overturned in the House of Lords (*Nell Gwynne House Maintenance Fund*). The taxpayer's attempts to find analogies with *Tolsma* and *Glawe Spiel* were rejected.

First Tier Tribunal (TC01560): *Findel plc*

2.11.2 Charity definition

Although a number of VAT (and other tax) reliefs depend on an organisation being a 'charity', there has up to now been no definition of the term for tax purposes. It has been fairly clear that it would include an organisation which is registered with the Charity Commission and which applies its income for purposes traditionally regarded as charitable (relief of sickness or poverty, education); but there have been cases in which other organisations have argued that they should be regarded as charitable.

A statutory definition was included in Sch.6 FA 2010. It is now expected that this will be brought into effect for the purposes of VAT and CGT with effect from April 2012. The definition requires that an organisation will only be treated as a charity if:

- it is established for charitable purposes only;
- it is subject to the control of a UK or equivalent foreign court in the exercise of its jurisdiction with respect to charities;
- it is registered with the Charity Commission in the UK if it is required to do so under the Charities Act 1993, or has met any equivalent registration requirement abroad;
- its managers are “fit and proper persons” to be managers of the body or trust.

HMRC have discretion to consider whether the charitable status of a body is affected by the presence of someone who is not fit and proper among its management. There has been considerable discussion about the power of HMRC to declare that a charity manager is not fit and proper and thereby take away the charitable status; HMRC say that they will consider whether the presence of the person puts tax at risk, taking into account any history of tax fraud, misrepresentation, identity theft and regulatory actions taken against the person.

SI/2012/Draft

2.11.3 Charity singles

The Treasury announced that it would “waive the VAT” on the charity singles released by the X-Factor finalists and by the Military Wives. What this means is that a charitable donation equal to the VAT will be made by the government – it is not possible for a one-off exemption or zero-rating to be granted on the grounds that the supply is charitable.

PN 147/11; PN 133/11

2.12 Other supply problems

2.12.1 Price Marking Order

In general, the price shown on retail goods must be the VAT-inclusive price payable at the till – it is not permitted to add the tax later, as is customary in the USA. Where there is a change in the rate of VAT, it is permitted to make such an upward adjustment for a set period after the rate change. This was amended from 14 to 28 days in relation to the last two VAT rate increases on 1 January 2010 and 4 January 2011. A new statutory instrument has amended the rules in Northern Ireland to match this 28-day rule, although there is no suggestion yet that there will be a general increase in the rate of VAT in the foreseeable future.

SI 2011/330

2.12.2 Scale charge

A trader was assessed for failing to account for a scale charge on private use of fuel. HMRC calculated the full amount due as £620; the trader argued that it should be one-fifth of that amount, on the basis that four-fifths of the use of the car was for business.

Sir Stephen Oliver considered the alternative treatments of road fuel set out in Notice 700/64 and what he called "the black letter of the UK law" might be. As the trader had no detailed and contemporary records to show what the mileage was in the period being assessed, the scale charge was mandatory, and the appeal was dismissed.

First Tier Tribunal (TC01561): *Stu's Fruit & Convenience Store*

HMRC have issued an updated version of the Notice on *Motoring expenses*. It appears that the main change from the May 2007 version is simply to incorporate up-to-date scale charges, although as these change each year the document will be out of date again in April 2012.

Notice 700/64

2.12.3 Transfer of going concern

A German businesswoman sold the stock and fixtures and fittings of his sports retail shop to another business. He retained the shop itself, leasing the premises to the purchaser for an indefinite period. The German authorities ruled that this could not be a VAT-free transfer of a going concern because not all the assets had been transferred.

The Court ruled that the decision in *Zita Modes* requires that the expression 'a totality of assets or part thereof' covers the transfer of a business or of an independent part of an undertaking, including tangible intangible elements which, together, constitute an undertaking or a part of an undertaking which is capable of carrying on an independent economic activity; but it does not cover the simple transfer of assets, such as the sale of a stock of goods which the transferee intends to sell off rather than use in a business.

The Court considered that ownership of the premises was not crucial for the transferee to be able to carry on a business. The transfer, together with a lease of the premises (even if potentially subject to short notice cancellation), put the transferee in a position to trade, and it was therefore a transfer of a going concern.

CJEU (Case C-444/10): *Finanzamt Lüdenscheid v Christel Schriever*

2.12.4 More on sacrifices

HMRC have issued a further Brief to clarify particular aspects of their change of policy on salary sacrifice arrangements.

First, they have extended the old policy to cover the completion of any salary sacrifice arrangements entered into up to 27 July 2011, when they issued the previous Brief. This is helpful because it means that an annual arrangement running from say 1 April 2011 to 31 March 2012 can be completed without changing the VAT treatment part way through. If the arrangement is binding and extends beyond 31 December 2011, HMRC will allow the salary forgone to be free of VAT until:

- The date that a fixed term agreement expires or the fixed number of salary sacrifice payments specified within the agreement are completed.
- The date of an employee's annual salary/benefits review. HMRC will regard any salary sacrifice arrangements put in place after that date as

a new agreement for VAT purposes. This will be the case even if the employee continues to receive the same taxable benefits as before the review.

- The date of any other review or renegotiation that leads to a change in the provision of benefits under a salary sacrifice agreement or to a change in an employment contract.

Following one of the above events VAT will be due on any taxable benefits provided on or after 1 January 2012 by way of salary sacrifice.

Any new agreements entered into from 28 July 2011 onwards will be subject to the policy in the previous Brief: VAT will be due on salary forgone after 1 January 2012.

R & C Brief 36/2011

There is an article by Alex Millar about salary sacrifices and the *AstraZeneca* decision in *Taxation*, 27 October 2011.

Taxation 27 October 2011

2.12.5 Updated Notices

HMRC have issued a revised version of their notice on *Clubs and Associations*, replacing the March 2002 edition. It does not highlight any particular changes, but states that it explains:

- the basic rules of VAT and how they apply to clubs and associations;
- the VAT treatment of subscriptions and other payments;
- the scope of the exemption for subscriptions to trade unions and certain public interest bodies; and
- the treatment of prizes and appearance money in competitions in sports and games.

Notice 701/5

HMRC have issued a revised version of their notice on *Disposals of antiques, works of art etc from historic houses*, replacing the January 2002 edition. It states that there are no substantive changes other than to improve readability.

The main issue is whether assets of the house are within the scope of VAT. If admission is charged, the house is used for a business purpose, and potentially disposal of assets can be VATable. However, a distinction has to be drawn between private and business assets, both in claiming input tax and in accounting for output tax.

Notice 701/12

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Storage facilities again

A company owned and operated two self-storage facilities. One comprised a building: HMRC accepted that letting of units in this building constituted the exempt supply of a licence to occupy land. At the other site, the storage units comprised independently constructed steel containers which were arranged together in blocks. HMRC argued that they were not "immovable property" because they were not fixed to the ground – they rested on a concrete base and were held in place by their own weight.

HMRC applied to have the present appeal held over while waiting for the Upper Tribunal to hear an appeal in *Hanbridge Storage Services*, where HMRC lost before the FTT. The Tribunal refused the stand-over application.

In relation to the issue of immovable property, the Tribunal examined the precedent case of *Maierhofer* (Case C-315/00), in which temporary structures erected to house asylum seekers were held to be immovable property. The Tribunal concluded that there was a scale of immovability, and exemption would depend on where on that scale a particular situation fell – there was no exhaustive definition. The chairman commented that these units appeared less movable than the containers in *Hanbridge*, and decided that they were immovable for the purposes of the exemption.

HMRC also argued that there was no exclusive possession of the units because the agreement excluded it. The Tribunal commented that this meant it could not be a lease (and ruling that out was the probable intention of the phrase), but it could be licence to occupy.

Lastly, HMRC argued that there was a package of services which was not predominantly land. In effect, it was a safeguarding service – the precise location of the storage unit was of no significance to the customer. Here, the Tribunal agreed with the taxpayer that there was not a package but a single supply.

The taxpayer argued that the supplies at its two sites were effectively identical. The principles of fiscal neutrality therefore required that they should be treated in the same way, and HMRC had accepted that the building was exempt. The Tribunal found this persuasive, and allowed the appeal.

First Tier Tribunal (TC01394): *UK Storage Company (SW) Ltd*

3.1.2 Scots law

HMRC have issued a new version of their Notice on Scottish Land Law Terms. It includes such matters as "ish" (the end date of a lease), "these presents" (the deed itself in which the words are used, rather than a gift), and "solum" (the ground on which a building has been constructed), as well as important differences between English and Scottish terminology such as "missives" and "the register of Sasines".

Notice 742/3

3.2 Option to tax

3.2.1 Reader's Queries

A Reader's Query in *Taxation* considers whether a block of flats let to a company should be subject to an option to tax, where the company does not use the flats for residential purposes but lets them out for short-term accommodation (i.e. similar to a hotel). The answers comment on the difficulty of establishing VAT liability where a building is designed as one thing but used as another.

Taxation, 10 November 2011

Another Reader's Query concerned a property development business which had purchased a pub with the intention of building 20 residential units. VAT was paid on the purchase, and the enquiry related to whether the option to tax would be disapplied on a subsequent sale. The answers suggested that it should have been disapplied on the original purchase, and there might now be a problem with recovery of the VAT.

Taxation, 1 December 2011

3.3 Developers and builders

3.3.1 A business purpose

A married couple owned a three-bedroomed cottage. In 2010 they applied for VAT registration on the basis that they were engaged in converting it into two dwellings and intended to sell one. HMRC refused on the basis that the eventual sale would be exempt in any case.

The Tribunal examined the facts and agreed that there would be a zero-rated element in respect of the enlargement of the property. Note 16 excluded zero-rating for the enlargement of an existing building except "to the extent that a new dwelling was created" thereby. To the extent that the new dwelling used part of the old property (35%), the sale would be exempt; but it was possible to make an apportionment and treat the new dwelling, to the extent that it was outside the footprint of the original (65%), as zero-rated. The appeal was allowed.

First Tier Tribunal (TC01523): *A Wright and M Wright*

3.3.2 Not a dwelling

A contractor partnership agreed to construct a new office for a customer. The total charges would put it above the VAT registration threshold so the firm registered for VAT. However, they accepted the customer's assurance that the work should be zero-rated, because the building would also be used as a dwelling. HMRC subsequently ruled that it should have been standard rated, and raised assessments on the basis that 7/47 of the amount received was output tax.

Although the plans showed that the building could be used as a dwelling, they – and the invoices and other paperwork – also showed that the firm should have been aware that this was not the intended primary use. The partners had accepted the customer's assurance in good faith, and could not now recover the VAT from him because the customer had gone into liquidation. The Tribunal therefore had sympathy with the appellant, but could only confirm that the VAT was due.

First Tier Tribunal (TC01425): *D & H Developments*

3.3.3 Course of construction?

A company received assessments amounting to £93,000 in relation to 55 building projects carried out over 2.5 years on which it had treated its supplies as zero-rated when HMRC believed they should be standard rated.

Following correspondence and a hearing, further evidence was provided in relation to most of the projects, and the eventual liability was considerably reduced. The Tribunal decision records the appeal as "formally allowed", but it is clear that some of the assessment was accepted (and some of the projects were charged at 5% rather than 17.5% or 0%).

The Tribunal put on the record the "diligence and fairness" of the HMRC officer who raised the assessments and processed the evidence to reach the proper result.

First Tier Tribunal (TC01578): *C & O Plastering Ltd*

3.3.4 Updated manuals

HMRC have published an updated version of their manual V1-8A *Construction*. It provides additional information on the treatment of buildings and construction and the availability of the zero and lower rates. It should be read in conjunction with Notice 708. It has been rewritten to reflect HMRC's current policy and to clarify those areas where previous advice may have been unclear.

http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD1_023493

3.3.5 Updated Notice

HMRC have published an updated version of their Notice *Construction*. It provides additional information on the treatment of buildings and construction and the availability of the zero and lower rates. It should be read in conjunction with Notice 708. It has been rewritten to reflect HMRC's current policy (incorporating 8 R&C Briefs issued in 2009 and 2010) and to clarify those areas where previous advice may have been unclear. It includes a change in the treatment of 'serviced' building plots, clarification on the treatment of 'extra care' units and deposits, the removal of a concession affecting charity buildings, and a change in the 'change in use' provisions.

Notice 708

3.4 Input tax claims on land

3.4.1 Planning restrictions

An individual made a claim under s.35 for £17,773 in relation to a barn conversion. HMRC refused, and did not object to an appeal being made out of time. The barn conversion was intended to be used as a granny annexe, but the appellant's mother died before construction was complete, so it was never used for that purpose.

Nevertheless, the Tribunal agreed with HMRC that the planning condition "*the development hereby permitted shall not be used other than for the purposes of ancillary residential accommodation to the adjacent farmhouse known as 'Home Farm' without the prior written consent of the Local Planning Authority*" meant that the "separate use" of the building was prohibited (even if not the separate disposal). As a result, it did not qualify as a "dwelling" and a s.35 claim was ruled out.

First Tier Tribunal (TC01486): *Gerrard Silver*

3.4.2 Contravention of consent

A woman purchased a property next to her house, intending to build a pair of semi-detached houses for her daughters to live in. The local council refused planning permission for this project, but agreed to allow construction of a bungalow containing two residential units subject to a covenant that required the whole property to be occupied by the woman and her family. The property was purchased in the 1980s, vacant possession was obtained in the 1990s, and construction was not completed until December 2009. The building was constructed with an internal door linking the two sides, but this was later blocked up and plastered over.

A DIY builders' claim for £25,000 was rejected on the grounds that the bungalow as constructed did not comprise "self-contained living accommodation" and had not been built in accordance with the planning consent. The Tribunal agreed that it did not satisfy the condition of Sch.8 Group 5 Notes 2(c) (because of the covenant about family occupation) or (d) (because the door shown on the approved plans had been plastered over), and the DIY claim therefore failed.

First Tier Tribunal (TC01521): *Mrs SA Searle*

The issue of restrictions on disposal in planning consent is considered in a Reader's Query in *Taxation*. The problem is that the builder thinks that he is constructing a dwelling on the basis of the plans, and should therefore be able to zero-rate the work within Item 2 Group 5 Sch.8; however, if the building fails to meet the conditions in Note 2, the builder has to standard rate the work, so the builder must also pay attention to the planning consent. The answers confirm that the builder would be unlikely to win an appeal.

Taxation, 14 December 2011

3.4.3 Goods or services

An individual made a claim under s.35 for £11,314 in relation to the construction of a dwelling. HMRC disallowed £2,108 in relation to the supplies of various services. In the end, the dispute before the Tribunal related only to two bills for "groundworks" (total VAT £370) where the contractor had gone out of business. The Tribunal agreed with HMRC that the supplies should have been zero-rated, and having overpaid his contractor, the claimant had no recourse against HMRC.

First Tier Tribunal (TC01414): *Ken Hewitt*

3.4.4 New building or not?

A company made a claim under the DIY scheme (which is itself unusual). The claim was refused on the basis that the works did not amount to the construction of a new dwelling – more than a single facade required by planning permission had been retained from the previous building on the site. The appellant had persuaded the local council to classify the project as new build and to refund VAT charged on building control fees.

The appellant did not appear before the Tribunal, so no first-hand evidence of his point of view was available, but the documents suggested that more than a single wall had been retained (including his own statement in a letter to his MP complaining about HMRC's attitude). In addition, there was nothing in the planning consents about retaining any facade, so the conditions were not satisfied. The appeal was dismissed.

First Tier Tribunal (TC01494): *Jonathon Berry Ltd*

3.5 Other land problems

3.5.1 Updated Notice

HMRC have issued a revised version of their notice on *Hotels and holiday accommodation*, replacing the January 2002 edition and incorporating updates that had previously been issued as appendices.

Notice 709/3

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Exchange rates

HMRC have issued the usual Information Sheet setting out exchange rates in the quarter to September 2011 for businesses registered under the special scheme for e-traders.

Information Sheet 12/2011

4.1.2 VAT rates

Ireland is raising its top VAT rate from 21% to 23%. The current expectation of VAT rates throughout the EU in 2012 is:

Austria	20	Since Jan 1984
Belgium	21	Since Jan 1996
Bulgaria	20	Since Jan 1999
Cyprus	17	Up from 15 on 1 March 2012
Czech Republic	20	Since Jan 2010
Denmark	25	Since Jan 1992
Estonia	20	Since July 2009
Finland	23	Since July 2010
France	19.6	Since April 2000
Germany	19	Since Jan 2007
Greece	23	Since July 2010
Hungary	27	Increase in January 2012
Ireland	23	Increase in January 2012
Italy	21	Since Sept 2011; proposal to rise to 23 in Sept 2012
Latvia	22	Since Jan 2011
Lithuania	21	Since Sept 2009 (may rise to 23 in 2012)
Luxembourg	15	Since Jan 1992
Malta	18	Since Jan 2004
Netherlands	19	Since Jan 2001
Poland	23	Since Jan 2011 (may rise to 24 in 2012)
Portugal	23	Since Jan 2011
Romania	24	Since July 2010
Slovakia	20	Since Jan 2011
Slovenia	20	Since Jan 2002
Spain	18	Since July 2010
Sweden	25	Since July 1990
UK	20	Since Jan 2011

4.2 Where is a supply of services?

4.2.1 Phonecards

A UK company (L) sold phonecards to distributors in other member states. It did not account for any output tax, arguing that the supply was to businesses who would account for a reverse charge. HMRC issued a ruling that it should account for output tax on supplies of services to consumers when they redeemed their phonecards. Questions on how this should be dealt with were referred by the Tribunal to the CJEU.

The Advocate-General expressed the opinion that the key to determining this issue is the "legal fiction" in the Directive's treatment of an agent acting in his own name. In reality, where L sells to Intermediary who sells to Consumer, L is agreeing to supply services to C against a prepayment which has been collected by I in the capacity of agent. However, the Directive treats an agent acting in his own name as a principal. If the national court considered that art.6(4) 6th Directive (art.28 Principal VAT Directive) applied to the circumstances of the case, I would be treated as receiving the supply from L (subject to the reverse charge) and as making the supply to C (subject to output tax). L would then have no output tax liability on redemption.

The opinion considers four possible ways of construing the supplies:

- as two successive supplies of services (from L to I and L to C, both chargeable on L – the UK government's position);
- as two parallel supplies of services (telecommunications services from L to C, with ancillary distribution services supplied by I to L – recommended by the Netherlands);
- as a chain of supply (from L to I and from I to C – the taxpayer's position, and also one of two lines favoured by the Commission);
- as a deemed chain of supply under the agency rules, as set out above (the Commission's alternative approach).

The Advocate-General points out that phonecards, which operate by providing the consumer with a PIN which enables him to access the international phone network, are not like conventional vouchers – they do not have to be "presented" to be redeemed, and are therefore not akin to a means of payment. They are "a device that facilitates the use of the right of access to telecommunications services, which the customer receives upon the payment of the price to the distributor or his retailer, as the case may be".

The conclusion is that the first two approaches should be rejected; the third is also unattractive because the distributors do not really acquire telecommunication services from L which they sell on. The most convincing answer is the fourth. The opinion recommends the following answers to the questions put by the UK Tribunal:

Where a taxable person ("Trader A′) sells to another taxable person ("Trader B′) phonecards containing information enabling their buyer ("End User C′) to access and receive telecommunications services from A to the amount specified on the card (provided that A has received from B the consideration agreed between them) Trader A supplies to end user

C a service consisting of a right of access to telecommunications service against prepayment. However, pursuant Article 6(4) [6th Directive], if Trader B takes part in his own name but on behalf of Trader A in the supply of that service to end user C, which is for the national court to ascertain, Trader B shall for VAT purposes be considered as having received that supply of service from Trader A and as having supplied it to End User C.

83. If the Court chooses not to follow this proposal, or if the national court is unable to find that the distributors act on behalf of Lebara, I suggest in the alternative the following answer to the preliminary questions of the First Tier Tribunal, Tax Chamber:

Where a taxable person ("Trader A") sells to another taxable person ("Trader B") phonecards representing the right to receive telecommunications services from Trader A, and Trader B subsequently sells the phonecard to End User C who makes the international telephone calls represented in the phonecard, Trader A makes a single taxable supply of telecommunications services at the time of the sale to Trader B. The subsequent purchase and use of the card by an End User does not represent a further taxable supply by Trader A.

CJEU (A-G) (Case C-520/10): *Lebara Ltd v HMRC*

4.2.2 Place of establishment

A German national moved to Austria and established a business there: he supplied staff to companies in Germany. The Austrian authorities issued him with a VAT registration, and he treated the supplies as subject to the reverse charge. The German authorities noted that he still had a residential address in Germany and continued to spend a reasonable amount of time there, and decided that he was not "a person established abroad" for the purposes of the reverse charge procedure. They assessed him to output tax. He appealed, and questions were referred to the CJEU.

The court considered a difference between the German law version of the relevant provision (in translation, "a person established abroad") with the same concept in several other versions (Spanish, Danish, English, French, Italian, Dutch, Portuguese and Swedish), where the wording is "a taxable person who is not established within the territory of the country".

The court also noted that this expression is not defined within the 6th Directive or the Principal VAT Directive, but it is defined in art.1 8th Directive. That provision lists a number of connecting factors which may mean that a trader is not eligible to make an 8th Directive claim. The most important factors are the seat of the economic activity and the existence of a fixed establishment from which business transactions are effected. Only if these cannot be established is it necessary or relevant to consider the trader's private residence. It was therefore not permissible to consider a private residence in the current case, because there was no doubt that the business was established in Austria.

The court went on to strengthen its conclusion by reference to the customer's need for legal certainty. It would be relatively easy for the German customers to be confident that they were being invoiced by a business that was established in Austria; it would be very difficult for them if they also had to investigate the private residence of the owner of that business.

CJEU (Case C-421/10): *Finanzamt Deggendorf v Markus Stoppelkamp*

4.2.3 Exhibition services

A company supplied temporary stands for business customers to use at fairs and exhibitions in order to present their goods and services. The Polish tax authority issued assessments based on a ruling that these supplies were ancillary to exhibitions and therefore supplied where the exhibition took place under art.52(a) VAT Directive. The company appealed, claiming that the supplies should be classified as advertising and therefore supplied where the customer belonged.

The Court has now ruled that it is for the national court to determine exactly how such services should be categorised. However, it gave guidance on how the matter should be determined.

In past cases, the CJEU has held that an advertising service includes a wide range of promotional activities which are intended to inform the public about a product and increase sales. Accordingly, anything which forms an integral part of an advertising campaign is likely to be a supply of advertising. Therefore:

It follows that the supply of services consisting of the design and temporary provision of a fair or exhibition stand must be considered to be a supply of an advertising service, within the meaning of Article 56(1)(b) of Directive 2006/112, in the case where that stand is used for the dissemination of a message intended to inform the public of the existence or the qualities of the product or service offered by the hirer with a view to increasing the sales of that product or service or where it forms an inseparable part of an advertising campaign and contributes to conveying the advertising message. This will be the case, in particular, where the stand constitutes an aid for the dissemination of a message informing the public of the existence or the qualities of the products or is used for the organisation of promotional events.

By contrast, services which are more related to the physical side of the exhibition (rather than the message) are likely to be within art.52. This applies:

when it relates to the design and the temporary provision of a stand for a specific fair or exhibition on a cultural, artistic, sporting, scientific, educational, entertainment or similar theme or a stand corresponding to a model in respect of which the organiser of a specific fair or exhibition has prescribed the form, size, material composition or visual appearance.

...the design and the temporary provision of a stand used for purposes of a specific fair or exhibition must be regarded as constituting a supply of services which is ancillary to the activity carried on by the organiser of that fair or exhibition, coming within the scope of Article 52(a) of Directive 2006/112.

It is necessary in this regard that the stand should be provided for a fair or an exhibition which takes place, whether on one occasion or repeatedly, in a specific location. As Article 52(a) of Directive 2006/112 requires the charging of VAT at the place where the service is physically *carried out, the application of that provision to the supply of a stand which is used at a multitude of fairs or exhibitions taking place in several Member States would risk being excessively complex and would thus jeopardise the reliable and correct charging of VAT.*

The Court explicitly rejected a suggestion from the German government that the supplies were connected with immovable property. The mere fact that a fair or exhibition stand must, on an ad-hoc and temporary basis, be installed on immovable property, or inside such property, was not sufficient to connect it to the land for VAT purposes.

On the basis of the guidance given, it seems likely that the tax authority has won on the facts of the particular case.

CJEU (Case C-530/09): *Inter-Mark Group sp. z o.o., sp. komandytowa w Poznaniu v Minister Finansów*

4.2.4 Advice to students

A company, incorporated in Scotland, provided advice to UK residents who wanted to secure sports scholarships to US academic institutions. HMRC initially agreed that the place of supply of its services was outside the EU because it was acting as an intermediary in respect of supplies that took place outside the EU. In 2010 HMRC changed their view and issued a ruling that the supplies were liable to VAT in the UK. The company changed its contracts in order to satisfy what it perceived as a requirement of HMRC for "outside the scope" treatment, but HMRC issued a further ruling that the revised contract also gave rise to a UK liability. The company appealed against both these decisions.

The Tribunal noted that HMRC had never given any explanation for their "change of mind" in 2010. The complexity of the issue in the hearing was compounded by the fact that HMRC did not appear to have addressed the law clearly at an early stage.

The Tribunal considered only the law after 1 January 2010, in particular s.7A and Sch.4A para.10 VATA 1994 and the Preamble to, and art.46 of, the VAT Package Directive 2008/8/EC. It also examined HMRC's Notice 741A and internal guidance on the place of supply of intermediary services.

The initial decision that the supplies were not those of an intermediary (and were therefore situated where the supplier was established) appeared to be based largely on the assertion that a fee would be charged whether or not the company was successful in securing a scholarship. Because there was no certainty that an underlying educational supply would take place, HMRC took the view that the service was not that of an intermediary.

The company changed its contract to offer a refund of up to 100% of the fees if no scholarship was obtained. The officer concerned did not accept that this made any difference, because the fee was paid in advance and there was a deduction for administrative services. The original ruling was therefore maintained in relation to the revised contract.

The Tribunal examined the company's services and the way they were supplied in detail. The issue turned on the scope of the word "intermediary" and whether it could be applied to the circumstances of the case. The Tribunal concluded that the company was acting as an intermediary within the meaning of both the UK and the EU legislation, and HMRC had never properly addressed the legal basis for their decision. The appeals were allowed.

First Tier Tribunal (TC01545): *Firstpoint (Europe) Ltd*

4.2.5 Carpentry

HMRC enquired into the turnover history of a carpenter who lived in London. They concluded that he had breached the registration threshold of £61,000 in the 12 months to July 2006, and issued a notice of compulsory registration with effect from 1 September 2006. This led to an assessment for arrears of £13,170, calculated on the basis that the turnover was VAT-inclusive because the customers were mostly private individuals to whom the carpenter did not propose to issue further invoices.

The trader appealed, claiming that the turnover included services which were supplied to customers in the Republic of Ireland. As they involved work on goods and construction services, the place of supply would be Ireland, and the turnover should not count towards the UK registration threshold. HMRC did not accept the evidence that the trader produced in support of this, but the Tribunal considered that it was credible and sufficient. The appeal was allowed.

First Tier Tribunal (TC01600): *R Carville*

4.2.6 Article

In a festive article in *Taxation*, Neil Warren considers a number of issues which would arise if Santa decided to rent out his reindeer as a means of transport – these would include place of supply, registration and business splitting.

Taxation 14 December 2011

4.3 International supplies of goods

4.3.1 Low Value Consignment Relief

In the March Budget, the lower limit for imposing VAT on postal imports ('low value consignment relief') was lowered from £18 to £15 with effect from 1 November 2011. This was intended to reduce the exploitation of this limit by businesses selling goods in competition with UK retailers.

Now it has been announced that LVCR is to be removed altogether for imports from the Channel Islands from 1 April 2012. HMRC have published frequently asked questions on their website about the change. They believe that businesses have exploited the relief in relation particularly to cosmetics, cut flowers, video games, health supplements, PC consumables (e.g. printer cartridges), stationery, greetings cards, clothing, toys, sports accessories and contact lens solutions. 75% of all international parcel post to the UK from outside the EU is estimated to originate in the Channel Islands. They believe that other advantages of doing business with the UK from the Channel Islands will prevent businesses simply relocating elsewhere to continue to exploit LVCR, which will remain at £15 for postal imports from other non-EU countries.

http://www.hmrc.gov.uk/news/removal-lvcr.htm; www.hm-treasury.gov.uk/d/vat_low_value_consignment_relief.pdf

David Gauke, Exchequer Secretary to the Treasury, explained the change as follows:

These reforms will ensure that UK companies, especially small and medium sized enterprises, can compete on a level playing field with those larger companies with the resources to set up operations in the Channel Islands. We are also protecting a significant amount of tax revenue [estimated cost of LVCR is currently £140m a year]. *By making these changes, we are striking the best possible balance between the costs of collecting small amounts of VAT and protecting the interests of UK taxpayers and businesses.*

http://www.hm-treasury.gov.uk/press_122_11.htm

HMRC have also issued a new version of their *Guide for international post users*, replacing the July 2011 edition. New features include a table to list the customs charges applicable to goods according to their value and a link to Form BOR 286, which is used to request a refund of customs charges when goods are imported by post.

Notice 143

4.3.2 Onward supply/returned goods reliefs

In February 2009 HMRC assessed a company for customs duty of £8,705 and import VAT of £19,900 in relation to cars which had been imported in 2007. The Tribunal considered the background to the arrival of three "batches" of cars with different circumstances, and also the director's assertion that he had a number of agreements with HMRC that particular rules on importation would not be rigidly applied. The Tribunal did not agree that he had any legitimate expectations that would bind HMRC not to follow the law.

The Tribunal decided that he did not meet the conditions for onward supply relief, because that would require a number of formalities including the completion of EU Sales Lists. However, if the appellant paid the import VAT he would then be in time to claim it back, if he could show that he had despatched the vehicles on arrival to a German registered customer (as he claimed).

The Tribunal was satisfied that one batch of 18 Renaults were reimported within 3 years of their export from the EU, and they were therefore not liable to customs duty because of Returned Goods Relief. However, the other two batches of cars were subject to duty because there was no evidence that they qualified for RGR (indeed, the evidence suggested that they were probably exported much longer ago).

In respect of one vehicle, the appellant claimed that he had only handled the paperwork for the importation, which remained in the ownership of a Russian oligarch. If that was true, HMRC would not have enforced the 3 year rule – but as the appellant was a dealer and he appeared to be acting as importer, he was liable.

First Tier Tribunal (TC01500): *Radford Racing Ltd*

4.3.3 Post clearance demand

Some similar issues arose in a case about hot tubs which were being imported from the USA to the UK and sent on to EU and non-EU European countries. HMRC assessed the company on the basis that it was merely acting as a freight forwarder and was not allowed to claim onward supply relief (which requires that the claimant makes a zero-rated supply of the goods themselves, rather than simply despatching them on behalf of someone else). The company argued that it was acting at all times as an agent of the US supplier and was therefore entitled to claim.

The Tribunal examined the evidence and decided that, on the balance of probabilities, the company was only acting as a freight forwarder. Even if that were not the case, HMRC's decision on the basis of the evidence available to them was a reasonable one, and they would not be unjustly enriched by charging the VAT in these circumstances.

First Tier Tribunal (TC01624): *Big Misters Shipping Co*

4.3.4 Customs procedure 42

The European Court of Auditors has estimated that losses of some €2.2bn arise annually (extrapolating from 7 member states reviewed in 2009) because customs procedure 42 is not adequately controlled. This is the mechanism by which an importer claims exemption from duty and VAT when imports are to be transferred immediately to another EU member state, where the duty and VAT ought to be due. The losses arise because either the goods stay in the original member state without duty being paid, or else move to the second member state without duty being paid.

The ECA recommended the following actions:

- amend the Customs Code Implementing Provisions to implement uniform communication of the complete VAT data for each intended transport;

- importers should be held jointly and severally liable for VAT losses in the Member State of destination when the VAT statement is not submitted by them;
- the Member States' custom electronic clearance system should carry out automatic verification of VAT data;
- create a common EU risk profile for these imports; and
- legislation should be changed to improve the exchange of information necessary for correct charging of VAT in the Member State of destination.

eca.europa.eu/portal/pls/portal/docs/1/10582726.PDF

4.3.5 Sailaway boats

HMRC have issued a Brief to remind businesses and the public that UK residents can no longer purchase a boat using the VAT Sailaway Boat Scheme from 1 January 2012. The Brief explains the background to the change, which ends a concession because HMRC believe that it contravened EU law.

It will still be possible for a business to zero-rate the direct export of a boat where the business itself delivers the boat outside the EU, or makes the necessary arrangements and obtains evidence of export within three months of the supply. It will also still be possible for an overseas resident to obtain a VAT refund under the old Sailaway Boat Scheme. The change means that it will no longer be possible for a UK resident customer to obtain a VAT refund on the basis that it will be kept outside the EU.

R & C Brief 38/2011

4.3.6 New Means of Transport

An individual purchased a new car in Germany, transported it to the UK where it was registered, then took it to Spain. HMRC argued that the car was chargeable to VAT in the UK. The individual was not present or represented, having asked for the matter to be recategorised as a “default paper” appeal – but HMRC wanted a hearing, so the appeal was heard in his absence. However, the Tribunal concluded that there was a possibility that the car was in fact subject to Spanish VAT, and asked the owner to make further written submissions.

The Tribunal examined some contradictory evidence and the rules on NMTs, as well as the precedent case of *X v Statteverket* (Case C-84/09). It decided that, on the balance of probabilities, the acquisition of the car was in the UK for the purposes of the European legislation, and the appeal was therefore dismissed.

First Tier Tribunal (TC01455): *Ian Feltham*

4.3.7 Tackling fraud on road vehicles

Following consultation, the government has confirmed that measures will be introduced to take effect in 2013 to prevent VAT evasion on road vehicles imported for use on UK roads. The entry of the vehicle will have to be reported to HMRC before it can be registered with DVLA.

www.hm-treasury.gov.uk/d/vat_evasion_road_vehicles.pdf

A summary of responses to the consultation document has been published. A number of changes to the original proposals has been made as a result of the responses, including an extension of the notification period to 14 days, allowing paper notification as an alternative to online (although that will be the norm), and changes to the requirements to pay the VAT where HMRC deem it to be "non-secure".

It is interesting to note that the "stakeholders consulted" include the US Air Force as well as motor industry bodies.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_031787

4.3.8 Intrastat submission

HMRC have published a Tax Information and Impact Notice (TIIN) about the new mandatory requirement for Intrastat declarations to be submitted electronically. Draft legislation has been issued which is intended to take effect on 1 April 2012. At the same time, the due date will change from the end of the month following the reporting month to the 21st of the month following.

http://www.hmrc.gov.uk/thelibrary/emandation.pdf;
http://www.hmrc.gov.uk/thelibrary/intrastat-duedates.pdf

It has been announced that the thresholds for submitting Intrastats will remain unchanged from 1 January 2012 at £250,000 for dispatches and £600,000 for arrivals. The delivery terms threshold remains £16m.

For declarations with a reference period of January 2012 onwards, the low value consignment threshold rises from £130 to £180, and there are other minor changes to reporting codes which are explained in a R&C Brief and in Notice 60.

R&C Brief 44/2011

4.3.9 Article

There is an article by Neil Warren about the *X* and *Facet* cases and the so-called "fallback rule" for acquisitions in *Taxation*, 6 October 2011.

Taxation, 6 October 2011

4.3.10 Updated Notice

HMRC have issued a revised version of their notice on the *VAT Personal Export Scheme*. It replaces and cancels two previous notices, 705 and 705A. This scheme allows motor vehicles to be supplied in the UK free of VAT if they will soon be exported to a destination outside the EU.

Notice 707

4.3.11 Reader's Query

A Reader's Query in *Taxation* considers the problem of a Dutch business importing goods from China which are found to be surplus to requirements. Rather than returning them to China, they are then shipped to the UK on behalf of the Chinese business. The answers explain that it is essential to work out who has acted as importer and at what point. It may be possible to achieve a simple result if the Dutch business acts as the Chinese supplier's agent, but the facts may have already made such a solution impossible.

Taxation 24 November 2011

4.4 European rules

4.4.1 Green Paper responses

The Commission has published a summary of responses to the Green Paper consultation on the future of VAT. Two-thirds of the responses came from Sweden, where a national campaign spread a misunderstanding that the consultation related to the possible recategorisation of non-profit organisations as taxable persons. The Commission states that this was not the point and these responses have therefore been disregarded in the document.

http://circa.europa.eu/Public/irc/taxud/baggage/library?l=/results_consultation/1417007-sy_consultation/_EN_1.0_&a=d

On 6 December the Commission adopted a Communication on the future of VAT which stated that the system must be made more workable for businesses; it must be made more efficient in supporting Member States' fiscal consolidation efforts and sustainable economic growth; and the huge revenue losses that occur today due to uncollected VAT and fraud must be stopped.

http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/key_documents/communications/com_2011_851_en.pdf

4.4.2 List of things to do

The European Commission's work programme for 2012 includes an intention to protect public revenues in the area of VAT fraud. This includes adoption of a "quick reaction mechanism" which will allow member states to apply for a derogation to deal with emerging threats more quickly.

IP/11/1134

4.4.3 Different limitation periods

Following on from the Advocate-General's opinion in the last update, the CJEU has now considered the problems for the general VAT principles of effectiveness, non-discrimination and tax neutrality if there is a significant difference between the time limits within which a customer can claim back overpaid VAT from a supplier (in the UK, generally six years) and a supplier can claim back the same overpayment from the authorities (in the UK, four years). The Italian law has a similar discrepancy in the time limits and provides no mechanism for resolving the unfairness that might arise if a customer obtained a court order requiring reimbursement from a supplier who would then be out of pocket.

The Advocate General considered that such a situation can comply with EU law provided that the national law is applied in accordance with the principles of legal certainty, the protection of legitimate expectations, and the respect for property rights. The full court ruled that the law would satisfy the principle of effectiveness only if "it is possible for that taxable person effectively to claim reimbursement of the VAT from the tax authority. That condition is not satisfied where the application of such rules has the effect of totally depriving the taxable person of the right to obtain from the tax authority a refund of the VAT paid but not due, which the taxable person has himself had to pay back to the recipient of his services".

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

4.4.4 Input tax standstill rules

A Netherlands tax adviser objected to a new law which restricted the input tax deduction on cars with mixed business and private use. The Netherlands had such a law when the 6th Directive took effect, but increased the level of disallowance at a later date.

The Advocate-General has given an opinion that this is in breach of the "standstill" rule in art.17(6) (which permits member states to retain but not extend blocking orders in force when the Directive entered into force). If the result is a greater block than is necessary to reflect the private use of the car, the national court should disapply the domestic provision.

CJEU (A-G) (Case C-594/10): *T.G. van Laarhoven v Staatssecretaris van Financiën*

4.4.5 Parliamentary resolution

A resolution passed by the EU Parliament called for:

- measures to fight VAT fraud, said still to cost the EU €100m a year;
- simplification for SMEs, some of which say they prefer to deal with non-EU counterparties because the VAT regulations are easier;
- more incentives in the VAT system for "green" products.

http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2011-0436&language=EN

4.4.6 Italy taken to task

The Commission has issued a reasoned opinion to formally request Italy to implement:

- the Principal VAT Directive 2006/112/EC;
- Directive 2009/162/EU, which made amendments to the Principal Directive to provide more consistent application of principles across the EU; and
- Directive 2009/162/EC, which made provisions to fight against tax fraud in relation to certain imports.

http://ec.europa.eu/eu_law/infringements/infringements_en.htm

The Commission has also commenced infringement proceedings against Italy in relation to its exemptions for ships – these are in some areas too wide and in others too narrow, and the Commission has applied for a direction that they should be amended to comply with the Directive.

http://ec.europa.eu/eu_law/infringements/infringements_en.htm

The Advocate-General has given an opinion that Italian procedural rules, under which the state may abandon a case which appears to be going against it, are acceptable under EU law and do not amount to a waiver of tax that ought properly to be collected. The rule applies where the authorities have been unsuccessful at both the first and second instance appeals and the case has taken more than 10 years to reach the third level – the upper court concludes the appeal without making a decision on the substance, and the taxpayer effectively wins by default.

The question arose in relation to a disputed VAT liability for a period in 1980 or 1981 (the year of liability was part of the dispute) which had been settled in the taxpayer's favour at the first appeal in 1986 and the second in 1990. The tax authority brought a further appeal in July 1990 but nothing happened until 2008, when the authority confirmed that it was still pursuing the matter.

The Advocate-General's opinion distinguishes this rule from the general amnesty which was found to be in breach of Italy's community law obligations in case C-132/06. That related to the administrative procedures for which the state was primarily responsible; this related to judicial procedures, and only to individual cases. There was a possible issue with the doctrine of fiscal neutrality, but overall the law did not appear to breach the Directive.

CJEU (A-G) (Case C-500/10): *Ufficio IVA di Piacenza v Belvedere Costruzioni Srl*

4.4.7 Human rights and VAT

A Moldovan company appealed against a VAT liability on the basis that its supplies were exempt under the law in force at the time. The Moldovan courts found in its favour in 2002. In 2005, the Ukrainian Parliament changed the law, and the tax authorities reassessed the tax, arguing that the amendment had retrospective effect. After the Ukrainian Supreme Court ruled in favour of the tax authorities, the company appealed to the European Court of Human Rights (which has jurisdiction over a wider group of countries than the EU).

The ECHR agreed that it was contrary to article 6 of the European Convention on Human Rights and article 1 of the First Protocol to give retrospective effect to legislation and thereby reverse a decided case decision.

ECHR (Case 7359/06): *Agurdino Srl v Moldova*

4.4.8 Bulgaria taken to task

The Commission has issued a reasoned opinion to formally request Bulgaria to change rules which it considers to be discriminatory against international traders and therefore contrary to the VAT Directive. Traders involved in intra-Community transactions have to wait twice as long after the end of a tax audit before they are entitled to receive a VAT refund. If they wish to receive the repayment earlier, they have to deposit a security or guarantee for twice as long.

IP/11/1276

4.4.9 French rules acceptable

A French taxpayer was liable for import VAT but failed to pay it, and the claim against it became time-barred. Nevertheless the taxpayer claimed to deduct the import VAT that had never been paid to the authorities. In France, deduction is conditional on actually paying the VAT. The taxpayer argued that the right to deduction under the Directive is absolute, but the Advocate-General has given an opinion supporting the French rules. A rule requiring payment of import VAT before deduction is allowed is not generally permitted under the Directive, but can be maintained as a transitional measure; and VAT is only deductible as input tax where the claimant has a civil obligation to pay that VAT. Where the statute of limitations has run out, the unpaid liability is not VAT and cannot be deducted.

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

4.4.10 French rules unacceptable

The CJEU has granted the Commission a declaration that France is in breach of its obligations under the VAT Directive in allowing a derogation from the reverse charge procedure to businesses which are not established in France, provided that they appoint a tax representative there. Such traders must apply for a VAT identification in France, and the law permits "the offsetting of the deductible VAT of the seller or provider against the VAT collected by one or more of his or her customers". The Commission objected to all these measures as infringing a number of articles of the Directive. The Court agreed that articles 168, 171, 193, 194, 204 and 214 were all breached.

CJEU (Case C-624/10): *Commission v French Republic*

4.4.11 Portugal, the Netherlands, Finland and Poland taken to task

The Commission has applied to the CJEU for a declaration that Portugal's implementation of the tour operators rules is not consistent with the Directive. The particular problem is that the Portuguese scheme allows supplies to persons other than travellers (i.e. other travel agents) to be included within the margin scheme.

CJEU (Application) (Case C-450/11): *Commission v Portuguese Republic*

The Commission has also applied to the CJEU for a similar declaration in relation to the Netherlands rules on tour operators, although the very brief application does not spell out which particular aspect of the local scheme is objectionable.

CJEU (Application) (Case C-473/11): *Commission v Kingdom of the Netherlands*

The Court has granted orders concerning Finland's and Poland's versions of TOMS, which allow the scheme to apply to sales between businesses. The judgment has not been issued in English, but it appears that the Court has upheld the Commission's position.

CJEU (Case C-309/11): *Commission v Republic of Finland;* (Case C-193/11): *Commission v Republic of Poland*

4.4.12 Adjustment of deduction required?

Where an input is not subsequently used to make taxable supplies, an adjustment of deduction is generally required. However, art.185(2) provides an exception where goods have been stolen. Questions have been referred by the Bulgarian court to clarify the meaning of the conditions which apparently apply to this exception:

1. In which cases is it to be assumed that there is a theft of property duly proved or confirmed within the meaning of Article 185(2) of Directive 2006/112, and is it necessary in that regard that the identity of the perpetrator has been established and that that person has already been finally convicted?

2. Depending on the answer to the first question: does the expression 'theft of property duly proved or confirmed' within the meaning of Article 185(2) of Directive 2006/112 cover a situation such as that in the main proceedings, in which a pre-litigation procedure for theft was initiated against person or persons unknown, a fact that is not disputed by the revenue collection department and on the basis of which it has been assumed that there is a shortfall?

3. In the light of Article 185(2) of Directive 2006/112, are national legal provisions such as those laid down in Articles 79(3) and 80(2) of the Law on VAT and a tax practice such as that adopted in the main proceedings permissible, under which the input tax deduction made on the acquisition of goods which are subsequently stolen must be adjusted, if it is assumed that the State has not made use of the power afforded to it to provide expressly for adjustments to the input tax deducted in the case of theft?

CJEU (Reference) (Case C-550/11): *ET 'PIGI – P. Dimova' – P. Dimova v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' - Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite*

4.5 Eighth Directive reclaims

4.5.1 Updated Notice

HMRC have completely rewritten their Notice on *Refunds of VAT in the European Community for EC and non-EC businesses*. Directive 2008/9/EC has replaced the 8th Directive with the new electronic refund procedure, and the new notice fully explains the new procedures. The 13th Directive (86/560/EEC) continues to apply to refund claims from businesses established outside the member states.

Notice 723A

4.5.2 Out of time

In November 2009 an American businessman submitted a Form VAT 65A to reclaim VAT incurred in the UK. It was initially rejected by HMRC on the basis that it was unsigned and there was no certificate of status attached. It was sent back on 10 November 2009 with a warning that the deadline for claiming in relation to the year to 30 June 2009 was 31 December 2009. The signed form and certificate were not returned until February 2010.

The trader tried to rescue the situation by arguing that the expenses were billed on 15 April 2009 but were not due for payment until 15 August 2009. If the costs could be moved to August 2009, a claim could be made by 31 December 2010. The Tribunal rejected this – the invoice date fixed the time of supply in advance of the delivery or due payment dates.

The appellant also argued that the supply was education and therefore should have been exempt. The judge commented that this was a matter for the supplier, the Said Business School (a wholly-owned subsidiary of Oxford University). If the appellant could persuade the school that it had overcharged him, he could recover the VAT from them.

The judge also commented that the processing of 13th Directive claims follows a 'strict approach'. Although this appellant suffered some delays in the USA in obtaining his certificate of status, he had had 8 months in which to do this, and the judge did not think that was unreasonably short.

First Tier Tribunal (TC01419): *Robert H Smith Investments & Consulting*

5. INPUTS

5.1 Economic activity

5.1.1 A share of intellectual property rights

Two Slovakian companies (T and V) jointly applied to patent an invention (26 February 2007). They then entered (5 July 2007) into an agreement whereby one (V) would assign its rights under the patent (which had not yet been registered) to the other (T) in return for a payment. V raised a VAT invoice and T claimed a deduction. The tax authorities refused to allow this, noting that T and V were registered at the same address and had the same managing director. T had also not paid the input tax over to V. V was placed in administration in 2008.

The deduction claimed was for SKK 73.5m, which is approximately £2m.

The dispute over the deduction of the VAT was referred to the CJEU. The question was not the most obvious one: it asked whether there was a right of deduction where the assignee of an intellectual property right (i.e. T) was already a co-owner of that right and therefore presumably could enjoy the benefits of ownership anyway.

The Court commented that it was for the national court to determine the legal consequences of an assignment of rights in an unregistered patent. If there was a genuine and legally effective transfer of rights in return for consideration, there was in principle a taxable transaction and therefore a right of deduction. The fact that the transactions may have had the obtaining of a tax advantage as a motive did not make any difference.

The Court also passed back to the national court the responsibility for determining whether the transactions constituted an abuse of rights. It highlighted the possible factors which might indicate this: the fact that the invention at issue has not yet been registered as a patent, that the right to that invention is enjoyed by a number of persons most of whom are established at the same address and are represented by the same natural person, that the input VAT payable has not been paid and that the company which assigned the share of co-ownership was placed in administration.

CJEU (Case C-504/10): *TANOARCH s.r.o. v Tax Directorate of the Slovak Republic*

5.2 Who receives the supply?

5.2.1 Payment to release customer from obligations

A company (C) supplied office equipment. Many of its customers used finance leases. Sometimes the goods became obsolete before the end of the lease term. On four occasions, C made a payment to the lease company to terminate the leases early. The lessor issued VAT invoices to C, which claimed input tax. HMRC disallowed this, ruling that it was in respect of a supply that had been made to the customer, not to C.

The Tribunal considered that the payment by C were an inseverable part of its supply of new equipment to the customer. It had to make sure that the previous lease liabilities were settled in order to allow a new deal to happen. That was clearly in its commercial interests and something that it did in the course of making taxable supplies of equipment. It was therefore entitled to deduct the input tax charged by the lessor.

Although the customer was the person liable under the original lease, the deal to supply the new equipment included obligations imposed upon C to make sure that the lease was terminated. It was therefore possible to distinguish the situation from that in *Loyalty Management* (Case C-53/09), where the Nectar promoter was held to have received nothing in relation to the supply of redemption goods or services to participants in the scheme.

First Tier Tribunal (TC01503): *Canotec Ltd*

5.3 Partial exemption

5.3.1 House wins again on PESM in Court of Appeal

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.

HMRC tried again in the Court of Appeal, arguing that the Upper Tribunal had come to an unreasonable decision and had failed to follow the correct approach. The Court dismissed this argument, holding that the Tribunal had understood and applied the law correctly. There was a finding of fact that the catering activity, while not profitable at present, was nevertheless a business in its own right, independent of the gaming activity. That finding could not be disturbed and was justification for the decision that the PESM was fair and reasonable.

Court of Appeal: *London Clubs Management Ltd v HMRC*

5.3.2 Special method approved

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

"*In most HP transactions, the goods are resold at cost without any margin to cover overhead costs. As there is no margin on the HP goods, the cost of the overheads will normally be built into the price of the supply of credit. In this scenario, HMRC's view is that the overheads are purely cost components of the exempt supply. Otherwise the business would continually enjoy net VAT refunds despite:*

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

This Brief was later reissued as RCB 82/2009.

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

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

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

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

Presumably this will make HMRC look again at their policy on HP finance. They will have to decide whether to accept defeat, or to appeal and defend RCB 82/09 in the Upper Tribunal.

First Tier Tribunal (TC01401): *Volkswagen Financial Services (UK) Ltd*

5.3.3 University guidelines

A Cambridge college used the method known as the "CVCP Guidelines" in preparing its VAT returns over a number of years. This was effectively a generally agreed partial exemption special method for colleges which had been negotiated between the Committee of Vice Chancellors and Principals and Customs & Excise. It made a voluntary disclosure to reclaim further input tax, arguing that the CVCP guidelines did not give it proper relief for capital expenditure. HMRC repaid some of this, then assessed the college to claw it back again.

The CVCP guidelines are effectively a type of flat rate scheme. Colleges are entitled to deduct as input tax a percentage of the output tax chargeable on three "tunnelled" areas of taxable activity, rather than calculating actual input tax and apportioning it. The original agreement was withdrawn by HMRC in 1997 because a number of higher education establishments had made retrospective claims outside the guidelines; HMRC announced that formal PESMs would have to be agreed in writing.

Magdalene College submitted a claim in 2003 for a repayment of input tax going back to 1973 based on a new suggested PESM. It appealed against HMRC's refusal of this claim. It made a further claim in 2005 in respect of input tax allegedly underclaimed from 2002 to 2005. HMRC paid some of this but refused the remainder, and the college appealed against that refusal (but dropped that appeal in 2010 – that element was not before this Tribunal). In 2007, after winning (mostly) a Tribunal case involving two Oxford colleges ((VTD 20,233: *Wadham College Oxford and Merton College Oxford*), HMRC wrote to Magdalene stating that the repayment would be clawed back. The college appealed against that decision.

On appeal, the Tribunal had to consider four issues:

- whether the 2003 reclaim was correct in principle, i.e. the CVCP guidelines did not allow for all expenditure of the college – if so, it was effectively covered by the *Fleming* transitional period and should now be paid;
- whether the way in which the CVCP had been operated produced the correct result (i.e. even if the expenditure was within the CVCP guidelines, was the college still entitled to more input tax?);
- whether the clawback assessment was in time;
- whether the college had a legitimate expectation of being allowed to keep the money following HMRC's acceptance of the voluntary disclosure, in that the claim had been fully verified before being settled and had been paid in accordance with HMRC's policy at the time.

Sir Stephen Oliver considered that, with the very limited exception of the capital goods scheme, VAT makes no distinction between revenue and capital expenditure. If the guidelines did not cover capital expenditure, they would surely have said so explicitly. Although the percentages allowed might have become unfair at some point between 1973 and 2003, they had nevertheless been agreed between the taxpayer and Customs (by the taxpayer operating the guidelines) and it was not open to the taxpayer to change an agreed special method retrospectively.

The Oxford college decisions had raised the possibility that there might be “gaps” in the “tunnel” approach – taxable activities that had not been taken into account and which should therefore justify additional input tax recovery – but that did not extend to gaps in the inputs. Capital expenditure was covered by the method, and unless the college identified other taxable income that had not been taken into account, there was no basis for an additional claim. This dealt with the first and second issues.

HMRC had agreed to pay £223,974 of the 30 September 2005 reclaim on 20 July 2006. The clawback assessment was raised on 28 September 2007. The college argued that the time limit ran from the end of the return periods to which the reclaim related – September 2002 to March 2005. The college argued that HMRC had had all the information for more than a year, and the Oxford colleges decision could not be a “new fact” that would start the 12 month limit running again.

The Tribunal relied on the Court of Appeal’s decision in the 1996 case of *Croydon Hotel & Leisure Co Ltd v Customs* as authority for the proposition that the limitation period for an assessment to claw back a repayment ran from the period in which the claim was originally made, not the period for which the claim was made. The precedent quoted by the college (*Laura Ashley Ltd v Customs*, HC 2004) had turned on a different question (whether the fact that an assessment was raised for the wrong period invalidated it). The assessment was therefore in time because it had been raised within 2 years of the return period in which it had been made.

Sir Stephen decided that the Tribunal did not have jurisdiction over the question of legitimate expectation. He considered that the remarks of Sales J in the *Oxfam* case, on which the taxpayer’s views on the validity of an appeal based on legitimate expectations were founded, were non-binding “obiter dicta”. Instead, he considered himself bound by other precedents that suggested the Tribunal did not have such jurisdiction (e.g. the 2003 HC decision in *National Westminster Bank plc v Customs*).

Nevertheless, he also commented on the college’s claim that it had been unfairly treated, and disagreed with it. He did not see the statements that the college relied on as binding on HMRC; there were general statements about not applying changes of policy retrospectively against taxpayers, but not a “clear, ambiguous and unqualified representation” that the repayment was made without reservation or the possibility of a clawback.

The college therefore failed on all points.

First Tier Tribunal (TC01522): *The Master and Fellows of St Mary Magdalene*

5.3.4 Farmhouse sale

A farmer sold her farm after the cessation of trade, incurring £11,122 of professional fees, which she claimed as input tax on her return. After a visit, an officer stated an intention to assess £8,100 of this as residual input tax which was apportioned to exempt supplies. The farmer accepted the offer of a review, which resulted in the assessment being increased to cover all the input tax claimed.

The taxpayer's representative argued that there was a sufficient link between the sale of the farm and the past taxable supplies by the farm to make the input tax residual. The Tribunal did not agree: there was a clear and immediate link between the expenses and an exempt supply, and the authority of cases such as *Midland Bank* and *BLP Group* required the input tax to be attributed in that way. The appeal was dismissed.

First Tier Tribunal (TC01519): *Mrs L A Parkhouse*

5.3.5 Capital goods scheme considered

A company (T) appeared to achieve a fortunate result in a dispute about the operation of the capital goods scheme. It had purchased four aircraft hangars in June 2004, paying VAT of £332,500 (which was charged at the last minute by the vendors – it appears that the directors did not fully understand the consequences). The hangars were used by the company itself and by associated companies. In October 2006 T transferred the property to an associated company and treated the supply as exempt. HMRC raised an assessment to claw back input tax of £232,750 under the CGS.

The company appealed, arguing that this was the wrong assessment. In fact, it should not have claimed this input tax back to start with, as its intention was always to put the buildings partly to exempt use. This should have been taken into account in the year of acquisition using the standard method override, leaving the initial recovery "correct" and avoiding the need to make any further CGS adjustments. It was too late to make such an amendment by the time HMRC raised the issue in 2008, and clearly much too late in 2011.

The Tribunal accepted these contentions. There had been no change of intention and therefore nothing that ought to trigger the CGS. Although this may seem a surprisingly favourable decision, the company's accountants pointed out at an early stage that there was no reason for the company to suffer "sticking VAT" – all its trading activities were taxable, and it could have avoided any exempt activity by forming a VAT group or opting to tax. These are things that cannot be done after the event to correct an error, so the alternative "wrong assessment" argument has worked instead to achieve "the right result".

First Tier Tribunal (TC01543): *Turbine Motor Works Ltd*

5.3.6 Updated Notice

HMRC have issued an updated version of the notice on the *Capital Goods Scheme*, replacing the January 2002 edition. Although it does not list the amendments, it reflects the major rewriting of the law which took effect from 1 January 2011. It also covers the transitional rules which will continue to apply to CGS assets purchased before 1 January 2011 until the end of their adjustment period.

Notice 706/2

5.3.7 Holding company input tax

The Portuguese court has referred some interesting questions about the way in which holding companies are treated for partial exemption purposes:

(a) Is Article 17(2) [6th Directive] to be interpreted as precluding the Portuguese tax authorities from requiring the appellant, a holding company, to use the pro rata deduction method for all the VAT incurred in its inputs, on the basis of the fact that the main corporate purpose of that company is the management of shareholdings of other companies, even when such inputs (acquired services) have a direct, immediate and unequivocal relationship with taxable transactions - supplies of services - which are carried out downstream in the context of the complementary activity of supplying legally permitted, technical management services?

(b) May a body that has the status of a holding company and is subject to VAT on the acquisition of goods and services that are thereupon wholly transmitted to companies in which it has a holding, with payment of the VAT, when that institution combines the main activity it carries out (management of shareholdings) with an accessory activity (supply of technical administration and management services), deduct all the tax incurred in respect of those acquisitions by applying the method of deduction based on actual use set out in Article 17(2)?

CJEU (Reference) (Case C-496/11): *Portugal Telecom SGPS, SA v Fazenda Pública*

5.4 Cars

Nothing to report.

5.5 Business entertainment

5.5.1 Entertainment or advertising?

A company held a launch party for a new cruise ship attended by 2,336 people, including Sophia Loren who christened the liner. It claimed back input tax of £111,000, arguing that the party was either "advertising" or "a product demonstration" rather than business entertainment. The Tribunal said that this distinction did not matter: the definition of entertainment ("hospitality of any kind") was very wide, so expenditure could be in either of the categories claimed and still be business entertainment. The input tax was blocked.

It is interesting to note that the original claim was made under the 13th Directive, as the claimant was a Swiss company. The party had been organised by a UK company and held at Dover. HMRC had ruled that the UK company organising the event had to charge VAT because the place of supply was not shifted to where the customer belongs. Following the implementation of the VAT package, it might be argued that this could be an ordinary B2B service; but presumably there will be a list of people who are permitted to attend, and even if they are not paying personally for the right of admission, the cruise ship company would be. The Tribunal noted that the issue of place of supply was not included in the notice of appeal and the Tribunal therefore did not have jurisdiction to consider it, but the chairman expressed the opinion anyway that the service of the organiser did not constitute an advertising service.

There was also a question about the jurisdiction of the Tribunal to hear appeals about the question of whether particular expenditure was a luxury, amusement or entertainment. According to s.84(4) VATA 1994, such an appeal can only succeed if the appellant shows that the Commissioners have acted unreasonably. The appellants put forward a number of arguments to show that this was the case; however, the Tribunal did not accept any of them. As the chairman agreed with the conclusion, he was unlikely to find that it had been arrived at unreasonably.

The appellant also tried to make something of R & C Brief 44/2010 on entertainment of overseas customers. The launch party included travel agents, journalists, celebrities, competition winners, royalty and two of the Appellant's directors; there was no evidence that any of them were overseas customers. The appeal was dismissed.

First Tier Tribunal (TC01598): *CI Cruises International SA*

5.5.2 Updated Notice

HMRC have issued an updated version of the notice on *Business Entertainment*, replacing the May 2002 edition. The main change is the incorporation of the revised rules and policy on entertaining overseas customers as set out in R & C Brief 44/2010. The notice explains the meaning of "entertainment", the distinction between employees and others, and the extent to which entertaining expenditure gives rise to input tax recovery.

Notice 700/65

5.6 Non-business use of supplies

Nothing to report.

5.7 *Bad debt relief*

5.7.1 Credit note or bad debt?

A car dealership company (B) sold Ford cars. B had no corporate relationship with Ford. In 2002 B went into receivership. It held a number of cars for which it had not paid F. In accordance with the supply agreement between the two companies (which was terminated if either party went into an insolvency procedure), F reclaimed the cars and issued credit notes. The supply agreement contained a "retention of title" clause which was legally effective and which entitled F to recover its cars in priority to other creditors.

B's receivers needed to continue the business in order to try to sell it as a going concern, for which they needed stock. They agreed with F that, after the credit notes had been issued, F would re-sell the same cars to the receivers on the same terms. In effect, F exercised its rights under the supply agreement by issuing the credit notes, but then decided to carry on a new informal supply agreement with the receivers. The cars were not physically repossessed by F.

B's receivers subsequently submitted a claim for repayment of input tax in respect of these cars. The Commissioners rejected the claim and B appealed, contending that the credit notes should not have been treated as effective for VAT purposes (cancelling the input tax entitlement in the pre-insolvency period), and that F should have claimed bad debt relief instead. This would have benefited B because B would not have had to repay the input tax under the usual bad debt rules if an insolvency procedure commenced between the input tax claim and the six month deadline at which F would make its claim.

This was particularly important to the administrative receiver from Baker Tilly, who was being sued by a secured creditor for accepting the credit notes at face value. The creditor, NatWest, argued that the proper treatment would have resulted in a much higher recovery for itself. The administrator therefore claimed back the VAT essentially in order to pay NatWest, using the argument put forward by NatWest in its lawsuit.

The Tribunal rejected this contention and dismissed B's appeal, holding that the credit notes had been correctly issued and that F could not have claimed bad debt relief since it had legally (if not physically) "recovered" the cars in accordance with the supply agreement. The original supply had been reversed, so there was no input tax for B to claim. However, it was not a straightforward case: the company's counsel had argued strongly from precedent cases that the supply did not cease to be a supply because of the retention of title clause, and the reclamation of the cars by F was not a supply either.

The High Court confirmed the Tribunal's decision. The parties had agreed that the first supply agreement had been rescinded, cancelling the original supplies, and the credit notes were validly issued on that basis.

In early 2009, the Court of Appeal remitted the case to the Tribunal for reconsideration. The credit notes would only have the effect of cancelling the original supply (and therefore cancelling the associated right to input tax) if there was a contractual agreement between B and F that the supply should be cancelled. The original Tribunal did not consider this question:

it appeared to accept that the credit notes must be assumed to reflect such a contract, rather than questioning whether the credit notes did so.

As the Tribunal's primary findings of fact did not justify its conclusions, it should examine the case again. It was possible that it would come to the same answer, but it was also possible that it would accept the taxpayer's argument: F acted unilaterally in repossessing the cars and issuing the credit notes, and B accepted that conduct not because of a contractual agreement but because it had neither the power nor the commercial incentive to do anything else.

The case was further complicated by the death of the original Tribunal chairman to whom it was remitted; Judge Nowlan then could not agree with his Tribunal member, Julian Stafford, and had to reach a decision based on his own casting vote. The decision therefore repeats the facts and the possible legal analyses in considerable detail and reaches the conclusion that there was no agreement to rescind the contract. This means that the dealer has won (unless HMRC appeal again) – if there was no rescission, the credit notes were ineffective, and bad debt relief should have been claimed instead.

First Tier Tribunal (TC01432): *Brunel Motor Co Ltd v HMRC (and related appeal)*

5.7.2 Reduction in consideration or bad debt?

Cumbria County Council supplied services to DEFRA during the 2001 foot and mouth outbreak. DEFRA refused to pay in full, and the amount was finally settled by mediation. As the Council had accounted for output tax on the full amount, it made a voluntary disclosure to claim some of it back (over £220,000). This was refused on the basis that it was a bad debt claim made outside the statutory time limits.

The Council asked for a review (and then another), arguing that it was not claiming bad debt relief but an adjustment of consideration under reg.38 SI 1995/2518. There should be no time limit on reg.38 claims.

The Tribunal examined the history of the transactions, invoices and subsequent dispute. It was clear that the Council had been required to act for DEFRA without agreeing terms in advance, and found itself in disagreement about how much would be reimbursed after the event.

The Tribunal found that the settlement constituted an adjustment of consideration within reg.38 SI 1995/2518 rather than a bad debt claim. Accordingly, the time limit for such claims did not apply, and the appeal was allowed.

The HMRC officer who took the decision was criticised by the Tribunal judge for making an assertion that the settlement between the Council and DEFRA was "factitious" (by which the Tribunal understood him to mean in some way artificial and contrived) without any evidence to support it. The Council had made a valid "quantum meruit" claim against DEFRA which had been settled by genuine negotiation, and reg.38 was the proper means of adjusting the VAT to reflect it.

First Tier Tribunal (TC01463): *Cumbria County Council*

5.8 Other input tax problems

5.8.1 Another batch of carousels

The Tribunal continues to be occupied with carousel fraud cases.

A company claimed just under £3m in respect of four monthly periods from February to May 2006. The Tribunal considered that the correct standard of proof in MTIC cases remains the civil standard of "balance of probabilities". On this basis, it was more probable than not that the directors knew of the fraud.

First Tier Tribunal (TC01483): *Martem Ltd*

Three connected companies claimed £14.5m of input tax on deals between 18 April and 15 June 2006. The Tribunal concluded that the transactions were too artificial and the directors knew that they must be connected with fraud. if they did not know, there was nevertheless no other reasonable explanation, so they should have known.

First Tier Tribunal (TC01473): *Midland Mortgages Ltd and others*

Another company claimed £1.2m of input tax in June and July 2006. The Tribunal considered the "due diligence" undertaken to have been wholly inadequate if the trading had been at arm's length. The conclusion could only be that it was window-dressing and the directors knew that the transactions were connected with fraud.

First Tier Tribunal (TC01479): *A R Communications & Electronics Ltd*

Another company claimed £200,000 of input tax in July 2006 in relation to transactions in semiconductors. A small assessment was also in dispute. The Tribunal accepted that the trader had sincere intentions and had not intended to become involved in a fraud. However, he should have become suspicious when it turned out to be impossible to find any evidence of the existence of a particular type of semi-conductor that his company appeared to be trading in. It appeared that he continued to trust his suppliers and customers when it was no longer reasonable to do so, and he should have been aware that there was no other reasonable explanation than fraud.

First Tier Tribunal (TC01472): *Coracle Ventures Ltd*

A company applied for an interim payment of £60,000 while waiting for the hearing of its appeal over £1m of input tax which was denied in relation to an alleged MTIC fraud. The Tribunal refused to grant such an application, holding that doing so would effectively prejudge the outcome of the main appeal. Arguments based on the Convention on Human Rights (among other things) were rejected.

First Tier Tribunal (TC01451): *Aleena Electronics Ltd*

A company applied for an interim payment of £675,000 in relation to dealings in i-Pods and other consumer electronics in the period September 2006. It was a contra-trader in a clean chain, but the Tribunal was satisfied that the directors knew that their transactions were connected with fraud in other supply chains. As usual, the way in which the business was conducted made no sense in any other context.

First Tier Tribunal (TC01464): *J P Commodities Ltd*

A company claimed £10m in respect of transactions between 6 March and 31 May 2006. The Tribunal concluded from the evidence that the director knew perfectly well that he was entering into a dishonest trade.

First Tier Tribunal (TC01429): *Ixes (UK) Ltd*

A company claimed £550,000 in respect of the returns for March and June 2006. At the end of a massive decision (617 paragraphs), the Tribunal concluded that the director knew that the transactions were connected with fraud, even though they were "clean chain" deals taking place before the fraud in the dirty chain.

First Tier Tribunal (TC01411): *Digi Trade Ltd*

A company claimed £303,000 in respect of transactions in July, October and November 2006. At the end of an even longer decision (648 paragraphs), the Tribunal came to the same decision.

First Tier Tribunal (TC01509): *Earthshine Ltd (in liquidation)*

Two connected companies claimed £475,000 and £190,000 in respect of transactions, mainly in computer chips, in July to October 2006. The director had been convicted in 2009 of dealing in counterfeit computer goods; HMRC argued that this indicated a man who was prepared to cross the line into illegal activity.

Unusually, however, the Tribunal concluded that the director neither knew nor had the means of knowing that his transactions were connected with fraud, and allowed the appeal. He had been involved in the computer business for many years, and he appeared to be taking his due diligence procedures seriously. He had experienced extended verification of several repayment claims and had been repaid on each occasion. He had repeatedly checked the identity of counterparties with Redhill over two years and had never had an unsatisfactory result. On the balance of probabilities, the Tribunal did not think that the *Mobilx* test ("no other reasonable explanation but fraud") was satisfied.

First Tier Tribunal (TC01415): *Express Computers Ltd, Hillcraft Trading Ltd*

A company claimed £3.8m in respect of transactions in March, April and May 2006. The Tribunal considered the connection to fraud through contra-traders and decided that, although this company was in a "clean chain", it nevertheless had the means of knowing – indeed actually knew – that the transactions were wholly contrived and artificial, and were therefore likely to be tainted. Its appeal was dismissed.

First Tier Tribunal (TC01628): *Matrix Europe Ltd (in liquidation)*

A company claimed nearly £1.5m in respect of transactions in June and July 2006. The Tribunal chairman commented that it "the classic profile of a MTIC trader in that it added no value to the product; it traded back to back, with little or no risk of loss; it had a dramatically increased turnover; it was never (other than on one occasion) left holding stock; it took little account of the specifications of the phones in which it was trading; it disregarded the credit ratings of the companies with which it traded and it ignored the improbability of the phones, all of which were two-pin plug, being imported to the UK as part of a genuine trade". The Tribunal was satisfied that certain employees knew of the connection with fraud, and the only question was whether their knowledge should be imputed to the company, given that one of them was not a director. It appeared that the individual had the authority to commit the company to deals, and the company had to suffer the consequences.

First Tier Tribunal (TC01605): *Option NTC Ltd*

One appeal was unusual in that it featured the purchase of speed camera detectors rather than mobile phones or computer chips. There were just three transactions in the July 2006 period and a VAT reclaim of £241,500. The director of the company had previously worked for an organisation which ran a website for mobile phone dealers, and this was considered to indicate knowledge of the risks of MTIC fraud.

The Tribunal found the director unreliable. He claimed to have had long-standing business relationships with the counterparties, but this was not true; his due diligence appeared to have been designed to minimise the risk of a challenge from HMRC, not to provide genuine information about the transactions. The appeal was dismissed.

First Tier Tribunal (TC01577): *Bliss Trading Ltd*

A company claimed £2m in respect of transactions in April, May and June 2006. The Tribunal concluded that the director should have asked more questions, and if he had done so, he would inevitably have realised that there were significant doubts about the transactions. The decision was said to have been reached "with some hesitation", but the result was the usual one.

First Tier Tribunal (TC01579): *Annova Ltd*

A company claimed £114,000 in respect of transactions in CPUs and iPods in August 2006. Although its directors were aware of the risks of fraud in the industry, they had received a large number of visits and had never previously had a problem. They had good knowledge of the suppliers and had obtained favourable credit reports on several of them from an independent agency, which went beyond the normal due diligence of MTIC traders. Although not satisfied with all the evidence, the Tribunal held that HMRC had not made out on the balance of probabilities that the directors should have considered that the only possible explanation for the transactions was fraud.

First Tier Tribunal (TC01532): *Crucial Components Ltd*

5.8.2 Warning on subcontractors

HMRC have issued a warning to employers who take on subcontract or temporary labour through agencies to make sure that they are confident that VAT and other taxes will be paid. Some of the recommended checks are familiar from the notices about carousel fraud:

Businesses should ask:

- *Does the labour provider need/have a Gangmaster Licensing Authority (GLA) licence?*
- *What is the history of the business?*
- *Is it a live company on the Companies House register?*

- *Have you visited the trading premises? Are they consistent with the business of finding and employing workers?*
- *Do they obtain workers from other labour providers?*
- *Are their proposed fees realistic, allowing the business to meet statutory minimum wage and tax obligations and still make a profit?*
- *Do they have Employers' Liability Insurance?*
- *Are you making payments to a third party, for example a factoring agent? If so, why?*
- *Is the business VAT registered and set up for PAYE? Obtain a copy of the VAT certificate.*
- *Is the business paying its workers the National Minimum Wage?*
- *Do the workers being supplied have the right to work in the UK?*

Checks could include:

- *Check directors' identities by asking for passports*
- *Ask for copies of Certificate of Incorporation, VAT registration certificate and GLA licence*
- *Verify VAT registration details with HMRC before you use them*
- *Ask for their bank details*

HMRC believe that there is a particular risk with a likely increase in the need for temporary staff in connection with the London Olympics.

NAT 108/11

5.8.3 Toolkit

HMRC have issued an updated version of their toolkit for agents to help their clients make sure that input tax is being correctly claimed. It is supposed to be effective from 1 June 2011. The updating covers a number of recent developments, summarised by HMRC as follows:

- preventing the application of the *Lennartz* approach to purchases of land, buildings, aircraft, ships, boats and other vessels made on or after 1 January 2011;
- extending the Capital Goods Scheme (CGS) to certain purchases of aircraft, ships, boats and other vessels made on or after 1 January 2011;
- extending the CGS to require input tax adjustments to reflect changes in the level of non- business use, including private use, of assets purchased on or after 1 January 2011;
- a number of technical changes in the operation of the CGS;
- extending the requirement to make 'payback' and 'clawback' adjustments when input tax is claimed or restricted on the basis of intended levels of business use, and that intention changes before use occurs;
- the treatment of input tax incurred in the course of entertaining overseas customers;

- the introduction of formalised special methods to apportion VAT incurred for business and non-business purposes and, where businesses are required to carry out partial exemption calculations, special methods incorporating both business/non-business and partial exemption calculations.

As before, the toolkit goes through a number of "big questions" about the processing of input tax, then analyses the risks of error and the ways in which those risks can be mitigated.

http://www.hmrc.gov.uk/agents/toolkits/vat-input-tax.pdf

5.8.4 Pre-registration tax

A hairdressing salon claimed the VAT some fitting-out expenses on its first VAT return. HMRC ruled that three invoices related to services received more than 6 months before the EDR. This depended on treating "goods supplied with services" by a project manager as being incidental to those services; the company argued that it had obtained the goods in this way because the manager would be able to get the best available price, but the invoices were still purchases of goods.

The Tribunal reviewed the facts and a number of precedent cases, including *Card Protection Plan* and several that related to exactly the same issue. The chairman concluded that one of the invoices indeed related to a service; one related to goods, where the main "service" was buying the goods at a favourable price, and was therefore incidental to those goods; and one covered two independent supplies of goods and services. The appeal was therefore allowed in part.

First Tier Tribunal (TC01633): *Sassoon Bury Ltd*

5.8.5 Advisory fuel rates

The fuel-only advisory mileage rates have in recent times changed twice a year, but after changes in March, June and September 2011, HMRC announced another revision to operate from 1 December. As in September, the only change appears to be a 1p reduction in the rate for one of the bands for LPG cars, so it is not clear why they bothered.

The rates from 1 December (1 September/1 June 2011/1 March 2011 in brackets) are:

Engine size	Petrol	LPG
1400cc or less	15p (15p/15p/14p)	10p (11p/11p/10p)
1401cc – 2000cc	18p (18p/18p/16p)	12p (12p/13p/12p)
Over 2000cc	26p (26p/26p/23p)	18p (18p/18p/17p)

Engine size	Diesel
1600cc or less*	12p (12p/12p/13p)
1601cc – 2000cc	15p (15p/15p/13p)
Over 2000cc	18p (18p/18p/16p)

* 1400cc up to 31 May 2011

For the month following an announced change (i.e. the month of September) employers may use either the old or the new rate.

http://www.hmrc.gov.uk/cars/fuel_company_cars.htm

5.8.6 Diplomatic reliefs

The March 2011 Budget included an announcement that legislation would be introduced to enact indirect tax and duty reliefs for diplomatic missions, international bodies and visiting NATO forces. It has been decided not to change the existing arrangements which have this effect. New secondary legislation will be introduced to provide VAT relief for European Research Infrastructure Consortia.

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Revised Notice

HMRC have issued a revised version of their notice *Group and divisional registration*. The notice has been updated to improve readability and to amend legal references, but there have been no significant technical changes. The last update, in December 2004, reflected more substantial changes to the legislation – the eligibility conditions for joining a VAT group were amended in August 2004. There have been no similar amendments since then, although the current infringement proceedings brought by the Commission may require a review of the rules.

Notice 700/2

6.1.2 Confirmation of legislation to come

Draft legislation for a number of changes coming in the Finance Bill 2012 was published on 6 December 2011. The legislative changes will include enactment of concession 3.2.2 on the valuation of reverse charges which are supplied intra-group – the legislation as it stands would charge VAT on the whole value of services supplied to a UK company by an overseas group member, including the value of bought-in and in-house services. The intention is only to catch bought-in supplies. A summary of responses to a consultation document is available on the HMRC website.

www.hm-treasury.gov.uk/d/vat_grouping_esc.pdf

6.2 Other registration rules

6.2.1 No retrospection

A sole trader took over a business as a going concern on 1 October 2006, selling designer second-hand clothing and accessories. Following a fall in turnover she applied for deregistration on 2 November 2010. She wrote to request a repayment of the VAT accounted for on sales after 1 September 2010. She pointed out that she could in fact have deregistered at the end of 2008, but because of her annual accounts were only prepared by her accountant after her year-end, she had not realised that her turnover had fallen.

HMRC said that they could not deregister her retrospectively, so 3 November (when they received her application) was the earliest date on which she could be deregistered. The Tribunal expressed sympathy but could offer no remedy – the law was clear. She should have noticed at an earlier stage that her turnover had reduced – after all, even if the annual accounts were only prepared once a year, she could have regularly considered the total of the last four VAT returns when she submitted them each quarter.

First Tier Tribunal (TC01535): *Ilkley Dress Agency*

6.2.2 Reader's Query

A Reader's Query in *Taxation* raises the possibility of claiming input tax on an exempt property project by virtue of an existing VAT registration as a carpet dealer. The property project would be by way of business, so as long as both were carried on by the same person, the result would be a partially exempt trade rather than two separate activities. As long as the VAT on the exempt project fell below the de minimis levels – which would require great care over dates and amounts, according to the figures given – complete recovery would be available.

Taxation, 8 December 2011

6.3 Payments and returns

6.3.1 Flat rate scheme

A company was registered for VAT from April 2004. A new accountant told the director about the FRS in March 2009 and it applied to use the scheme on 23 May 2009. It was authorised to do so from the beginning of the current return period, 1 April 2009.

The accountant later wrote to HMRC asking for the admission to the scheme to be backdated to April 2005, generating a VAT saving of £17,700. The accountant argued that this was very high in comparison with other taxes owed by the company and its retained profits, and to deny the repayment would cause hardship. HMRC refused.

The Tribunal considered precedent cases cited by the appellant including *Anderson* (VTD 20,255) and *Wadlewski* (VTD 13,340). The second was about a retrospective amendment to a retail scheme rather than the FRS, but the Tribunal had come to the conclusion that the amount of money involved made the circumstances exception so as to allow the taxpayer to go back. The Tribunal observed that this decision had not always been followed in similar cases on retail schemes, let alone the FRS.

It appeared that HMRC had taken all the relevant information into account and had come to a reasonable decision based on it. The appeal was dismissed.

First Tier Tribunal (TC01496): *Anycom Ltd*

6.3.2 NAO on online returns

The National Audit Office has issued a report on the effect of HMRC receiving tax returns online. This states that take-up rates for PAYE in-year returns and Income Tax Self Assessment had increased to 94% and 77% respectively, broadly in line with forecasts. The rates for VAT and Corporation Tax had increased to 67% and 42% respectively, each some 20% below forecast. Rates for PAYE, VAT and Corporation Tax have increased further during 2011-12. In the light of actual rates achieved and greater knowledge of customer behaviour, HMRC has lowered its original forecasts of 100% take-up by 2012 to around 97% by 2013-14 for the three business taxes (even though online submission will be compulsory for all of them except in cases of religious objection). The 2013-14 forecast for Self Assessment is 84%.

The NAO estimates that the department has so far saved £126m through the use of online filing, although as it says HMRC "do not yet fully understand the relative costs of dealing with paper and online returns or the costs and benefits of seeking greater take-up", it is hard to see how they can quote such a precise figure.

www.nao.org.uk/publications/1012/online_tax_returns.aspx

6.3.3 Guidance on completing returns

HMRC have issued a revised version of Notice 700/12. It provides new information on:

- completion of the return when using a special VAT accounting scheme
- using the online VAT return
- paying electronically and qualifying for extra time
- using an accountant or agent to send your return online
- using commercially produced software packages to allow both single and bulk submissions, and
- the cleared funds rule for cheque payments by post.

Notice 700/12

6.3.4 Interest rates

New rules on interest payable on amounts owing to and from HMRC came into effect across a range of taxes on 31 October 2011. They are made under FA 2009 s.101 and s.102. Although nearly all taxes are now covered by these new rules, VAT is only to be brought within them from a date to be appointed by the Treasury, and no date has yet been announced.

SI 2011/2446

A separate "appointed day order" has implemented the rule in s.103 FA 2009 about setting the rate of interest for the purposes of the above provisions. Again, these do not yet apply to VAT.

SI 2011/2401

6.3.5 Legislation to come

A response document to the consultation on moving VAT returns online was published on 6 December and can be found on the HMRC website. At the same time HMRC confirmed that certain VAT forms will be removed from the regulations by secondary legislation to be published in February 2012 (making it possible to change the forms by tertiary legislation instead of having to issue statutory instruments); the VAT registration threshold for foreign businesses making supplies in the UK will be removed from 1 December 2012; and online filing will be required for traders with turnover below £100,000 a year (known as "Tranche 2") from 1 April 2012.

Several respondents to the consultation suggested that those who still wish to file on paper should be allowed to do so, but HMRC do not agree. They intend to require online filing except where they can be persuaded that the trader has a genuine religious objection to using a computer.

www.hm-treasury.gov.uk/d/vat_online_registration.pdf; NAT 99/11

6.4 Repayment claims

6.4.1 Reference to proceed on interest

Grattan is a mail order company. It paid commissions to selling agents which should, since 1978, have been treated as reducing the taxable value of sales of goods to those agents. Grattan originally accounted for output tax on the full amount and later received a repayment with simple interest. Grattan appealed in respect of two disputes with HMRC:

- whether it was also entitled to a repayment for the commissions paid before the 6th Directive came into force, i.e. those paid between 1973 and 1977;
- whether it was entitled to compound interest on all its repayments.

In TC00908, the First-Tier Tribunal examined the arguments based on EU and UK law and precedent in detail, and decided to refer questions on both issues to the CJEU. It would not be enough to wait for the decision in *Littlewoods*, because the issues were different; it would also not be appropriate to wait until the *Littlewoods* decision before framing the questions, as HMRC argued.

HMRC applied for leave to appeal against the decision to refer. Initially the FTT judge refused this, but following the Court of Appeal's decision in *Wilkins*, the same FTT judge heard the arguments again (TC01144) and decided to grant a limited stay of the reference to the CJEU while the question was appealed to the Upper Tribunal.

HMRC argued that the issues in the case were not within the jurisdiction of the CJEU, because the questions Grattan wanted to be referred dealt not with unknown EU legal principles but rather with the application in the UK's administrative procedures of EU legal principles (effectiveness and equivalence) that were already well understood. The issue was effectively exactly the same as that in *Wilkins*, where the Court of Appeal had declined to refer a question, preferring to wait for the *Littlewoods* decision.

The Upper Tribunal considered that the Tribunal had very wide discretion to refer a question. The fact that it was identical to a question that the Court of Appeal had declined to refer did not mean it was improper; it was possible that the CJEU might refuse to accept the question, but that did not mean it could not be put. The judge concluded:

"*We consider that to be perfectly intelligibly understood to be an enquiry as to the content and interpretation of the relevant principles of effectiveness and equivalence (in the special context of tax) rather than any sort of assumption that these principles are now closed to further development and all that remains is an enquiry as to their application to United Kingdom procedural rules. And HMRC are not prejudiced in our dismissal of this appeal since if HMRC are indeed correct that no question as to the content and scope of EU law arises, it is, as we have observed, open to the CJEU to decline to accept the reference.*"

Upper Tribunal: *HMRC v Grattan plc*

The FTT has now framed the questions for reference, and has noted that "this question needs only to be addressed if the Court of Justice decides, in Case C-591/10 (*Littlewoods*), that where the remedy provided by a

Member State in such an overpayment situation provides 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 VATA 1994, that remedy does not accord with EU law."

The FTT also refers to another question already referred under reference C-877/11. This relates to the basis of assessment of a supply of goods and does not impact on the interest question.

The question referred is:

If the Court of Justice concludes that the answer to the Question 1 referred in the case of Littlewoods Retail Limited v The Commissioners for Her Majesty's Revenue and Customs (Case C-591/10) is in the negative:

(1) Do the EU law principles of effectiveness and/or of equivalence require the remedy for an overpayment of VAT in breach of EU law to be a single remedy for both the reimbursement of the principal sums overpaid and for the use value of the overpayment and/or interest?;

(2) In circumstances where there are alternative remedies under domestic law, is it a breach of the principles of effectiveness and/or of equivalence for the remedy or remedies not to be in the statutory provisions governing the making of the principal reimbursement claims and the appeals from administrative decisions on those claims?; and

(3) Is it a breach of the principles of effectiveness and/or of equivalence to require a claimant to pursue the principal reimbursement claim and the claim for simple interest in one set of proceedings before the Tax Tribunal and the balance of the remedy required by EU law in respect of the use value of the overpayment and/or interest in separate proceedings before the High Court?

The FTT decision also sets out the history of the dispute, the national legal background and the main contentions of the parties.

First Tier Tribunal (TC01533): *Grattan plc*

6.4.2 Unjust enrichment

Danish law was in breach of EU Directives in imposing a duty on various types of oil. A company which purchased these oils reclaimed the duties directly from the authorities, who refused to repay it. The also claimed damages in compensation for having had to pay the unlawful duty.

The Court commented that the principle of effectiveness was relevant: the taxpayers should not have paid the duty, and they should therefore have a right to recover it. The member state should not make it effectively impossible or excessively difficult to exercise that right. Subject to that, member states are generally left to determine the method by which refunds of taxes are processed.

The ruling of the court was therefore that a member state may refuse to repay duties directly to a consumer on the grounds that the consumer was not the person who paid the duties to the state; but this is only a valid ground for refusal if the consumer can effectively exercise the right by making a claim for repayment against the supplier (who will then be able to reclaim the overpaid duty from the member state). If this is not possible (e.g. because the supplier is insolvent), the consumer should be permitted to make the claim directly.

Similarly, the Court ruled that the member state could refuse a claim for compensation only if the consumer could bring an action for damages against the taxable person who charged the excessive duty – who would, presumably, be entitled to recoup the damages from the state which required the duty to be levied.

CJEU (Case C-94/10): *Danfoss A/S and Sauer-Danfoss ApS v Skatteministeriet*

6.4.3 Capping

A trader received a central assessment for 11/05 and a visit from the bailiffs in February 2006 (the Tribunal noted that this seemed very quick). After non-submission of several returns and mail being sent back undelivered, the trader submitted duplicate returns for a number of periods in August 2009. These showed nil liabilities for all periods, including 11/05. HMRC refused to repay the £958 assessed because the cap applied.

The Tribunal agreed with HMRC that there were no legal grounds under the VATA for a repayment to be made. The chairman commented that there might be grounds for a repayment under HMRC's care and management powers, given that the trader was unwell and a properly evidenced application showing hardship might meet with success. However, no such application had yet been made. The decision explained the correct procedure and left it to the appellant to pursue it if he wished.

First Tier Tribunal (TC01443): *Andrew George Burr*

The owner of a cafe wrote to HMRC in February 2011 to "register an interest in making a claim" in respect of the takings of a gaming machine "in a period prior to 2005". HMRC replied, stating that this was not a "claim" because it was too vague, and the time limit for making claims had expired. A claim must meet the requirements of reg.37 and be accompanied by "such documentary evidence as is in the possession of the claimant, state the amount of the claim and the method by which that amount was calculated". The trader proceeded to a hearing, although he did not attend. Not surprisingly, the Tribunal agreed with HMRC on all issues, and struck out the appeal.

First Tier Tribunal (TC01595): *Bartholomew Corvi t/a A & B Corvi Seaview Cafe*

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Invoicing Directive

The Second Directive on VAT Invoicing (2010/45/EU) takes effect on 1 January 2013. The Commission has published explanatory notes to help traders understand the main consequences of the changes. The notes are not legally binding, but are supposed to be practical and informal advice on the consequences of the changes. The notes are also intended to be a work in progress that will be updated and improved over time.

The current version of the notes covers the following issues (references are to the provisions of the Principal Directive):

A: Requirement for paper and electronic invoices

1. Invoices must reflect an actual supply – recital 10 of Directive 2010/45/EU

2. Definition of e-invoices – Article 217

3. Customer acceptance – Article 232

4. Authenticity of origin – Article 233(1), third subparagraph

5. Integrity of content – Article 233(1), fourth subparagraph

6. Legibility – Article 233(1), first and second subparagraphs

7. Choice of means of ensuring authenticity of origin, integrity of content and legibility – Article 233(1), second subparagraph

8. Business controls – Article 233(1), second subparagraph

9. Reliable audit trail – Article 233(1), second subparagraph

10. Advanced electronic signature and EDI – Article 233(2)

11. Point in time of issue and end of storage period – Article 233(1), first subparagraph

12. Storage of invoices – (see document number D3)

B: Issue of invoices

1. Article 219a – Which Member State's rules are applicable?

2. Article 221(3) – Applicable Member State's invoicing rules for exempt supplies

3. Articles 220(2) and 221(2) – Invoicing rules for exempt financial supplies (Article 135(1)(a) to (g))

4. Article 224 – Self-billed invoices

C: Content of invoices

1. Article 226(2) – Sequential numbering

2. Article 226(7a) – Cash accounting

3. Article 226(11) – Exempt supplies

4. Articles 91 and 230 – Conversion of the VAT amount in to the national currency

5. Article 226b – Simplified invoices

D: Storage of invoices

1. Article 247 – Storage period

2. Article 248a – Translation and languages used on invoices

3. Article 247 – Medium of storage

http://ec.europa.eu/taxation_customs/taxation/vat/traders/invoicing_rules /index_en.htm

6.7 Assessments

6.7.1 Underdeclaration

A trader was assessed in respect of the takings of a cafe in Brighton. He claimed that the business belonged to his brother, not to him, and so he was the wrong person to be assessed. He also claimed that the amount of the assessment was wrong, and it was not raised to best judgement.

The Tribunal reviewed the evidence and found that, on the balance of probabilities, the trader had not shown that his brother owned the business. There were a number of factors that pointed to him owning it. It was regrettable that HMRC had not interviewed him in person before issuing the assessment, and the Tribunal hoped that this would happen in future similar cases.

As regards best judgement, the Tribunal found some flaws with the assumptions made by the officer – in particular basing an extrapolation across the whole year on one day in high summer and one day only slightly outside high season – but not the exceptional circumstances such as bad faith that would lead to the assessment being fatally flawed. The calculations were amended to reduce the assessment from £49,000 to £37,000, but the validity of the assessment in principle was confirmed.

First Tier Tribunal (TC01599): *Ishag Salama t/a Izzy Store*

A partnership running a convenience store was assessed for underdeclared takings and operating an unauthorised variation on a retail scheme. The trader offered no evidence to support its assertions that HMRC's calculations were unfair; as the methodology appeared reasonable and the onus was on the trader to displace the assessment, the appeal had to be dismissed.

First Tier Tribunal (TC01565): *Messrs Tufail, Din, Akbar & Tufail*

6.7.2 Reader's Query

A Reader's Query in *Taxation* highlights the difference between correcting an error and being assessed by HMRC. A trader discovered an £8,000 error shortly before a compliance visit, discussed it with the visiting officer, and agreed that it would be assessed rather than corrected on the next VAT return (as they would have done if they had not had a visit). The assessment came with a £200 interest charge, which would not have arisen had reg.34 been used.

The answers explain the difference between the rules on penalties and on interest, and also the situations in which HMRC cannot apply interest and those in which they do not do so as a matter of policy – where there is "no loss to the Exchequer requiring commercial restitution". The respondents suggested that the client should ask for the interest charge to be reviewed.

Taxation 20 October 2011

6.8 Penalties and appeals

6.8.1 Default surcharge

HMRC have issued two further updates of the Notice on *Default Surcharge* after only five months (December 2011 replacing November 2011 replacing June 2011). It appears that the amendments are only minor, and there is still no indication of when s.59 VATA 1994 will be replaced by the late filing and payment regime of Sch.55/56 FA 2009 which already applies to most other taxes.

The latest version includes reference to "faster payments" as a method of electronic funds transfer in para.3.1.1. It does not give any guidance on how long HMRC believe the different methods of funds transfer take to arrive.

Notice 700/50

Successful appeals

The managing director of a company was contacted by telephone on 28 February 2011 to be told that the company had not submitted VAT returns for the last three quarters. He had been unaware of this and immediately rectified the situation. The company had previously never failed to submit a VAT return.

On appeal, the director explained that the person responsible for submitting returns had been found to have defrauded the company of £45,000 over a five year period. Nevertheless, he had given her a second chance because she had worked for him for twenty years. He believed that her demotion may have led her to act maliciously in failing to submit the returns.

HMRC argued that relying on this person was not the act of a reasonable trader, as well as being ruled out as a reasonable excuse by s.71. The trader pointed out that he had corrected the situation as soon as HMRC had contacted him directly; up to that point he had no way of knowing that there was a problem, because the staff member had intercepted all calls and correspondence from HMRC.

The Tribunal accepted that this was an exceptional circumstance and constituted a reasonable excuse.

First Tier Tribunal (TC01458): *Blaze Group Holdings Ltd*

Partly successful appeals

A company submitted a number of returns late and received central assessments which turned out to be less than the true liability. HMRC raised error penalties under Sch.24 FA 2007 in respect of 5 periods (mitigated by 75% for two periods, 40% for one and 30% for the last two) and default surcharges in respect of 3 periods (as well as three earlier periods triggering liability notices and extensions).

The company appealed: in correspondence it claimed that it had never received any of the surcharge liability notices, but it dropped this argument at the hearing. The Tribunal held that it had no reasonable excuse for accepting inadequate assessments. Its bank declining to honour an offered overdraft facility was a reasonable excuse for the first period, resulting in a recalculation of the later surcharges, but it could not provide an open-ended escape from the consequences of late payment. The company continued to receive VAT from its customers and used that VAT to enable it to trade.

First Tier Tribunal (TC01459): *Littlemoss Preservation Ltd*

A firm of solicitors was in financial difficulties in late 2008. It negotiated a time to pay arrangement for the liability for October 2008, and default surcharge was suspended under s.108 FA 2009. It then opened further negotiations in January 2009 because it was unable to pay its debts; the negotiations took some time to conclude, but a further instalment agreement was reached in January 2010, covering all periods up to October 2009.

HMRC applied default surcharges to the periods January 2009 and October 2009. They did not accept that the start of negotiations in January 2009 clearly related to the current return – it appeared to be a renegotiation of the October 2008 instalments. By April and July, the current returns were clearly included in the negotiations and surcharges were suspended. However, October 2009 was not included in the agreement, so a surcharge applied for that period as well.

The Tribunal accepted that the time to pay arrangement was under negotiation before the due date for the January return, so it should have cancelled the liability for that period. The result was that the October 2009 surcharge should be reduced from 10% to 5%.

First Tier Tribunal (TC01564): *Levi Solicitors LLP*

A company managed to persuade HMRC to cancel two surcharges in relation to late receipts of payment in 2009. HMRC urged the director to check how long the chosen method of electronic transfer would take. The second of these letters commented that “HMRC is currently unable to accept Faster Payments”. The company paid its next quarterly liability using Faster Payments, which ought to arrive on the same day (4 February 2011), but actually reached HMRC one day late (8 February). This gave rise to a surcharge, but as it was less than £400 it was not collected. The trader claimed not to have received the notice which extended the liability period as a result of this default, but the Tribunal accepted that it had been delivered on the balance of probabilities to the central administration area at the taxpayer’s business address. It had therefore been duly served for the purposes of extending the period. There was no reasonable excuse for this period because the director should have read and acted on the warning about Faster Payments.

The next quarterly payment was also made through Faster Payments on 6 May and arrived on 9 May. This time, the chairman considered that a reasonable excuse existed – he accepted that the director had not actually seen the surcharge liability extension, so he reasonably assumed that the Faster Payment made for the December quarter had arrived on time. This constituted a reasonable excuse and therefore cancelled the surcharge.

The result was that the actual surcharge was cancelled, even though part of the appeal (against the first default) was dismissed.

First Tier Tribunal (TC01575): *Palmun Ltd*

A trader was late submitting five payments. The Tribunal accepted HMRC’s argument that it had no time to pay arrangement in place during this period, but it accepted the company's argument that it believed that it did. This constituted a reasonable excuse for the late payment for the first three periods. After that it should have realised that there was a problem because HMRC were trying to levy default surcharges; there was therefore no reasonable excuse for the fourth and fifth periods, but the rates of surcharge were reduced to 0% (first default) and 2% (first default in a surcharge period).

The problem arose because the company had agreed time to pay for two earlier periods, and had believed that permission for similar instalment payments had continued. The director said he did not see the surcharge liability notice for the first period for which HMRC no longer allowed time to pay; in the next period the instalment payment pattern continued, but no default surcharge was triggered, which HMRC could not explain. The Tribunal therefore accepted that there were possible grounds for the director's reasonable belief that HMRC had accepted the pattern of payments.

First Tier Tribunal (TC01568): *G Wilson (Glaziers) Ltd*

Unsuccessful appeals

A company installed new software and had a problem with the submission of the VAT return. Rather than submitting an inaccurate return, the managing director decided to have the records fully reconciled and corrected before submission. This was the company's third default, so a surcharge was levied at 5%. The Tribunal commented that the trader should have contacted HMRC straight away to discuss the problem and agree what should be done about it; the failure to do this meant that there was no reasonable excuse.

First Tier Tribunal (TC01459): *TLC Incentives Ltd*

Three companies owned by the same individual had a poor record of defaults: one had defaulted 48 times between 08/01 and 11/10; the second 16 times between 05/06 and 11/10; and the third 31 times between 08/01 and 08/10. The trader appealed against a total of about £52,000 in surcharges. The grounds of appeal were that assessments raised in November and December 2008 could have been incorrect, the surcharges could have been incorrectly calculated, and that the appellants have a reasonable excuse by reason of financial difficulties.

There was no evidence to support the first two contentions and the third could not constitute a reasonable excuse. The appeals were dismissed.

First Tier Tribunal (TC01452): *McFletch Ltd and others*

A company provided expert witness services. The income depended on reimbursement of clients by the Legal Services Commission, which was notoriously slow in settling up. The director argued that he was in the same position as *Steptoe*; he also believed that he had agreed a "time to pay" arrangement with HMRC, which would have cancelled the surcharges.

The Tribunal did not agree that the situation was the same as in *Steptoe*. There were several distinctions to be drawn, but the most crucial was that this taxpayer could have used the cash accounting scheme. He accepted that this would have solved his problems but said that he had only become aware of it recently. The Tribunal agreed with HMRC that this negated his reasonable excuse: the situation was not beyond his control. There was no unexpected external event which caused the problem – it was his own raising of invoices and failure to research the possibility of cash accounting that created it.

While the Tribunal accepted that he genuinely believed that he had agreed time to pay, there was insufficient evidence that he had actually done so. The fact that HMRC had cashed his instalment cheques and not replied to letters was not enough to imply agreement to his proposal to pay by instalments. The appeal was dismissed.

First Tier Tribunal (TC01437): *DNA Defence Ltd*

A trader appealed against surcharges at the 10% and 15% rates on the grounds that HMRC had not sent blank return forms for the periods in question (02/09 and 05/09) after the company had moved offices. The company was liable for VAT of £2,362.50 each quarter in respect of rent received on an opted property. The surcharges were only £236 and £354; presumably surcharges at 2% and 5% had not been collected.

The Tribunal ruled that non-delivery of the returns was not a reasonable excuse. While HMRC had not dealt with the matter efficiently, they had also not been properly notified of the change of address. The trader was convinced that he had a valid grievance, and was referred to the Adjudicator's Office as the only possible source of redress.

First Tier Tribunal (TC01438): *The Datoo Partnership*

A barrister received a third default (at 5%) which triggered a surcharge of £1,100 after being one day late submitting his return. He appealed on three grounds: non-delivery of the liability notice, a reasonable excuse for one of the periods, and disproportionality.

The Tribunal found that, on the balance of probabilities, the notices had been delivered in the normal way and the barrister had failed to take note of them. The circumstances did not constitute a reasonable excuse (the due date was the beginning of a major trial away from his home base, but the barrister had had 36 days since the end of the quarter in which to comply).

HMRC argued that the Tribunal did not have jurisdiction in relation to proportionality and that *Enersys* was wrongly decided. The Tribunal declined to consider these arguments, finding instead that the barrister had not provided sufficient evidence that a penalty of £1,100 fell within the *Enersys* principle of "not merely harsh but manifestly unfair". The appeal was dismissed.

First Tier Tribunal (TC01439): *Mark Kelly*

A company fell into the payments on account regime for the first time in the quarter to July 2009. The company had been settling some earlier VAT liabilities by instalments, and there was therefore some confusion with money passing one way and the other around the end of July 2009 as the instalment payments proved excessive. However, the first payment on account (due 31 July 2009) was undoubtedly paid late (4 August) and the balancing payment was also not settled until after the due date. There were further defaults in respect of the next two quarters.

Unusually for recent appeals, the company decided not to pursue the "disproportionality" defence in the hearing, having raised it at a preliminary stage. Presumably it was thought unlikely to succeed because the company had taken some time (certainly more than a single day) to correct its failings.

The Tribunal decided that the confusion did not amount to a reasonable excuse. The company's defence was not helped by the fact that the people who dealt with the matter at the time no longer worked there and were therefore not available to give evidence, and the people now in charge had not been involved at the time. However, it appeared to the Tribunal that the company should have understood what liabilities it was supposed to settle.

First Tier Tribunal (TC01446): *Claranet Ltd*

A company appealed against surcharges for 8 of the 10 periods from 09/08 to 12/10. It had a long history of problems with VAT payments and had entered into and breached a number of time to pay arrangements. Its main ground of appeal (at a hearing to which it did not send a representative) was that surcharges should be suspended during the currency of a time to pay arrangement, but the Tribunal held this could not apply where the company had failed to comply with its side of the agreement.

First Tier Tribunal (TC01507): *Key Recruitment (UK) Ltd*

A trader submitted his March 2010 return online on the last possible day (i.e. 7 days after the due date). Once he had done so, he knew the amount he had to pay, so he initiated an electronic payment. Naturally this arrived after the deadline, and he was charged with a surcharge at 15% amounting to £690. The company had not suffered a surcharge in recent periods, but was within the regime because of late submission of a repayment return for June 2009; the rate of 15% applied because of late payments before that.

The Tribunal noted that the appellant had appealed out of time because it had not realised it had to use a particular form – the director had asked for a review of the conclusions of the review, not realising that this could only happen once, and had thought that he had given sufficient notice of his intention to disagree with the decision.

The Tribunal did not consider that the payment had been despatched in time to give the trader a reasonable expectation that it would arrive by the due date, nor did "needing to complete the tax return in order to know how much to pay" constitute a reasonable excuse.

First Tier Tribunal (TC01507): *Eyestar Consulting Ltd*

A 15% surcharge was confirmed in respect of a trader who did not attend the hearing. The company had initiated a BACS transfer on Friday 4 February 2011, but this could not hope to arrive by the due date of Monday 7 February. The Tribunal ruled that HMRC's guidance was clear and accurate – BACS transfers may take 3 working days – and the trader ought to have been aware of it.

First Tier Tribunal (TC01555): *Saffrons Cross Recovery Ltd*

A company paid its VAT on the last due date, Saturday 7 May 2011, using the "faster payments" system. It claimed that it had a reasonable belief that the payment would arrive on the same day. The Tribunal dismissed its appeal against a surcharge, holding that it had been given adequate warning that account had to be taken of bank holidays and weekends. This warning had been contained in a letter in which HMRC agreed to drop a previous surcharge on the basis that the trader had failed to realise that HMRC's bank was not at the time within the fast pay system. The director appeared not to have read, or not paid attention to, the whole of this letter.

First Tier Tribunal (TC01622): *Red Contractors Ltd*

A company appealed in respect of a 15% surcharge of about £3,000 after five successive late returns and payments. Its three defences amounted to reliance on another and insufficiency of funds, and none of them could be a reasonable excuse without something more exceptional. The directors could also have contacted HMRC to discuss their problems, but they had not done so.

First Tier Tribunal (TC01615): *Millside Ltd*

A company appealed in respect of a 15% surcharge of about £5,300. Its excuse was a customer delaying payment of £150,000 and the bank not allowing any flexibility to pay the VAT; however, no evidence was produced to show that these assertions were facts, nor was evidence provided to show that the company genuinely could not pay it VAT liability without the £150,000. The appeal was dismissed.

First Tier Tribunal (TC01601): *Eternity Bridal Ltd*

A company appealed in respect of three surcharges for submitting returns and payments 19, 9 and 7 days late. Its chartered accountant submitted that "the taxpayer has been unjustly penalised for late delivery of paperwork". The judge considered that the excuse offered amounted to the internal administrative inadequacies of the company, and the appeal was dismissed.

First Tier Tribunal (TC01585): *Global Petroleum Analytics Ltd*

A company appealed against a 10% surcharge of about £1,700. Its grounds were "disproportionality" alone – it did not offer a reasonable excuse, and appeared to be appealing out of time as a result of not realising straight away that there was an alternative ground for appeal. The judge allowed the appeal to proceed out of time. After detailed consideration of precedents and arguments, he disagreed with HMRC's assertion that the Tribunal has no jurisdiction over this particular matter; but he also concluded, again after detailed examination of the facts under the standard headings that have become a feature of arguments about proportionality, that the penalty was not disproportionate in the circumstances. The appeal was dismissed.

First Tier Tribunal (TC01591): *Eco-Hygiene Ltd*

Appeals about other taxes

A company was charged penalties in respect of the late submission of year-end PAYE returns. HMRC alleged that the returns for both 2008/09 and 2009/10 were not filed until 6 May 2011. A total penalty of £2,000 was assessed.

As a preliminary point, the chairman criticised the wording of HMRC's letter to the taxpayer confirming the penalty. It said that the penalty might be avoided if there was a reasonable excuse, but this had to be "an exceptional event beyond your control". The chairman commented:

The assertion that for there to be a reasonable excuse, there must be exceptional circumstances is, as a matter of law, wrong. The words "reasonable" and "excuse" are ordinary English words in everyday use. As the relevant legislation does not provide a statutory definition for either of those words or for the phrase "reasonable excuse" there can be no justification for giving them anything other than their ordinary everyday meaning. For a reasonable excuse to be made out there are only two requirements. The first is that the appellant must put forward an excuse and then, if it does so, it must be decided whether, when viewed objectively, that excuse is reasonable in the context of the delay that has triggered the penalty. Each case will turn on its own facts, but every case involves applying the same test or approach; as explained above.

However, the appeal was based on the trader's assertion that the returns had been filed on time and must have been lost by HMRC – this was not about reasonable excuse. The appeal was allowed on the basis that HMRC failed to produce any evidence to demonstrate that the filing had not taken place; in a penalty or surcharge appeal, the chairman considered that the burden of proof rested with HMRC, not the taxpayer.

The fact that HMRC had only sent out the first notice of a penalty in January 2010 (for 2008/09) was also enough to reduce the penalty for that year. The chairman accepted that the company's accountant had genuinely believed that the return had been filed, in which case the late issue of the penalty notice was the first warning she would have had that anything was amiss. As extra penalties accrue for longer delays, an earlier warning would have reduced the penalty. A similar finding followed in respect of the following year, when the issue of the first penalty notice was equally late.

First Tier Tribunal (TC01538): *Green Island Promotions Ltd*

A similar decision was reached in another case on P35 penalties in which HMRC appeared to have failed to send out an authorisation code promptly to enable the company to file online. The chairman (the same one as in the above case) commented as follows:

20. A fair minded objective observer would readily identify conspicuous unfairness from the following:

(1) HMRC's failure to comply with the obvious intention of Parliament that where a penalty is incurred, that penalty should be promptly notified to and collected from the transgressor.

(2) The complete lack of any explanation for, or justification of, HMRC's dilatoriness in failing to send out a First Penalty Notice for four months or thereabouts.

(3) The fact that HMRC notifies and collects penalties or surcharges for failing to file a VAT return or failing to make a VAT payment, with expected promptness. By contrast, it shows no such inclination to act with promptitude in cases involving a penalty for failing to file end of year returns, which just happen to incur increasing penalty sums as time goes by.

(4) By failing to act promptly in notifying and collecting penalties due for a failure to file an end of year return on time, HMRC is thereby failing to give effect to the intention of Parliament that it should so act.

(5) It is an overwhelming inference that if HMRC can set its computer system to notify VAT penalties promptly, its computer system could also be persuaded to notify late filing penalties in respect of end of year returns, with equal promptness.

First Tier Tribunal (TC01634): *Corballon Ltd*

The same judge allowed an appeal against the different penalties that are now levied where the monthly PAYE liability is paid late. The appellant accepted that it had been late paying 9 of the 12 monthly amounts due between May 2010 and April 2011. The resultant penalty was 3% of the annual PAYE and NIC bill, a total of £29,800. The trader put forward the *Steptoe* defence of insufficiency of funds for an unavoidable underlying reason, including a number of bad debts and different banking arrangements being forced on it by its bank. The judge accepted that these were exceptional circumstances and the trader was doing all it reasonably could to pay its liabilities.

First Tier Tribunal (TC01608): *Dudman Group Ltd*

6.8.2 Misdeclaration

A trader sold kitchen carcases to a Spanish customer who quoted an invalid VAT number. The sale was therefore not eligible for zero-rating. HMRC assessed for the output tax and imposed a misdeclaration penalty.

The trader's appeal was effectively based on Notice 725 paras 4.10 – 4.12, which say that zero-rating will not be lost if the trader has taken all reasonable steps to ensure that the customer is registered. The following are stated as demonstrating that reasonable steps have not been taken:

- the VAT number you quote does not conform to the published format for your customer's Member State as shown at paragraphs 16.19, or
- you use a VAT number which we have informed you is invalid, or
- you use a VAT number which you know does not belong to your customer.

Unfortunately, the trader made no checks on the validity of the number. She relied on the fact that she had known the customer before he moved to Spain; the fact that her father's business had written off a bad debt owed by the man might have alerted her to possible problems. In the end she also lost money through unpaid invoices, so the requirement to pay the VAT was an insult added to an injury.

The chairman comments that no reference was made to the penalty by either party during their presentation of the case. She therefore had to ask to confirm that the penalty had been issued and it was under appeal.

Presumably the trader thought she would win on the assessment and then the penalty would fall away.

The Tribunal dismissed an appeal against the tax and the penalty, holding that there was no reasonable excuse, but ordered mitigation of the penalty by 50% as it appeared that none had been given and there was no suggestion that the trader had been anything other than co-operative.

First Tier Tribunal (TC01569): *JL Eydmann*

6.8.3 Late appeals

In VTD 14,466, a golf club was held to be liable for output tax on a taxable supply of services in respect of the requirement that members subscribe for an interest-free debenture in the club. The club had argued that the issue of the debenture was an exempt supply, but the Tribunal ruled that making an interest-free loan was also consideration for the taxable supply of sporting services. This was valued at the amount of interest that the club would otherwise have had to pay on the money.

After a case involving debentures issued by the *Rugby Football Union* (VTD 18,075), the club claimed a repayment. Initially HMRC resisted the claim, but later accepted that, from August 2001 onwards, the club would be treated as not making taxable supplies in respect of these debentures. There had been extensive correspondence over several years, but it appeared that the club had never quantified its claim nor formally appealed against a decision not to pay. It eventually dropped the appeal in 2006 because there was no longer any substantial dispute between the parties.

HMRC repaid output tax for the period from 2003 to 2006, but refused to repay for the earlier period because the club had not made a proper claim within the time limit (because it had not quantified the amount reclaimed). The club had also missed the time limit to appeal against the decision to refuse to repay.

The Tribunal examined the background in detail and declined to allow an appeal out of time. There were no grounds in the VAT Act, and the doctrine of legitimate expectations also did not assist the club.

First Tier Tribunal (TC01476): *Harleyford Golf Club*

A company applied for leave to appeal out of time. When the case first came before the Tribunal it was discovered that the company had been dissolved without the consent of its directors, and had to be reinstated. On its reappearance, the Tribunal noted that the company had failed to make returns on time, had failed to notify the Commissioners of a change of address, had failed to pursue input tax repayment claims, and had failed to serve its notice of appeal within time, even assuming that its own claim as to what constituted the decision under appeal was correct.

It appeared that the company's history was one of administrative confusion. It had originally supplied cash machines which were connected to the Link network, but these were disconnected after problems with the contracts were discovered. Accordingly, the company ceased to trade, and its VAT compliance was left in abeyance, including claims to recover input tax on purchases.

In the absence of any explanation for its delays, the company's application to have its appeal heard out of time was dismissed.

First Tier Tribunal (TC01399): *Pen Associates Europe Ltd*

An individual received two post-clearance demands in relation to importations of vehicles. He claimed that he had not appealed against them because he believed they were directed at a company in liquidation, and he did not realise they were personal to him. He finally lodged an appeal in May 2010, some seven months late. HMRC argued that he was out of time and did not have a reasonable excuse. The individual had been disqualified from acting as a director in April 2011, and HMRC argued that he was wholly unreliable.

The Tribunal considered the background and a number of precedent cases. The chairman concluded that there was a real risk of unfairness if the application was not granted, and no significant prejudice to HMRC if it was. There were some anomalies and contradictions in the evidence, but the chairman accepted that the individual genuinely believed that the liability was not due from him, and that was why he had not appealed earlier.

First Tier Tribunal (TC01480): *Matthew Richard Griffiths*

A company applied for leave to appeal out of time against assessments to VAT and penalties totalling over £60,000 for periods from 11/05 to 05/08. The company had incurred costs in relation to refurbishment of premises used by a subsidiary; this was disallowed because there was effectively an exempt licence to occupy granted to the subsidiary. The holding company argued that there was a "de facto VAT group", but HMRC refused to accept that such a concept existed.

The company wrote numerous times to dispute the decision after it had been made, but did not make a formal appeal until more than three years after the deadline had expired. The Tribunal did not consider that any satisfactory reason had been given for the delay; nor, on the basis of the information about the arguments that were put in outline in this preliminary hearing, did the Tribunal consider that the appeal had any prospect of success. Leave to appeal out of time was therefore denied.

First Tier Tribunal (TC01497): *Scan Corporation Ltd*

A local Conservative Club applied for leave to appeal out of time against a decision to refuse repayments in respect of *Linneweber* claims. The claim had been made on 28 December 2006 in respect of periods from 1 January 2003 to 30 September 2005, and it had been refused by a decision of 19 July 2007. No formal appeal had been made until 2011.

The Tribunal accepted that the decision letter was misleading. It said that the club would have to write to the reconsiderations team in Birmingham if it wanted to dispute the decision, and made no reference to a right of appeal to an independent Tribunal. Both of these features were wrong. However, the delay was some 3.5 years; the person who filed the claim was an accountant who surely should have at least asked a question about how the decision could be independently reviewed. Leave to appeal out of time was refused.

First Tier Tribunal (TC01531): *Biggleswade and District Conservative Club*

6.8.4 Costs

After winning a case about the standard rating of fruit smoothies, HMRC applied for costs relating to the appeal. The company objected, arguing that the 1978 Sheldon statement about costs should apply. This restricted HMRC's applications, even when successful, to circumstances in which the appellant had acted in some way vexatiously or inappropriately.

HMRC argued that the case was within the Sheldon statement as "substantial and complex, involving a large sum of money and which was comparable to a High Court case". As the case concerned a voluntary disclosure for £27m, one of these points was agreed.

The Tribunal considered that the simplicity of the question – "were fruit smoothies beverages?" – was belied by the complexity of the case and the decision. The hearing lasted 6 days and the decision notice was 40 pages long; each party had made written submissions of a similar length. In instructing leading counsel and a junior and calling an expert witness, the company had made the case similar to a High Court hearing. The exception applied, and costs were awarded to HMRC. The costs of the costs hearing were also awarded.

First Tier Tribunal (TC01450): *Innocent Ltd*

A company claimed a substantial repayment of VAT on the basis that its supplies had been treated as taxable under UK law but should have been exempt under art.13B(f) 6th Directive (a *Linneweber* claim). HMRC resisted the claim on the basis that the supplies had been made by a subsidiary rather than the holding company, but the holding company responded that it was the representative member of a VAT group into which the business of the company entitled to the claim had been absorbed, and it was therefore entitled to the repayment. Shortly before the case was due for hearing, HMRC dropped the disputed decision.

The company applied for and was awarded costs on the basis that HMRC had acted unreasonably in defending and conducting the proceedings. The Tribunal decision sets out in sorry detail the difficulties that can be caused to an appellant in trying to argue with an HMRC department which is no doubt under-resourced – the HMRC advocate who was responsible for the case found it difficult to obtain information from colleagues because they were on leave, and was himself on leave on the afternoon before the hearing was supposed to take place. The judge considered that the lack of preparation for the hearing constituted unreasonable behaviour.

First Tier Tribunal (TC01498): *Thomas Holdings Ltd*

The long-running litigation between the many companies controlled by Mr William M Lewis and HMRC has reached a further stage. One of his companies won an appeal and claimed costs, which were awarded. The costs were fees charged by another of his companies for acting as its VAT consultant. This appears to be a way in which an appellant in person could create an "external" bill for costs.

HMRC paid £6,500 of the £12,200 costs demanded and claimed that was generous. If the costs hearing awarded no higher figure, HMRC wanted the costs of the costs hearing. The chairman commented that there were unsatisfactory aspects to the claim – there were no original invoices, and the time records on which Mr Lewis had based his cost estimates were not contemporaneous and their accuracy was therefore hard to verify. However, it did appear that there were genuine costs; an award of £7,000 was made, requiring HMRC to pay another £500 and denying them the costs of the hearing.

First Tier Tribunal (TC01602): *PSI Engineering Ltd*

6.8.5 Problems with procedure

In connection with an appeal about alleged MTIC fraud, HMRC submitted seven witness statements at a late stage. The company objected. The Tribunal considered a number of conflicting precedents on the issue and concluded that four of the statements were so important that they should be admitted; they suggested that a large number of movements of money were circular and were therefore suggestive of fraud. Provided that HMRC met any additional costs arising from the late submission, they should be admitted. If the company asked for time to review the new statements, a fifth should also be allowed, but the last two did not add anything new and should be excluded from the hearing.

First Tier Tribunal (TC01491): *Masstech Corporation Ltd*

In another MTIC case the appellant disputed the admissibility of a number of late witness statements. The Tribunal commented that it was most unsatisfactory that HMRC applied on 20 May 2011 to adduce another 11 witness statements, including 6 from new witnesses, when there had been an understanding at a directions hearing on 19 July 2010 that no further evidence would be admitted. A published decision refers to 6 directions out of 29 for which reasons were given because the appellant might want to appeal further; it seems therefore that 23 of the directions ruled out the further statements. In the 6 remaining, the Tribunal did not consider that there was serious prejudice to the appellant in admitting the statements, and the main complaint against them was simply that they were late.

First Tier Tribunal (TC01557): *Hawkeye Communications Ltd*

6.9 Other administration issues

6.9.1 Single Compliance Process

The Single Compliance Process (SCP) is the framework within which HMRC envisage most future SME enquiry work being undertaken. It is supposed to reduce the burden of enquiries on business, although some suspect that it may also reduce costs for HMRC. Consultations and trials have been undertaken, and HMRC have recently announced an extension of the trials from January 2012 to March 2012. They say:

Following consultation with stakeholders, HM Revenue & Customs has agreed to extend the single compliance process trial to 31 March 2012 to make sure that sufficient data has been collected to test the process fully. Also, four more sites will be added (from January 2012) to further test the process and the internal implementation package.

The decision to test the roll out should not been seen as an indication that a decision has been made on the future of the single compliance process. It's still in trial stage and lessons are being learnt on the best design of the process and its impact.

A briefing paper has been issued giving further details of the approach and the intended objectives. A summary of the 5 stages of the SCP is given at Appendix 1:

1. SCP - Stage 1 – Planning

This is where a case is assigned and considered for an enquiry; the business and agent will not normally be involved at this stage. At this point the case will be reviewed for the risks identified and an initial estimate made of the level of intensity. At the same time, we will consider other HMRC interests along with any additional risks including cross-tax risks and whether there is a need for other specialist involvement. If, based on the risks or behaviours identified and reviewed, it is accepted for an enquiry, it will move to the next stage in the process which is where we make contact with the business.

2. SCP - Stage 2 - Contact

This stage is to prepare for and make first contact with the business and authorised agent, to arrange the enquiry, request information and issue formal notices of enquiry. This is where we will determine the tests we need to apply, the support required to address the risks identified and make a decision on information and documents needed to resolve those risks.

The method of initial contact will depend on the tax and whether a formal enquiry notice is required (e.g. S9A TMA70). Where there are risks:

- *for an indirect tax case this contact could be by telephone or letter,*
- *for a direct tax case this will be by letter.*

We will also check for current agent authority (64-8). We will copy agents into any correspondence, if authorised to do so and ask if the existing authority needs to be extended to other taxes, where more than one tax is involved.

We believe that principles of openness and early dialogue will help progress the enquiry.

In a Level 1 case, this contact will identify the areas we want to discuss, advise that we will carry out a remote check and we will confirm our intention to make progress by telephone, if that is what we intend.

For direct tax cases, in Levels 2, 3 and Level 4, having addressed the risks involved, if we consider that a face to face contact is appropriate, we will write to the business and the authorised agent, with any formal notice of enquiry required, explaining our concerns, identify the areas we want to discuss and advising that we will be contacting the business to arrange an appointment to carry out an enquiry at their premises or at their agent's premises, if this is what they would prefer.

For indirect tax cases, in Levels 2, 3 and Level 4, if having addressed the risks involved, we consider that a face to face contact is appropriate, as a formal opening letter is not required, initial contact will be by telephone and will be confirmed by letter. If contact cannot be made by telephone, we will arrange an appointment by letter. In these cases we will contact the agent at the business's request.

3. SCP - Stage 3 – Process

This stage is to undertake a risk-based enquiry and take proportionate and timely action to move to a position where the case can be resolved or closed. The major change is that we are seeking to move away from a position where we have routinely called for lots of business records to be sent to HMRC for inspection, as we recognise that this can slow down the process and represents a burden on our business.

This will involve initial fact finding relevant to our concerns. We will encourage dialogue, including full disclosure, right from the start and hope that through meeting with the business and authorised agent, we will develop our knowledge of the business background, understand how the business works, share our concerns, carry out any agreed observations and premises inspection. We will then review and update the risks and level of intensity. If at this point emerging facts indicate evasion, the business will be invited to an evasion interview where we will encourage full disclosure.

If we are reviewing records on-site, we will carry out appropriate sample checks, test records and if required organise a further visit or uplift records to complete our checks keeping within agreed timescales. We will give your business feedback at the end of the visit. If we review records off-site we will evaluate information and documents obtained, carry out sample checks, test records and determine next actions.

At the end of this stage we will agree the way forward by obtaining any further documentation and information or support needed to complete the enquiry. Notes of discussions will be made at the time. We will not issue type-written notes unless asked to do so.

If there are no changes to be made to returns, we will move to close the case. If we believe that changes are necessary to the returns, we will work with the agent and business to quantify the changes required and we will aim to agree these, whilst considering, discussing and agreeing behaviours for penalties and whether a referral needs to be made to a *specialist team. If, within our formal powers, we need to re-open earlier periods we will agree a basis for how we arrive at revised figures for the periods involved.*

If emerging evidence indicates additional tax is payable we will seek a payment on account (POA) and issue any appropriate penalty notices and factsheets.

4. SCP - Stage 4 – Resolve

The purpose of this stage is to follow settlement procedures to bring the correct tax into charge.

Where changes to returns are agreed:

In the case of a contract settlement we will invite an offer and payment including any interest and penalties.

For indirect tax cases, we will send a decision letter and assessment for the agreed amount and follow penalty procedures.

The Schedule 24 Penalty procedures are common to all of our tax regimes and may be charged where there is an inaccuracy in a return other than where a mistake has been made despite taking reasonable care. The penalty rate is behaviour based and where it is determined that reasonable care has been taken, a penalty will not apply. In certain circumstances, where the error did not arise as a consequence of deliberate behaviour, the penalty may be suspended subject to the Business meeting our suspension conditions.

Note: Tax specific penalties may be applicable to returns that fall outside the scope of Schedule 24 Finance act 2007.

Where changes to returns are not agreed:

If the business responds but cannot agree our proposals and we are prepared to change our view, we will re-calculate potential liability including interest and penalties and follow the route above.

If the business makes no contact, or responds but cannot agree our proposals and we are not prepared to change our view, we will in a direct tax case, send a letter of explanation advising of our intention to issue formal tax and, where appropriate, penalty assessments based on the computations proposed in Stage 3 as the expected offer.

For indirect tax cases we will send a decision letter and an assessment, based on the computations we issued at Stage 3 and follow Schedule 24 penalty procedures, (where appropriate and as described above).

If an appeal or request for review is received, we will follow the existing appeals and review process.

5. SCP - Stage 5 - Close

The purpose of this stage is to conclude the case and close actions.

At this stage we will finalise paperwork including confirming that case is to be closed, issuing closure letter if required, completing contract settlement paperwork and updating our records. Any necessary referrals will be made, including to Deliberate Defaulters Management Unit (DDMU), Risk Intelligence Service (RIS), National Minimum Wage

(NMW), Tax Credit Office (TCO), National Insurance Record Updates (EC), Construction Industry Scheme (CIS) Functional Lead Team.

If a late appeal is received we will follow the existing appeals and review process.

The majority of these stage 5 actions will be invisible to the business.

At each stage we will check that the case has been assigned at the correct level of intensity, whether the individual requirements of the case indicate that a change of level or approach is required and whether any specific information has changed our view on the level of intensity required.

It is intended that the new approach will be operational in May 2012, subject to the outcome of the trials.

http://www.hmrc.gov.uk/news/news-051011.htm

6.9.2 Business records checks

HMRC have announced an extension of their programme of business records checks which focus on the adequacy of the records of small and medium-sized enterprises. The pilot checks in 2011 found that 44% of businesses visited had "issues", while 12% had serious inadequacies.

The number of staff employed in this area will rise from 30 to 120; 12,000 checks are intended to be carried out by the end of the current financial year, with 20,000 planned for 2012/13 (which, at 167 checks per staff member per year, suggests that they cannot be particularly in-depth – or else the issues are identified very quickly).

The press release comments:

Initially, HMRC will only levy a record-keeping penalty in the most extreme cases of poor record-keeping. In the longer-term, HMRC intend to issue penalties of up to £3,000 for serious inadequacies in record-keeping. HMRC will issue guidance on this, and make a further announcement on when it will happen, in due course.

Press Release NAT 76/11

6.9.3 Compliance check factsheets

HMRC have updated the factsheet on *Compliance checks – Help and advice*. The new version gives more information about inaccuracy penalties under the new regime.

CC/FS8(T)

6.9.4 Fraud and dishonest conduct

HMRC have updated their online manual on the subject of VAT fraud to included references to the de-registration of sub-contract labour suppliers where the right to register is being abused.

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

HMRC have also issued new versions of Notice 160 *Compliance checks into indirect tax matters* (twice – In September and November 2011) and Notice 161 *Investigation into Traders with suspected serious indirect tax irregularities*. They reflect the changes in terminology to include "deliberate behaviour" as one of the irregularities that are subject to the more serious levels of penalties.

Notice 161 only applies to situations in which HMRC suspect knowing involvement in MTIC fraud.

Notice 160, Notice 161

There is also an updated version of Notice 300 *Civil evasion penalty investigations*. This explains what happens when HMRC apply their civil evasion penalty procedure in investigating a potential smuggling offence by a traveller or a trader, or fraudulent declarations and dishonest claims for repayment of duty or relief from duty. The procedure falls under customs law and does not relate to the old s.60 VATA 1994 penalty.

Notice 300

HMRC have published a summary of responses to their consultation on the possible new contractual disclosure facility which may be offered to people suspected of fraudulent conduct as an alternative to criminal prosecution. It can be accessed by searching "civil investigation of fraud – contractual disclosure facility" on the HMRC website.

www.hmrc.gov.uk

6.9.5 Dishonesty by tax agents

Following consultation, the government has confirmed that legislation will be brought forward to address dishonest conduct by tax agents. The consequences for a tax agent of being found guilty of a tax offence, or being penalised with one of the higher tariff penalties, are likely to become very serious indeed, with the possibility of HMRC having access to files of all other clients. The issue of a "conduct notice" would be appealable to the First Tier Tax Tribunal.

www.hm-treasury.gov.uk/d/tax_agents_dishonest_conduct.pdf

6.9.6 Relationship with tax agents

HMRC have also published a summary of the responses to a consultation about "HMRC's longer term vision for working with tax agents" which includes "enrolment" of trusted agents who will be able to "self-serve" by executing a number of basic transactions on behalf of their clients without the need to speak or write to HMRC.

HMRC say that they will advance this project at a slower pace, recognising that some of the proposals were controversial and would require compromise and acceptance by the agent community. At least they appear to recognise that the tax system would not work well without co-operation between agents and the department.

www.hm-treasury.gov.uk/d/tax_agents_dishonest_conduct.pdf

6.9.7 Reminder of campaigns

HMRC launched another disclosure campaign on 10 October 2011. It was aimed at private tutors and coaches who might not have declared all their income. They were given until 6 January 2012 to register for the "Tax Catch-Up Plan" which would limit penalties to no more than 20% of the unpaid tax in most cases.

Unlike the earlier "Plumbers' Safe Tax Plan", this would be unlikely to have a VAT aspect, because the work done by private tutors and coaches is normally exempt.

HMRC NAT 80/11

On 7 December 2011 HMRC announced the launch of a new taskforce to tackle tax evasion on property transactions in Greater London. The stated objective is to target cases where there has been a deliberate failure to comply with the option to tax rules, and will involve a review of all taxes involved in the transaction. This is one of 12 taskforces planned for 2011/12, and is part of the £900m programme of compliance work announced in 2010. This is intended to raise £7bn a year by 2014/15.

HMRC (SPEC) 19/11

Another campaign was announced in July 2011. Anyone who was not registered for VAT but trading above the limit was given until 30 September to register for an opportunity to receive a favourable deal (only a 10% penalty), but they also had to complete the registration process by 31 December. Presumably anyone who did the first but failed to do the second would be very foolish.

HMRC NAT 97/11

HMRC's "Agent Update" also notes the launch of taskforces:

- to tackle tax evasion in the construction industry;
- to tackle tax evasion by landlords in the North West and north Wales;
- targeting tax dodgers in Scotland;
- to tackle the non-filing of tax returns across the South East.

These will cover mainly direct taxes but may have VAT aspects.

Agent Update 27

6.9.8 Jail sentences

HMRC announced the sentencing of the fifteenth member of a MTIC fraud gang. The fraud involved buffer companies and mobile phones and attempted to steal up to £250m in VAT. The fraud was carried out from June 2001 to July 2003. The investigation lasted 10 years and there were six separate trials.

HMRC Press Release 20 December 2011

6.9.9 Advice on non-business activities

HMRC have published CAP1 *Advice on non-business activities*. This is intended to replace Code of Practice 10 and Notice 700/6, which covered the previous procedure for non-business "customers" to obtain advice and rulings from HMRC.

HMRC have also published a summary of the responses they received to their informal consultation about the new policy which was carried out between June and August 2011.

One of the difficulties with the service is the limitation placed on its scope by HMRC. The introduction to the document outlines when HMRC will and will not give a ruling.

When HMRC will give a response under this service

If you are a non-business customer or have a query which is not about a business activity and you:

- *cannot find the information you need about the tax treatment of a specific transaction(s) or issue(s) from HMRC's online guidance or helplines, or*
- *are uncertain about HMRC's interpretation of recent tax legislation as it applies to a specific transaction(s) or issue(s).*

You must have fully considered the relevant guidance and/or contacted the relevant helpline.

You can ask about a transaction:

- *you have already undertaken or*
- *one that you plan to undertake*

HMRC will tell you how they interpret recently passed tax legislation.

HMRC generally interpret recently passed tax legislation to mean legislation passed in the last four years. However they will give a view on legislation older than this where the subject or circumstances of your query are not covered in their published guidance and you have uncertainty about the right tax treatment.

When HMRC will not give a response under this service

If your query is about a matter other than the interpretation of recent tax legislation HMRC may still provide a suitable response, such as pointing you to the relevant online guidance.

If you ask for a view and HMRC do not provide it, they will tell you why.

Listed below are some of the reasons why HMRC might not give advice under this service:

- *You have not provided the necessary information – in which case HMRC will tell you what information they need (see the checklist at Annex A).*
- *HMRC do not think that there are genuine points of uncertainty - they will explain why they think this and direct you to the relevant online guidance.*
- *You are asking about a future transaction unless HMRC is reasonably satisfied that the transaction, as described, will indeed take place.*
- *You are asking HMRC to give tax planning advice, or to "approve" tax planning products or arrangements.*
- *Your application is about the treatment of transactions which, in HMRC's view, are for the purposes of avoiding tax.*
- *HMRC are checking your tax for the period in question. You will need to contact the officer dealing with the check.*

- *The time limit for HMRC to notify you of their intention to begin an enquiry into the Self Assessment return, to which the transaction you are enquiring about relates, has passed.*

http://www.hmrc.gov.uk/cap/news-311011.htm; http://www.hmrc.gov.uk/cap/cap1.htm

6.9.10 Consultation tracker

The latest version of HMRC's consultation tracker shows the following VAT-relevant consultations as either live or recently completed.

Consultation title	*Description*	*Type of consultation*	*Timing*
VAT cost-sharing exemption	Consultation will continue on the options for implementing the VAT cost sharing exemption into UK legislation	Informal consultation Formal consultation	Ongoing Open for comment 28 June - 30 September
VAT grouping extra statutory concession	Consultation on how best to legislate for ESC 3.2.2 to ensure its effect is maintained. ESC 3.2.2 allows the value of an anti-avoidance tax charge required within UK VAT groups to be capped at the value of services purchased by an overseas VAT group member and recharged to the UK.	Formal consultation	Open for comment 10 May - 3 August
Machine games duty	Consultation on the design characteristics of Machine games duty.	Formal consultation	Open for comment 24 May - 26 July
Tackling VAT evasion on road vehicles brought into the UK	Consultation on a new on-line vehicle notification system to be introduced to combat VAT fraud on road vehicles brought into the UK for permanent use on UK roads. This is a joint HMRC-DVLA initiative	Formal consultation	Open for comment 31 May - 31 August
VAT: consultation on the next steps for moving VAT online	The Government will mandate online VAT registration/de-registration and notification of changes from 1 August 2012. It will also mandate online filing of VAT returns and electronic payments for the second tranche of existing VAT customers (with a VAT exclusive turnover of under £100,000), for VAT periods beginning on or after 1 April 2012.	Formal consultation	Open for comment 8 August - 31 October

Digital by default	Consultation on how the Government will mandate use of the new online Registration Wizard for the main business taxes.	Formal consultation	Open for comment 8 August - 31 October
Simplification of regulatory penalties	Consultation on the range of penalties that HMRC can impose for failure to comply with regulatory obligations across the tax and duty regimes.	Formal consultation	Open for comment 17 June - 9 September
Working with Tax Agents: Dishonest conduct	Consultation on proposals allowing HMRC, with appropriate safeguards, to obtain the working papers of dishonest tax agents, penalise them and publish their details on the HMRC website	Informal consultation	Open for comment 14 July - 16 September

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

6.9.11 GAAR review published

Graham Aaronson QC has completed his report on the possible implementation of a General Anti-Avoidance Rule in the UK. His recommendation is for a narrowly focussed GAAR to apply initially to income tax, CGT, corporation tax, petroleum revenue tax and NIC, but not to VAT. He commented that VAT has anti-abuse principles derived from EU law, and applying a parallel domestic GAAR might risk being inconsistent with the Directive.

www.hm-treasury.gov.uk/d/gaar_final_report_111111.PDF

6.9.12 High risk tax avoidance schemes

After a consultation, HMRC have decided not to list "high risk avoidance schemes" in regulations. The proposal was effectively to extend the HMRC "spotlights" document, in which HMRC attempt to deter people from using schemes that they regard as ineffective. Use of a listed scheme would have been subject to a supplementary tax charge if it was successfully challenged by HMRC. It was considered too difficult to frame a set of rules which would be proportionate and enforceable, so HMRC are considering other alternative ways of deterring use of aggressive tax schemes.

CC/FS8(T)

6.9.13 Online manuals

HMRC have updated their online debt management manual, adding further information about outstanding VAT returns and enforcement action.

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

HMRC have updated their online insolvency manual, deleting reference to the Directors Disqualification Unit and adding extra information on the procedures for dissolved companies. Other minor amendments have been made in relation to notification of insolvency and VAT schemes.

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

HMRC have also updated their Notice on *Insolvency*. The main changes involve updates for the new penalty regime and a new section on the impact of the Capital Goods Scheme on insolvent businesses.

Notice 700/56

6.9.14 Complaints

HMRC have issued a new version of their factsheet on complaints. It explains how to complain, what information will be required, and what HMRC may do to put the matter right.

C/FS Complaints

6.9.15 Freezing and appealing

Two individuals were subject to a 'freezing order' following allegations of involvement in a VAT fraud. They were subsequently assessed to more than £300,000 of income tax each (with penalty determinations of lesser but also substantial amounts). They applied for their appeals against the income tax assessments to be stayed pending the resolution of High Court proceedings about the freezing order. They had no resources to pay for representation in what was likely to be a complex case, which they argued would mean they would be at a significant disadvantage compared to HMRC.

The First Tier Tribunal rejected this application: there was no justification for a stay of the income tax proceedings. The fact that a number of appellants appear in person before the First Tier Tribunal meant that they could have a hearing. It seems that the chairman did not accept that it would then be a hearing unfairly weighted in favour of HMRC.

First Tier Tribunal (TC01516): *Maxine and Anselm Peries*