VAT UPDATE
APRIL 2012

Covering material from January – March 2012

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VAT Update April 2012

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1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The HMRC website section which reports the progress of appeals reappeared on 21 January 2011 after lying dormant for some time. It says that it will be updated monthly, but it appears to be much less frequent or regular than that. The latest update appeared on 28 March 2012 (the first time it has lived up to the promise of being updated monthly).

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 (Advocate-General's opinion on *Littlewoods* in this update).

UK appeals awaiting hearing:

- *Bridport & West Dorset Golf Club Ltd*: HMRC have been granted 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
- *Croall Bryson & Co Ltd*: HMRC are appealing to the Upper Tribunal after the First-Tier Tribunal decided a car dealer was entitled to zero-rate supplies to wheelchair users on the basis of the evidence obtained (hearing date to be confirmed)
- *David Finnamore t/a Hanbridge Storage Services*: HMRC have been granted 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 was previously stated as 20 – 23 September 2011, but it now says “date to be confirmed”)
- *Esporta Ltd*: HMRC have been granted leave to appeal to the Upper Tribunal after the First-Tier Tribunal decided that sports club subscriptions paid in respect of a notice period were not taxable because the club did not make its facilities available to the members during that period
- *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 13 – 14 February 2012)
- *Honourable Society of Middle Temple*: HMRC have been granted 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.
- *SecretHotels2 Ltd*: HMRC have been granted leave to appeal to the Court of 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 (hearing scheduled for July 2012)
- *Simpson & Marwick*: HMRC have been granted leave to appeal to the Court of Session against the Upper Tribunal’s decision that bad debt relief could be claimed for the full amount of “VAT-only” invoices, rather than only the VAT fraction of them (where the invoice for the net supply had been paid by an insurance company)
- *Total Technology (Engineering) Ltd*: HMRC have been granted permission to appeal to the Upper Tribunal after the First-Tier Tribunal decided that a default surcharge was “disproportionate”
- *The British Disabled Flying Association*: HMRC are seeking permission to appeal to the Upper Tribunal after the First-Tier Tribunal decided supplies of adapted aircraft were eligible for zero-rating – FTT refused leave to appeal, so HMRC have applied directly to the UT
- *UK Storage Company (SW) Ltd*: HMRC have been granted leave to appeal to Upper Tribunal after First-Tier decided that a trader was supplying a licence to occupy land rather than storage services

In this update from previous lists:

- *Greener Solutions Ltd*: HMRC won an appeal to the Upper Tribunal on a First-Tier ruling that a trader did not have the means of knowing that its transactions were connected with MTIC fraud
- *Newey (t/a Ocean Finance)*: HMRC 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 has decided to refer questions to CJEU)

The list also confirms that HMRC will not appeal further in the *London Clubs Management Ltd* case, and have accepted the First-Tier Tribunal's decision on zero-rating of mattresses for disabled people in *Pure Independence (UK) Ltd*.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Consideration, not grant

A company was incorporated in 2007 with the purpose of operating a sports facility in Aberdeen. It was the result of a co-operative venture between Aberdeen City Council and Aberdeen University, and the intention was that the funding of the operation would largely come from the National Lottery through Sportscotland, a body which distributes lottery grants.

The company registered for VAT with the intention of claiming back VAT on capital costs of constructing its facilities. It was granted charitable status by the Scottish Charity Regulator, but it appears that it did not regard any of its income as exempt within Sch.9 Group 10. This point was highlighted, but not explained, in the accounts of the company for the years to 31 July 2009 and 2010.

The company operated in accordance with a contract between itself and its two 50% shareholders, the council and the university. This provided that 50% of its operating costs would be met by grant funding. The agreement provided certain service standards which had to be met, and gave the shareholders certain rights in relation to how the business was carried on.

Evidence showed that the business had been structured in accordance with VAT advice. The strategy had been to ensure that income was VATable rather than exempt (by making sure that the company was “subject to commercial influence” and was therefore not an eligible body); but it was assumed that the grant income would be outside the scope. It would therefore be possible to recover 100% of the input tax on expenditure, even though some of that expenditure was met out of receipts that were not subject to VAT.

The Tribunal considered a number of precedents about the link between consideration and supply, and the nature of the supply that HMRC contended the company made to the council and the university (mainly the provision of discounted access to the facilities for university students and Aberdeen residents). It concluded that the payment of the grants was not simply the gratuitous funding of a deficit but was consideration for a service that was supplied. It was therefore liable to output tax.

First-Tier Tribunal (TC01776): *Aberdeen Sports Village Ltd*

2.1.2 Public bodies

The March Budget releases included a Tax Information and Impact Note about the change to the statutory definition of “public body” for the purposes of VAT and the exclusion of public body activities from the scope of VAT. The changes will take effect from Royal Assent to the Finance Bill, and will cross-refer to the Principal Directive (art.13(1)).

www.hmrc.gov.uk/tiin/tiin766.htm

2.1.3 Employed or self-employed

In a curious case which was not directly related to VAT, the Tribunal had to consider whether a builder was acting as an employee of a doctor for whom he was supervising the refurbishment of a surgery. The builder had deregistered for VAT and intended to retire, but continued to carry out a number of small projects. The main tax point at issue was whether the doctor would be liable to pay the builder's tax and NIC under PAYE, but VAT could have been significant had the amounts of money involved been larger.

The Tribunal considered the facts in detail and tried to balance conflicting witness statements and arguments. It concluded that it was more likely that a doctor would engage an experienced builder on a self-employed basis rather than as an employee. The decision contains a useful review of the factors which will be taken into account in such a dispute, and also some of the precedent cases.

First-Tier Tribunal (TC01888): *T Coffey and Dr M Selvarajan*

2.1.4 Manual update

HMRC have updated their online manual on "Business/non-business". It includes changes to the treatment of boats and aircraft from 1 January 2011 (the inclusion of business/non-business adjustments in the capital goods scheme), the registration scheme for racehorse owners, expanded guidance on clubs and associations, and the removal of key points from case law to a separate section.

www.hmrc.gov.uk/manuals/vbnbmanual/vbnb10000.htm

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Insurance argument

The sale of Prudential's (P) general insurance business to Winterthur Swiss (W) in early 2002 was the subject of an important Tribunal decision (19,411) on place of supply of services in relation to the sale of a business. Another aspect of the deal has been considered by the Tribunal in late 2008, and that decision has come before the High Court on appeal..

The business was originally sold by P to W in a complex series of agreements. A month later, W novated its rights under the agreements in favour of a Bermudan subsidiary. In 2003 this company novated its rights again, this time in favour of a subsidiary of RBS. P was still running the business as agent but paying over the income to W, then the Bermudan company, and then RBS, in respect of their entitlements under the agreements. The beneficial owner then paid P commission, mainly in respect of renewal premiums for existing business.

HMRC ruled that this renewal commission was not exempt but standard rated. RBS appealed, but the Tribunal agreed with HMRC. P were not acting as an insurance broker or agent with respect to RBS, because they were not putting the parties to the insurance contract in contact with one another, nor were they carrying out work preparatory to the conclusion of the contract (which already existed).

It is a curious result for a curious reason: P could not be an insurance agent or broker because they were the insurer (previously); they were being paid for the use of their brand name (to the casual reader of the renewal notice, it would appear that P was still directly involved); that was much closer to marketing than it was to acting as an insurance broker or agent.

The High Court judge dismissed RBS's appeal against this decision, holding that the appearance of intermediation in this case was not enough to create the true relationship which would exist between a broker and two principals. P had not arranged a contract of insurance between RBS and the customer, so the money paid could not be insurance commission in the ordinary sense.

High Court: *Royal Bank of Scotland Group plc v HMRC*

2.3.2 Machine Games Duty

The Government has published a draft of the regulations which will implement Machine Games Duty under powers included in the Finance Bill 2012. The duty will apply from 2013 onwards and will be linked to the exemption of gaming machines from VAT.

The Machine Games Duty Regulations 2012, SI 2012/Draft

The March Budget releases included a Tax Information and Impact Note about the new duty. This includes the confirmation of the rates which will apply from 1 February 2013 – 5% for games with maximum stakes of 10p and maximum cash prizes of £8, and 20% for games with larger stakes and prizes.

www.hmrc.gov.uk/tiin/tiin738.pdf

2.3.3 Debt collection confirmed

The Court of Appeal has upheld HMRC's appeal against the High Court's decision in the *AXA* case. This seemed likely following the CJEU's ruling in early 2011, but the taxpayer did not give up, arguing:

- that the UK legislation granted an exemption for the services provided, even if the VAT Directive excluded debt collection;
- that the CJEU was not entitled to find that the services concerned constituted debt collection for the purposes of the exclusion from exemption;
- that further questions should be referred to the CJEU to clarify its reasons for excluding these services from the exemption.

The Court of Appeal rejected these arguments. Item 1 of Group 5 Sch.9 does not repeat the exclusion that appears in art.135(1)(d) of the Directive, but it is clearly intended to implement the whole of that provision. It is therefore to be interpreted in line with the underlying law: debt collection does not fall within "transfer, receipt or dealing with money".

It was clear that the CJEU had fully understood the services concerned and had ruled that they constituted debt collection. The Court of Appeal would not depart from a clear explanation of the meaning of the Directive given by the CJEU, nor was it necessary to obtain further clarification. HMRC's appeal against the High Court decision was allowed: no part of the supply fell within the exemption.

Court of Appeal: *HMRC v AXA UK plc*

2.3.4 Insolvency practitioners

After two earlier Briefs dealt with the decision of the Tribunal in *Paymex Ltd* (TC01210) (*R & C Brief 27/2011* and *R & C Brief 35/2011*), HMRC have now modified their view again. They will now accept that the work of insolvency practitioners in relation to the following procedures falls within the exemption:

- Individual voluntary arrangements
- Company voluntary arrangements
- Partnership voluntary arrangements
- Protected trust deeds (applicable only in Scotland)

The previous Brief restricted this only to IVAs and did not consider that the exemption extended to companies and partnerships (without explaining how they could be different). The new Brief states that IP services in relation to all other insolvency procedures remain standard rated.

R & C Brief 03/2012

2.3.5 Special investment funds

Another case on the exemption for management of special investment funds has been referred to the CJEU, this time from the Netherlands. The questions for reference are:

Can a taxable person who, pursuant to national pensions legislation, has established a separate pension fund for the purpose of safeguarding the pension rights of his employees and former employees, as participants in the fund, deduct the tax which he has paid on the basis of services supplied to him in respect of the implementation of the pension provision and the operation of the pension fund, pursuant to Articles 168 and 169 of Directive 2006/112/EC?

Can a pension fund, established with the objective of providing a pension for the participants in the pension fund at the lowest possible cost, where assets are brought to and invested in the pension fund by or on behalf of the participants, and where the resulting proceeds are shared, be classified as a 'special investment fund' within the terms of Article 135(1)(g) of Directive 2006/112/EC?

CJEU (Reference) (Case C-26/12): *Fiscale eenheid PPG Holdings BV c.s. v Inspecteur van de Belastingdienst/Noord/kantoor Groningen*

2.3.6 Education consultation

The March Budget included an announcement that the government will consult about the VAT treatment of education. The main subject appears to be the treatment of education provided by commercial universities, where there may have been complaints of unfair treatment.

Overview of Tax Legislation and Rates 2.53

2.3.7 Cost sharing

The March Budget releases included a Tax Information and Impact Note about the implementation of the cost-sharing exemption in art.132(1)(f) Principal Directive. The changes will take effect from Royal Assent to the Finance Bill. As previously announced, they will have retrospective effect, but as the conditions for the exemption have still not been finally confirmed, anyone taking advantage of it already has to do so at their own risk.

www.hmrc.gov.uk/tiin/tiin762.htm

2.3.8 Manual updates

HMRC have updated their online manual on "Insurance". Changes include updating of the place of supply rules (since 1 January 2010), new information about transfers of annuities and reinsurance contracts, and expansion of the explanation concerning the treatment of Lloyd's syndicates.

www.hmrc.gov.uk/manuals/vatinsmanual/vatins1400.htm

HMRC have substantially updated their online manual on "Finance". It reflects the new place of supply rules (since 1 January 2010) and the effect of a number of cases, not all of which are recent. The HMRC summary mentions *Kingfisher plc* (2000 STC 992) and the ECJ judgments in *AXA* (C-175/09), *Skandinaviska Enskilda Banken AB Momosgrupp* (Case C-

540/09) and *Velvet & Steel Immobilien und Handels GmbH* (Case C-455/05). The detailed list of amendments also refers to *Everything Everywhere (T-Mobile)* and *Tierce Ladbroke* in respect of payment handling services; *GFKL* on the transfer of defaulted debts; *Paymex* in relation to insolvency practitioners; and several others.

www.hmrc.gov.uk/manuals/vatfinmanual/updates/vatfinupdate210212.htm

2.3.9 Notice updates

HMRC have updated Notice 701/21A *Investment Gold Coins*. It replaces the February 2011 version and explains which gold coins are regarded as exempt and which are treated as taxable.

Notice 701/21A

HMRC have updated Notice 701/32 *Burial, cremation and the commemoration of the dead*. It has been updated from the January 2006 edition to improve readability. It distinguishes between the VAT exempt supply (“making of arrangements for disposal of the remains of the dead”) from the many related supplies that may be made in connection with funerals and commemorations, which are standard rated.

Notice 701/32

2.4 Zero-rating

2.4.1 Budget 2012

The March Budget contained a number of proposed measures to address "borderline anomalies", most of them in relation to zero-rating. These have attracted considerable press attention. All the following changes are scheduled to be implemented on 1 October 2012, unless their unpopularity has led to a change of heart before then. A draft statutory instrument has been issued making all the proposed amendments to Schedule 8. There is also a consultation about the proposals until 4 May, which suggests that they are not yet absolutely certain to proceed.

The Value Added Tax (Zero-rating and Exemptions) Order 2012 (draft); www.hmrc.gov.uk/budget2012/vat-con-4801.pdf

The first is the proposal to change the definition of "catering" to include all food which is above the ambient temperature at the point of supply, apart from freshly-baked bread. This is intended to remove the anomaly that take-away outlets have to charge VAT on pies, toasted sandwiches and hot chicken products, but bakeries and supermarkets may sell the same items as zero-rated. The law is expected to define hot food as "*For the purposes of paragraph (b) of Note 3, "hot food" means food which, or any part of which, is above the ambient air temperature at the time it is provided to the customer, other than freshly baked bread*".

Connected with this is the extension of "catering" to cover the sale of food for consumption in areas adjacent to a retailer, or in areas shared with other retailers (i.e. a food hall in a shopping mall). The consultation documents states that the main areas that are likely to be affected are "*tables and chairs on the pavement outside a café, food courts in shopping centres, other similar shared eating premises such as in motorway service stations, airports, railway stations etc.*" Areas that are not affected would include "*benches in a shopping centre for resting, airport departure seating*". The law is expected to read "*For the purposes of note (3), in the case of any supplier, the premises on which food is supplied include any area set aside for the consumption of food by that supplier's customers, whether or not the area may also be used by the customers of other suppliers*".

Both of these measures are described as "closing loopholes".

www.hmrc.gov.uk/budget2012/tiin-4803.pdf

"Sports nutrition drinks" will also be reclassified to make sure that they are always standard rated, rather than being zero-rated as a food in liquid form. This will depend on the marketing – products designed to enhance physical performance, accelerate recovery after exercise or build bulk, and other similar drinks, including syrups, concentrates, essences, powders, crystals or other preparations of such drinks will be standard-rated.

Outline of Tax Legislation and Rates 1.47

The supply of static caravans (i.e. those larger than are capable of being towed on the road) is zero-rated because they can be used for residential accommodation. This will be withdrawn unless the caravan is designed and constructed for year-round occupation. The intention is to make sure that caravans which are actually used for holiday accommodation are charged to VAT.

Outline of Tax Legislation and Rates 1.47

Claimants of some benefits are entitled to receive some supplies zero-rated. As disability and other benefits are all being absorbed into the new Universal Credit from April 2013, consequential changes to the law will be made to make sure that the same treatment continues to apply to the same people. The law will be amended by statutory instrument.

Outline of Tax Legislation and Rates 2.52

2.4.2 Sale of adapted cars

Following the recent case of *Croall Bryson & Co Ltd*, the Tribunal has heard another case about whether adapted cars qualified for zero-rating. A partnership was initially assessed to VAT of £48,457, but this was reduced on review to £13,839; after the first-named partner presented the facts to the Tribunal in the morning of the hearing, HMRC agreed all but two outstanding issues with the appellant over lunch. There therefore remained only two disputed sales, one of a Land Rover and the other of a Range Rover. The VAT on these two vehicles (on a VAT-inclusive basis) would have been about £9,800.

The Tribunal examined the facts, the legislation and the HMRC guidance in detail. It considered that the tests for zero-rating could be separated into two:

- the purchaser must be a qualifying person, that is a handicapped person who usually uses a wheelchair (HMRC's guidance was misleading in suggesting that the person had to be dependent on a wheelchair – the statutory test was "usually", not "always");
- the vehicle must be a qualifying vehicle, that is it must have been substantially adapted to enable a handicapped person to use it.

It was not necessary for there to be a direct link between the two – HMRC tried to make something of the fact that one of the purchasers was able to drive a car without the steering wheel spinner that was fitted to it, but the Tribunal ruled that this was not relevant. The two purchasers were clearly disabled people who normally used a wheelchair, and the fitting of the spinners – even if they could be easily removed and only cost £30 – was a substantial adaptation in that they enabled a handicapped person (not necessarily this handicapped person) to drive the vehicle.

First-Tier Tribunal (TC01730): *DG & CD Bunning (t/a Stafford Land Rover)*

2.4.3 Photobooks

HMRC have announced that they will not appeal the decision of the Tribunal in *Harrier LLC* (TC01562). This held that "photobooks" were zero-rated as printed matter, being a supply of goods with incidental services rather than the other way around.

HMRC will now accept that something is a book if it has, as a minimum, several pages, a cover stiffer than its pages and is bound. A book must also be designed to be read or looked at.

HMRC will not accept something as zero-rated if:

- the photobook's pages have the appearance and quality of individual photographic prints; or
- the photobook that is held out for sale is capable of being dismantled, with individual pages that are removable or where individual pages can be easily removed without damaging the binding (for example, spiral binding).

The decision also does not affect those photobooks where the customer is predominantly buying a photographic service, such as the service of the wedding photographer in *Risbey's Photography Ltd, Digital Albums Ltd* (VTD 20,783). These remain standard rated as a compound supply of services with incidental goods.

R & C Brief 04/2012

2.4.4 Manual update

HMRC have updated their online manual on "Food". Amendments have been made to refer to a number of recent decisions including *Manfred Bog*, *Deliverance Ltd*, *West Country Vending Services Ltd*, *AstraZeneca* (salary sacrifice), *SubOne Ltd* (Subway), *Innocent* and *GlaxoSmithKline*.

http://www.hmrc.gov.uk/manuals/vfoodmanual/updates/vfoodupdate030112.htm

2.5 Lower rate

2.5.1 Cable cars

The March Budget included an announcement that charges for transport in small cable cars will be subject to the lower rate of VAT from 2013 for at least 3 years, after which the situation will be reviewed. Cable cars which carry at least 10 people are already covered by zero-rating, but "small cable-based transport" is currently standard rated.

Outline of Tax Legislation and Rates 2.55

2.5.2 Charitable buildings

By contrast, the Finance Bill 2013 will contain provisions to remove the lower rate from energy-saving materials installed in buildings used for a relevant charitable purpose. Only residential buildings will continue to qualify (including residential property owned by a charity).

Outline of Tax Legislation and Rates 2.47

2.6 Computational matters

2.6.1 Unauthorised use of retail scheme

The Tribunal has heard a dispute about the operation of retail schemes. The decision starts with a useful review of the background to these schemes, including the reason for their existence, the law under which they are operated, the basis for assessments raised by HMRC, and the jurisdiction of the Tribunal to hear appeals.

Where a trader applies to change a retail scheme retrospectively, HMRC will allow this only in exceptional circumstances. The Tribunal only has a supervisory jurisdiction in respect of such a decision. On the other hand, where a trader has incorrectly operated the retail scheme that should be applied, HMRC can raise an assessment to collect the tax that ought properly to have been calculated under that retail scheme.

The appellant had last been visited before the retail schemes were revised by HMRC in 1997. When an officer visited in 2008, he concluded that the retail scheme calculations were an incorrect application of Apportionment Scheme 1: they used net figures instead of gross figures in working out the VAT, and did not include an annual adjustment. The officer raised an assessment for £10,417.

The trader's brother, who had an accountancy degree and acted as the bookkeeper, acknowledged that he had made mistakes in operating the retail scheme. However, he argued that he had been trying to operate Direct Calculation Scheme 1, not Apportionment Scheme 1. The apportionment scheme was not appropriate because the business had a turnover of more than £1m (although that would also rule out Direct Calculation Scheme 1). If the direct calculation scheme was used, an overpayment of some £9,160 had been made, and the trader made a claim for that amount. The HMRC review confirmed the original decision, and the trader appealed.

The Tribunal had to consider what ought to happen when a trader has made two errors – operating incorrectly a retail scheme he is not authorised to use. It concluded that the argument was not about whether the trader could retrospectively change the retail scheme in use; rather, it was about whether an assessment fairly reflected the output tax that should have been accounted for, given that the trader had made those two separate mistakes. As the assessment was itself based on Apportionment Scheme 1, which was not appropriate, HMRC should have taken into account all the circumstances in deciding what the fair result would be. This would include the fact that the trader achieved a very low mark-up on the main standard rated sales (fuel) and a higher mark-up on zero rated items (groceries and sandwiches).

The Tribunal decided that the appeal against the assessment should be allowed in principle. It was not possible to give a ruling on the precise monetary result, because no evidence had been produced about the reliability of the mark-up data which underpinned the voluntary disclosure and reclaim. The parties were invited to go away and discuss those data in the light of the ruling that HMRC should be considering a fair result rather than a formulaic approach to the outcome of the calculations.

First-Tier Tribunal (TC01865): *Munaf Patel t/a Cleggs Lane Service Station*

2.7 Discounts, rebates and gifts

2.7.1 Reader's Query

A Reader's Query in *Taxation* asked for the VAT consequences of a trader giving a client a case of 12 bottles of wine to hand on to his employees. In the view of the respondents, this could not be regarded as 12 separate gifts to different people (capable of being "small gifts") because the donor relied on the first recipient to pass the gifts on. It was therefore a single gift and exceeded the limit.

The respondents also distinguished between entertainment, which resulted in an input tax block, and business gifts, where the input tax would be deductible but an output tax charge could arise. The gift of a bottle would not be entertainment; opening the bottle and pouring the donee a drink would be entertainment.

Taxation, 19 January 2012

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 Sale of abandoned dogs

A charity received abandoned and rescued dogs and tried to find them new homes. It required a "donation" from the person who took the dog, and treated this as outside the scope of VAT. Following the case of *Gables Farm Dogs and Cats Home* (VTD 20,519), it applied to be retrospectively registered for VAT and to be treated as making zero-rated supplies of donated goods. HMRC refused a claim to recover input tax of £61,000 from 1 April 2006 to July 2010, ruling that the "donation" was not consideration for a supply.

The Tribunal allowed the charity's appeal. The "donation" was compulsory: if the applicant refused to pay it, the charity would not give them the dog. From the charity's point of view the donations were needed to cover costs incurred in kennelling, neutering and microchipping the dogs; but it was also considered that someone who refused to pay £100/£150 for a dog might not be able to afford to keep it, and would therefore not provide a suitable home. That was enough to make it consideration linked to the supply of the animal, so the situation was the same as in the earlier case.

HMRC had accepted the charity's registration after it had changed the wording on its website to make it clear that payment was required for a dog to be supplied. The Tribunal was satisfied that this did not represent a change in the underlying practice, but merely a clarification of what that practice was. It was accepted that the use of the word "donation" was not intended to mislead, but was understandable in the context of a charity.

First-Tier Tribunal (TC01653): *Three Counties Dog Rescue*

2.11.2 Definition of charity

As reported in the last update, the statutory definition of "charity" for VAT purposes has now been set by statutory instrument. This implements the provisions of FA 2010 Sch.6 Part 1. The change was made necessary by the decision of the CJEU in *Persche v Finanzamt Lüdenscheid* (C-318/07), which required member states to extend their charitable reliefs to similar organisations based elsewhere in the EU.

SI 2012/735

2.12 Other supply problems

2.12.1 Car fuel scale charges

An updated set of car fuel scale charges (s.57 VATA 1994) will apply for return periods starting on or after 1 May 2012. The lowest scale applies to cars with emissions ratings of 120g/km or less; the charges rise at each 5g/km increment above that until the maximum is reached at 225g/km or more. The rules about the application of the charge have not changed.

Note that the VAT treatment is now considerably different from the income tax treatment of taxable benefits, which are based on a percentage of a set figure of £20,200. The percentage is based on the CO_2 emissions rating, but there are different figures for up to 75g/km, 76 – 99g/km, 100 – 104g/km and then increasing at 105, 110 etc. up to 225g/km. There are therefore several different percentages covering the range of cars which all enjoy the minimum scale charge for VAT.

The Government intends to consult on legislation to be included in the Finance Bill 2013 to give effect to certain extra-statutory concessions relating to the scale charges and a proposal to amend the scale by annual public notice having the force of law instead of by statutory instrument.

SI 2012/882

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Budget 2012

The March Budget contained a number of proposed measures to address "borderline anomalies", some covered earlier under zero-rating, and two more relating to the exemption for letting of land. They are scheduled to be implemented on 1 October 2012.

It is proposed to add the provision of self-storage facilities to the list of supplies which are excluded from exemption under Sch.9 Group 1. This will effectively reverse the decision of the Tribunal in the two cases which have held that this is exempt (TC01081: *David Finnamore t/a Hanbridge Storage Services* and TC01394: *UK Storage Company (SW) Ltd*). Anti-forestalling legislation will take effect immediately from Budget day, 21 March (i.e. preventing prepayments to fix a tax point while the supply is still exempt).

The consultation document states that this change will level the playing field between providers of self-storage and other forms of storage (where there is a service which does not constitute a licence to occupy particular land). The second reason given is more likely to be the strongest motive for the Government: some self-storage providers have opted to tax in order to recover VAT on the cost of their buildings, then used avoidance arrangements to cancel the effect of the option and revert to exempting their supplies to customers.

To prevent the use of the new measure for avoidance, it will not apply to supplies between connected persons in circumstances where an option to tax would be disapplied. The measure will also only apply to the supply of services to end users – the rental of an entire storage building will not be covered.

The consultation document also notes that the Government will watch for evidence of the use of value-shifting between self-storage and related supplies of insurance, and may apply the higher rate of IPT to such insurance if there is evidence of abuse.

www.hmrc.gov.uk/budget2012/vat-base-broad-4801.pdf

The provision of a chair in a hairdresser's salon will also be added to the list of supplies excluded from exemption under Sch.9 Group 1. Exemption will only be available where a whole section of a hairdresser's shop is let – the rent of a whole floor, separate room or clearly defined area by a salon to a stylist will remain exempt unless services are provided by the salon owner such as laundry, booking and reception services etc. If these are also provided then the supply will be the same as the normal chair rental and is standard rated because a bundle of services is supplied. In order to prevent avoidance this will apply whether it is the salon owner who provides these services or someone connected to them.

As HMRC generally win cases on this point, it is less clear why they should want the law changed as well. The Tribunal consistently finds that this arrangement constitutes a standard rated licence to provide facilities rather than a mere licence to occupy land. The consultation document comments that this measure puts the matter beyond doubt for the future.

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Both of these measures are subject to consultation, with responses required by 4 May.

www.hmrc.gov.uk/budget2012/vat-con-4801.pdf

Tax Impact and Information Notices have also been issued on both subjects.

www.hmrc.gov.uk/budget2012/tiin-4801.pdf;
www.hmrc.gov.uk/budget2012/tiin-4802.pdf

3.1.2 Seasonal caravan pitches

An extra-statutory concession which exempts the supply of seasonal caravan pitches for residential rather than holiday use is being put on a statutory footing with effect from 1 March 2012. A pitch which is intended to be the occupant's principal place of residence for the period of occupancy is not excluded from exemption.

The law is also being clarified to make sure that failure to enforce planning consent restrictions cannot be used to justify exemption (or zero-rating) where the planning restrictions were intended to restrict use to seasonal holiday pitches. HMRC won the case of *Tallington Lakes* (2007) in relation to this point, but decided that the law should be put beyond doubt.

SI 2012/58

HMRC have issued a Brief aimed at caravan site owners to explain the tightening of the criteria for exemption of pitches. It includes a new para.4.1 which will be incorporated into Notice 701/20 in due course.

R & C Brief 05/2012

3.1.3 Article

In an article in *Taxation*, Neil Warren considers the VAT implications of changes in the use of commercial property. Conversions to residential use and transfers to charities present a number of VAT issues, and the use of different vehicles to own and operate the premises can create unintended VAT blocking because of intermediate exempt supplies in the chain.

Taxation, 19 January 2012

3.2 Option to tax

3.2.1 Reader's Query

A Reader's Query in *Taxation* raised issues in relation to the purchase of development land by a VAT-registered partnership which intended to develop residential accommodation for students for subsequent letting. The first question was whether it was possible to use a form VAT 1614D to disapply any option to tax which had been exercised by the vendor of the land. One answer points out that this does not appear to apply to a purchase of land – the legislation, the form and the Notices only refer to its use in relation to a "building or part of a building".

The answers go on to consider possible business structures to minimise the impact of VAT, possibly incorporating a zero-rated grant of a major interest to a connected person. This would appear not to risk being treated by HMRC as abusive following *R&C Brief 101/09* (originally issued as *R&C Brief 54/08*).

Taxation, 22 March 2012

3.3 Developers and builders

3.3.1 Relevant charitable purpose

A college appealed against HMRC's refusal to issue a zero-rating certificate in relation to the construction costs of a new campus building. The question was whether the buildings would be used for a "relevant charitable purpose", i.e. other than for a business purpose (as it was accepted that the appellant was a charity for the purpose of this rule).

The college argued that the nature of its funding, its mode of operation and its general characteristics were such that it was not in business at all so far as the activities intended to take place at the new campus were concerned.

The First-Tier Tribunal considered the facts of the case in detail, and then applied a number of legal principles to those facts. First, everyone agreed that the provision of grant-funded education is not a business for VAT purposes. This is backed up by the CJEU decision in *Commission v Finland* (Case C-246/08), where charging contributions for legal aid based on a means test broke the link between consideration and service and was therefore not a business activity.

However, there were a significant number of students who paid fees for their education. 11% paid up to half the cost, and 16% paid the full amount. Applying the *Lord Fisher* tests to these activities, the FTT chairman found that the college was engaged in business. HMRC were therefore correct to refuse the zero-rating certificate, and the appeal was dismissed.

The college appealed to the Upper Tribunal, arguing that the FTT had failed to appreciate that business use which was de minimis could be ignored. The FTT chairman appeared to have believed that this was only an extra-statutory concession and he could not therefore allow the appeal on that ground; however, as set out in RCB 39/09, HMRC regard the de minimis business use of buildings by a charity as a matter of interpretation of the statutory word "solely". It was therefore open to the chairman to allow the appeal if he had concluded that the business use was no more than 5% of the total. He had not drawn such a conclusion because he did not think it necessary. The Upper Tribunal remitted the case to the FTT for consideration of this point.

The college also appealed on the basis that the chairman had not reached a conclusion on a particular part of its skeleton argument. HMRC contended that the chairman had considered it and dismissed it. The Upper Tribunal judge decided that it was not entirely clear whether the chairman had reached a final conclusion – he appeared to indicate that more information was necessary. As the case was being remitted anyway, the chairman could clarify that issue at the same time.

The college had also argued before the First-Tier Tribunal that it was at the relevant time "a body governed by public law" in the sense required by art.13 VAT Directive, and it was therefore not to be regarded as a taxable person. Although this point was rejected by the High Court in the *Cambridge University* case in 2009, the Tribunal was asked to rule on the issue so that the college could argue in an appeal that the earlier case was wrongly decided. In the event, it did not appeal this point to the Upper Tribunal, as it must have decided that such an appeal would not succeed.

Upper Tribunal: *Wakefield College v HMRC*

3.3.2 Budget 2012

Another "borderline anomaly" to be removed from 1 October 2012 is the zero-rating of approved alterations to protected buildings under Sch.8 VATA 1994 Group 6 Item 2, and the related zero-rating of the grant of a major interest in a substantially reconstructed protected building under Item 1 where 60% of the work involved in the reconstruction qualifies as an approved alteration. This has been presented as removing the anomaly that repairs to listed buildings are charged to VAT, whereas altering them – apparently against the overall intention of listing – is favoured.

This means that zero-rating of such buildings will only apply in future if they are substantially reconstructed in the sense that zero-rating will only apply if the reconstructed building incorporates no more of the original building than the external walls, together with other external features of architectural or historic interest. The works in the project must be standard rated (or in some cases lower rated), but a business supplying a major grant at the end of such project will be able to recover all the input tax without having to charge output tax.

Transitional arrangements will provide for the retention of zero-rating where a contract for reconstruction was entered into prior to 21 March 2012, and at least 10% of the work (by cost) was completed before that date. On the other hand, anti-forestalling measures will be included in the Finance Bill, to apply from 21 March 2012, to prevent works (or incorporated building materials) after 1 October qualifying for zero-rating by artificially fixing a tax point before that date through prepayment or early delivery.

The anti-forestalling charge will become due on 1 October 2012, rather than on the date of the supply to which it relates. If the person making the supply has ceased to be a taxable person by that date, there are provisions for collecting the tax from the representative member of its group, or as a liability of the final VAT return period before deregistration.

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www.hmrc.gov.uk/budget2012/vat-base-broad-4801.pdf

A draft of the new legislation, in the form of a Statutory Instrument amending Group 6, has been issued as part of the consultation on all the VAT measures in the Budget.

www.hmrc.gov.uk/budget2012/vat-con-4801.pdf

3.3.3 Repair or alteration?

The "borderline anomaly" was well illustrated in a dispute in the Tribunal. A builder had replaced the bedroom ceiling in a protected building. This involved taking out plasterboard (presumably a relatively modern feature) and replacing it with laths and lime plaster (presumably the original type of ceiling). HMRC ruled that this was simply a repair, but the Tribunal decided that it was a "fundamental change to the fabric" and therefore qualified as an alteration. It also required and had been given planning consent, so it was zero-rated under Group 6 Item 2.

The decision has the unusual feature that the appellant was represented by one of the partners by speakerphone, as he was too ill to attend. The partnership had comprised a father and two sons; the father had recently died and the other brother had been diagnosed with cancer. As four representatives of HMRC had attended the Tribunal, the judge considered that it would be both efficient and fair to proceed with the hearing, ascertain the main facts first from those present, then obtain the appellant's representations by telephone.

The firm had specialised in this type of plaster work for over 40 years, and was one of the few businesses in the country capable of undertaking it. The local authority had specifically required the restoration of the original type of ceilings as part of a project to create separate bathrooms for the bedrooms (which HMRC had accepted was a zero-rated alteration). The ceilings undoubtedly needed to be repaired, as they had been damaged by leaking water from the roof. The Tribunal considered the possibility of allowing the extra cost of using the specialist method rather than simply replacing the damaged plasterboard (which would have cost about 20% of the actual charge); however, this approach was rejected. The difference was substantial, and it was therefore an alteration. That meant that it should be zero-rated in full.

First Tier Tribunal (TC01842): *EL Flood & Sons Partnership*

3.3.4 Extra care accommodation

HMRC have issued a Brief to clarify the liability of construction and development of what they call "extra care accommodation". This refers to self contained flats, houses, bungalows or maisonettes that are sold or let with the option for the occupant to purchase varying degrees of care to suit his or her needs as and when they arise.

HMRC have noted that some local authorities classify such buildings under Use Class C2, which is not the normal classification for flats, maisonettes and other dwellings (C3). Nevertheless, HMRC do not consider the planning categorisation as determinative of whether zero-rating is available. Instead, they will consider the statutory definition of a dwelling and a major interest grant in the normal way, and zero-rating will be available where the conditions are satisfied.

R & C Brief 47/2011

3.3.5 New manual

HMRC have published a new online manual on “Construction”. It gives additional information on the application of the zero and lower rates to construction and supply of buildings, including details about “building materials” and the definitions of relevant residential and relevant charitable purposes. There are also sections on self-supply of construction services and the DIY builders’ scheme.

www.hmrc.gov.uk/manuals/vconstmanual/VCONST01000.htm

3.3.6 Article

In an article in *Taxation*, Neil Warren considers the VAT problems of building projects, including the different VAT liabilities that can apply to different types of work; the different VAT rates that may have to be charged by the main contractor and sub-contractors; and the borderlines between new build and refurbishment, conversion and extension.

The article considers in particular the cases of *David and Elizabeth Sherratt* (TC01180) and: *Timothy and Sally Stevens* (TC01671).

Taxation, 1 March 2012

3.4 Input tax claims on land

3.4.1 Meaningless planning restriction

A married couple constructed a farmhouse in the Exmoor National Park. Somerset County Council granted planning permission subject to a restriction that the house must not be transferred or disposed of separately from the 100 acres of land to which it was attached. HMRC considered that this ruled out a DIY builders’ claim.

The couple had obtained outline planning permission in 1990. They moved into the property in 1998 but only obtained a certificate of completion in 2008, when they submitted their refund claim. They had contacted HMRC in about 2004 and been given a copy of the 2002 edition of Notice 719.

At the first hearing, the parties were unable to produce the crucial planning permission document. The hearing was therefore adjourned and Somerset County Council was asked to produce a certified copy. Two more hearings were required, and further representations were invited from the parties but not received. The Tribunal eventually gave its conclusions based only on the document that the Council had provided.

It was clearly the type of planning restriction that would normally rule out a building qualifying as a dwelling. However, the Tribunal identified a number of apparent inconsistencies and anomalies in the document, including the fact that it appeared to have been issued by the wrong body –

the National Park authority was the sole planning authority for development in the park, so the Council's planning restriction had no effect. It had been issued under a mistake of law.

As there appeared to be no effective legal restriction on the separate disposal of the house, the DIY claim succeeded.

First-Tier Tribunal (TC01671): *Timothy William Stevens; Sally Mary Stevens*

3.4.2 Meaningless planning permission

A married couple bought a bungalow with the intention of demolishing it and building a house for their retirement. They applied for planning permission and carried out the project, living in a caravan in the garden while it was completed. The local council monitored the project and raised no objections. It was only when the DIY builders' claim was submitted that anyone noticed that the planning consent did not mention the demolition of the former building. It appeared only to refer to alterations, not replacement.

The council was willing to grant planning permission after the event to make the development lawful, but refused to exercise powers which exist under the planning legislation actually to backdate the revised consent to the beginning of the project. Although this would still not mean that consent existed at the time the development was carried out, HMRC accepted that the exercise of this power would have solved the problem and allowed them to pay a DIY claim.

The Tribunal had sympathy with the appellants, who had acted throughout in good faith and had done everything that they ought to have done. However, the requirements of the law were exact and they had not been met, so the Tribunal had no choice but to dismiss the appeal. The chairman expressed the hope that the council would, even now, rectify the situation.

First-Tier Tribunal (TC01804): *Kenneth Jones and another*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Rate changes

HMRC have advised that:

- the standard rate of VAT in Ireland has risen from 21% to 23% with effect from 1 January 2012;

Information Sheet 13/2011

- the standard rate of VAT in Hungary has risen from 25% to 27% with effect from 1 January 2012;

Information Sheet 02/2012

- the standard rate of VAT in Cyprus will rise from 15% to 17% with effect from 1 January 2012.

Information Sheet 3/2012

HMRC have also published the usual table of exchange rates for use by those registered under the special scheme for e-traders in the quarter to 31 December 2011.

Information Sheet 01/2012

4.2 Where is a supply of services?

4.2.1 Place of supply of foreign exchange services

A company provided foreign exchange services to customers, many of whom were young people from Australia, New Zealand and South Africa working in the UK. The company claimed back input tax on the basis that it was entitled to credit in respect of “specified supplies” to persons “belonging outside the EU”. HMRC assessed the company on the basis that the customers belonged in the UK at the time of the supply.

The company provided evidence of the type of visa on which many of their customers entered the country – 10,554 out of 16,339 customers in the period under review were on “working holidaymaker” visas. They would be likely to take temporary work on 3 to 6 month contracts; the visa entitled them to stay for a maximum of 2 years, although only a few stayed for the full length of time.

There was some dispute about the “typical customer”. HMRC considered that the company provided services to well-paid financial professionals, offering them tax mitigation strategies including the provision of personal service companies registered in Jersey to reduce the NIC on their earnings while in the UK. Many of them earned enough to send money home. They were not “typical backpackers”. The company emphasised that its customers were usually young, on an “overseas experience” without a settled purpose, assets or dependants. They did not “belong” in the UK.

The Tribunal noted that the Principal VAT Directive at art.56 refers to a person belonging in “the place where he has his permanent address or usually resides". There seemed to be no EU case law or guidance on what this means. The UK case of *Razzak* appeared to support the appellant, but the circumstances were very different, as the person in that case wanted to leave the UK at the earliest opportunity. The Tribunal quoted at length from Lord Scarman's judgment in the case of *Shah v Barnet London Borough Council* [1983] – this turned on the definition of "ordinarily resident", which is a term from direct taxation, but the Tribunal believed that it was relevant to the interpretation of art.56.

The Tribunal concluded that even an 18-month typical stay was enough to qualify as a "settled purpose" so that the customers "belonged" in the UK. The type of work they did was not particularly relevant; the fact that they had no specific intention was also not relevant, given that they were likely to have a general intention to stay in the country for an extended period. The supplies did not qualify for input tax credit under the Specified Supplies Order, and the appeal was dismissed.

First-Tier Tribunal (TC01780): *First Contact Ltd*

4.2.2 Freight transport

The Budget included an announcement that the current temporary arrangement for freight transport carried out wholly outside the EU will be formalised. The problem with the existing rules was highlighted following the Haiti earthquake: under the standard rules for B2B services, supplies of transport for a UK-based charity would be subject to a reverse charge, which the charity could not recover if it was engaged in wholly non-business activity. The reverse charge is currently ignored if the supplies of transport services take place entirely outside the EU, and this will be confirmed by a change in the law.

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4.2.3 Manual update

HMRC have updated their online manual on "Place of supply of services" to reflect changes which took effect on 1 January 2011 and to give further details on reverse charges.

www.hmrc.gov.uk/manuals/vatpossmanual/VATPOSS08000.htm

4.3 International supplies of goods

4.3.1 Unreasonable decision on SIVA

A company which has a good compliance record is allowed to operate the Simplified Import VAT Accounting Scheme (SIVA) without providing security for the VAT which will be incurred during trading. A similar system operates for excise duty (EPSS). A new company acquired the assets and trade of such an approved importer, and appealed when HMRC refused to grant it the same authorisation. The company argued that its predecessor had an unblemished record, and it had taken on the senior employees who were responsible for that excellent compliance.

The application was refused because the new company had not been registered for at least three years. Because it did not take on the registration number of the predecessor and did not have continuity of directors, it could not rely on the compliance record of the previous business.

The Tribunal considered the law, HMRC's policy and the facts. It was clear that the officers had taken the decisions purely on the basis that the published criteria for granting approval were not met. They had not considered whether there was a real risk to the revenue, or whether the mitigating factors put forward by the appellant and its representatives had any bearing on the matter. This was described by the chairman as a "tick-box approach" which could not constitute a reasonable decision-making process. The appeal was allowed.

First-Tier Tribunal (TC01770): *Forth Wines Ltd*

4.3.2 Double taxation on acquisition of cars (1)

A Northern Irish car dealer bought some BMWs from a German company. An amount equivalent to German VAT was charged, ostensibly to protect the supplier's position if the goods were not removed from Germany. Even though the UK trader accounted for acquisition tax, the supplier did not refund the German "VAT".

The UK trader accounted for UK output tax on the profit margin rather than the full selling price, which may have appeared to be a reasonable way around the problem. However, HMRC inspected the records and ruled that this was impossible. The trader asked HMRC to discuss the matter with the German authorities, who confirmed that German VAT should not have been charged on the despatch of the cars; however, by this time the German supplier had become insolvent and the principals had disappeared.

The trader appealed to the Tribunal against an assessment for £49,000 of output tax, mainly based on the argument that it would be suffering double taxation. The Tribunal had to dismiss this appeal: it had no power to make HMRC effectively give credit for German VAT. The only remedies available to the trader were in Germany – either against the supplier, which had definitely overcharged it, or possibly the German authorities. According to the CJEU decision in *Reemtsma Cigarettenfabriken Gmbh v Ministero delle Finanze*, a Member State might have to refund its VAT to a trader where relief by the normal channels was excessively difficult to obtain. However, that would probably depend on proof that the supplier had accounted for the output tax to the German authorities in the first place.

First-Tier Tribunal (TC01785): *J B Davison*

4.3.3 Double taxation on acquisition of cars (2)

A similar situation arose in relation to a non-taxable purchaser who bought a motor home for holidaying in Germany, paying German VAT at 19% of €5,915. The motor home was to be kept at the taxpayer's home in the UK when not in use for travelling, which required registration in the UK. This in turn led to a liability for VAT on a new means of transport (charged at 15% because the car was brought into the UK on 23 December 2009). The German supplier had gone into liquidation and was therefore unable to refund the German VAT; HMRC argued that this was unfortunate, but it imposed no obligation on them.

An interesting feature of the decision is a list of questions which the Tribunal put to HMRC at the end of the hearing. The first was what would happen in the reciprocal situation, where a German resident had been charged UK VAT by a supplier which went into liquidation. HMRC responded that they would would consider each case on its merits, and if there was no doubt that the supplier had accounted for the output tax to them, they might make a discretionary refund to the customer. However, they could not force another tax authority to adopt the same policy, and they were not aware of the situation ever having arisen.

HMRC also agreed to make an informal approach to the German authorities to confirm that VAT had been paid in the UK and ought therefore not to have been charged in Germany. However, it was normal practice for German motor dealers to protect their position on NMTs in this way, and HMRC did not expect the German authorities to make a repayment unless they were satisfied that they had received the original VAT charged.

The Tribunal expressed sympathy for the appellant, but felt compelled to reject the appeal. As with the earlier case, the solution lay with the German authorities, not with HMRC.

First-Tier Tribunal (TC01872): *Richard Munday*

4.3.4 Zero-rating problem

A company was assessed to output tax of £215,754 in respect of supplies (of pharmaceutical products such as razor blades and toothbrushes) which were zero-rated on the basis that goods had been despatched to a customer in Spain. The customer had been deregistered in Spain in 2006 and could no longer be traced. The shipping documentation proved to be unreliable.

The appellant sought to rely on the *Teleos* principle – that zero-rating should not be denied where a trader had acted in good faith and had done everything in its power to confirm the veracity of the documents. The Tribunal did not find that the trader was complicit in a fraud, but also did not consider that everything possible had been done. There were features of the documentation that suggested further enquiries ought to have been made. These were clearly not made, and the appeal was dismissed.

First-Tier Tribunal (TC01875): *Kenco Spares Ltd*

A company treated 7 consignments (of pharmaceutical products, mainly drugs) as zero-rated exports to Nigeria. HMRC ruled that it had not obtained the evidence required to support zero-rating as specified in Notice 703, and raised an assessment for £74,419. HMRC initially raised the assessment for the period 01/07 in which the supplies took place, but subsequently withdrew it and replaced it with an assessment for period 04/07 “because of the three-month time limit to provide evidence of export”.

HMRC also disallowed zero-rating on two more supplies made in 03/07, and disallowed input tax on two purchases on the basis that the consideration was not paid within 6 months of the date of supply. The further assessments were for £10,142 and £14,964.

The Tribunal had to consider a large amount of confused evidence about transactions which appeared to have been inconsistently documented. The weights recorded on shipping documentation did not match the goods that were supposed to be contained in those shipments. Some goods were recorded as being exported from Heathrow when other documentation suggested they only left the EU from Vatry in France. Explanations given by the director of the company were not considered credible.

However, the Tribunal was satisfied that, in spite of the discrepancies, there was enough evidence to satisfy Notice 703 in respect of three of the supplies, and in respect of the payment of one of the two purchase invoices. The appeal was allowed in part.

First-Tier Tribunal (TC01821): *Arkeley Ltd (in liquidation)*

4.3.5 Postal packets

A new statutory instrument, The Postal Packets (Revenue and Customs) Regulations 2011, has made amendments to the rules concerning the posting of packages into and out of the customs territory of the EU. It came into force on 12 January 2012. It replaces SI 1986/260, revoking some provisions which have been superseded by the Community Customs Code (EU Regulation 2913/92/EEC) and re-enacting others with modifications.

SI 2011/3036

4.3.6 Budget 2012

The Budget included confirmation of the withdrawal of Low Value Consignment Relief for mail order goods imported into the UK from the Channel Islands.

Jersey challenged the legality of this measure in the High Court, arguing that it was contrary to EU VAT law to target such a measure only against a particular territory such as the Channel Islands. However, the High Court rejected the argument, ruling that the change was consistent with EU law. Jersey’s Economic Development Minister said that the senate was considering lodging an appeal.

www.hmrc.gov.uk/tiin/tiin874.htm

The Budget also contained further details of the measure that will be introduced from April 2013 to prevent VAT evasion on road vehicles brought into the UK. There will be a requirement to notify HMRC within 14 days of bringing a vehicle into the UK for permanent use on the UK roads. It will not be possible to register or licence a vehicle until HMRC have been notified and any VAT due has been paid (or, if imported by a business, the VAT is considered by HMRC to be “secure” – i.e. the business is trusted to account for it).

There will be exceptions from the requirement to notify for UK residents returning from holiday, private importers and importers using certain schemes that are approved by DVLA.

www.hmrc.gov.uk/tiin/tiin768.htm

4.3.7 Intrastat reminder

HMRC have issued a Brief to remind businesses that the deadline for submission of intrastat returns is brought forward from the end of the following month to the 21st of the following month with effect from 1 April 2012, and that they must now be submitted electronically rather than on paper.

R & C Brief 07/2012

4.3.8 Notice updates

HMRC have issued a revised (January 2012) version of Notice 60. It has been restructured to improve readability. It also confirms that from 1 April 2012:

- the option to submit declarations on paper forms will be withdrawn; and
- the due date for submission of declarations advances to the 21st day of the following month.

There are changes to the delivery terms in use and a reminder that the threshold for low value consignment simplification has risen from £130 to £180.

Notice 60

In line with R & C Brief 38/2011, the Notice on the Sailaway Boat Scheme has been revised to confirm that it can no longer be used by UK residents.

Notice 703/2

HMRC have replaced the September 2004 version of the notice on the retail export scheme, called “Tax Free Shopping in the UK”. It explains the way in which the scheme operates, requiring the shopper to pay VAT in the shop and claim it back later after getting documentation stamped at the point of exit when the goods are presented to HMRC. The Notice has been rewritten to improve clarity, but most of the restrictions on claiming VAT remain the same.

A February 2012 version was issued cancelling the January 2012 version, but it was not made clear what new amendments had been made.

Notice 704/1

4.3.9 Manual updates

HMRC have updated their online manual on “The Single Market” to explain the CJEU decision in Facet Holdings (the “fallback rule” where a VRN is used to justify zero-rating of a despatch from another country) and its effect on the deduction of input tax on yachts which are bought using a UK VAT number but which never come to the UK.

www.hmrc.gov.uk/manuals/vatsmanual/VATSM3350.htm

HMRC have published a new online manual on “VAT IMPS (Imports)” to provide their staff with information and guidance on VAT on imported goods and import VAT reliefs.

www.hmrc.gov.uk/manuals/impsmanual/IMPS01000.htm

4.4 European rules

4.4.1 Budget 2012

The Budget included an announcement that a statutory instrument will be introduced in autumn 2012 to provide for VAT relief for European Research Infrastructure Consortia. For an explanation of what these are, see http://ec.europa.eu/research/infrastructures/index_en.cfm?pg=what.

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4.4.2 One-stop shop

The Commission has announced an extension of the special scheme for suppliers of electronic services which was introduced on 1 July 2003. It allows non-EU suppliers with customers in a number of Member States to register in just one country and report its liabilities throughout the EU to the authorities there – liabilities which arise and are due in each Member State where there are customers, because the B2C supply is chargeable to VAT where it is used and enjoyed.

From 1 January 2015, supplies of telecommunications and broadcasting services by EU suppliers to consumers will also become liable to VAT where the customer belongs. The special scheme will therefore be extended to EU suppliers of these services in order to simplify their VAT compliance. It will allow suppliers to use a web portal in the Member State in which they are registered to account for the VAT due in other Member States on supplies of these services to private consumers.

IP/12/17; http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/legislation_proposed/index_en.htm

4.4.3 Private use of a car

The Netherlands allowed the *Lennartz* approach to deduction of input tax on the purchase of a car with mixed private/business use, but provided for the output tax charge to be levied on a flat rate basis rather than being related to the actual extent of private use in subsequent periods. The CJEU has ruled that this is contrary to the Directive.

The appellant is a tax advisor. He objected to the Netherlands rules, which base the output tax on a fixed percentage of the list price of the car (similar to the UK rules for a benefit chargeable to income tax on an employee's company car). As this percentage had changed several times, the Netherlands court asked whether this breached the provision which allows Member States to retain input tax blocks which were in force when the 6th Directive took effect. The CJEU reformulated the question, observing that the "standstill clause" on input tax blocks was not relevant where the Member State allowed 100% deduction – this was about output tax, not input tax.

The court considered that Member States are required to implement rules which take into account the actual extent of private use. Only then is the charge proportional to the chargeable transaction (the self-supply of business assets). Flat rate simplifications are available in some areas of the Directive, but not here.

CJEU (Case C-594/10): *TG van Laarhoven v Staatsecretaris van Financiën*

4.4.4 Business use of a car

A Bulgarian company leased two cars which were used to transport a manager between home and work. The tax authority ruled that the VAT on the lease charges was not deductible because the car was supplied to the manager for no consideration. The Hungarian law contained a provision that regarded provision of commuting to employees as a service supplied for no consideration where it is to meet the needs of the taxable person's economic activity. This appears to be an output tax relief, but has been used by the authorities to deny an input tax deduction.

The company appealed, arguing that a general restriction on input tax deduction was contrary to the Directive. Questions were referred to the CJEU by the Hungarian Administrative Court.

The CJEU ruled that taxpayers can only deduct input tax in relation to the costs of acquiring a car if there is a direct and immediate link to the taxed transactions of the business. Where the car is leased, it is necessary to consider whether that link exists at the expiry of each period to which a payment relates. The use of a car for commuting could be linked to the whole activities of the business, but only in special circumstances (as in the *Julius Filibeck* case).

The court noted that a lease is usually regarded as a supply of services. However, it considered that a finance lease could constitute a supply of the goods themselves: "*where a financial leasing contract relating to a motor vehicle provides either that ownership of that vehicle is to be transferred to the lessee on the expiry of that contract or that the lessee is to possess all the essential powers attaching to ownership of that vehicle and, in particular, that substantially all the rewards and risks incidental to legal ownership of that vehicle are transferred to the lessee and that the present value of the amount of the lease payments is practically identical to the market value of the property, the transaction must be treated as the acquisition of capital goods*". If the lease contract results in the trader acquiring capital goods, a deduction is only permitted if the trader allocates the whole of the goods to the business and accounts for output tax on the provision of use of the asset without consideration.

The court stated that a trader still has a threefold choice on the purchase of capital goods which are partly used for business:

- to apply the *Lennartz* approach and bring the whole asset within the business;
- to exclude the asset entirely from the business;
- to bring the asset into the business to the extent that it is used for business.

The court held that a provision which excludes the right of deduction on the purchase of goods or services which are intended to be supplied on for no charge is compatible with the Directive, as long as it does not cover capital goods which the trader has allocated to the business.

CJEU (Case C-118/11): *Eon Aset Menidjmunt OOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto'*

4.4.5 Private use of a dwelling

A Belgian taxpayer constructed a dwelling which he later transferred to a company. It was used for business meetings by the company, but also used for private purposes by the director and his family. This constituted a benefit subject to income tax, because no consideration was payable by the director.

The company claimed input tax in relation to the transfer of the property. The Belgian authorities partly disallowed it on the grounds that the use by the director constituted exempt residential letting. The CJEU has confirmed its earlier ruling in *Seeling* (Case C-269/00) – it is not possible to have a "deemed exempt transaction", because exemptions must be narrowly construed. Any self-supply charge for private use by an employee would be taxable, so the company would have full deduction of the input tax. It would be for the national court to determine whether there was an actual leasing or letting, but without consideration that appears unlikely.

CJEU (Case C-436/10): *Belgian State - SPF Finances v BLM SA*

4.4.6 Business use of a maisonette

A Bulgarian company acquired a maisonette and claimed back the input tax on the cost. The authorities decided that there was no business use and disallowed the VAT, in accordance with Bulgarian VAT law. The company appealed, arguing that there was an intention to hold business meetings in the maisonette, and under EU law that gave it an absolute right to deduct the tax.

The CJEU ruled that the company would have the immediate right to deduct input tax in the period in which the expenditure was incurred on capital goods, if there was a genuine intention to use them for business purposes at that time and the assets were brought into the business accounts, even if they were not actually put to a business use immediately. It would be for the national court to determine whether the intention was genuine, and whether there was any fraudulent or abusive purpose.

CJEU (Case C-153/11): *Klub OOD v Direktor na Direktsia 'Obzhalvane iupravlenie na izpalnenieto'*

4.4.7 French rules unacceptable

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.

The Advocate-General supported the French rules. In her opinion, a rule requiring payment of import VAT before deduction is allowed is not generally permitted under the Directive, but could 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 had run out, the unpaid liability would not be VAT and could not be deducted.

The full court has disagreed with the opinion. Its judgment states that, in the absence of demonstrable fraud or failure to act with due care in the sense of the *Kittel* case, a member state cannot deny a deduction for VAT which is "due or paid" on an importation. The expression must cover the situation in which the VAT is due but is not paid.

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

The CJEU has also granted the Commission's application for a declaration that the French application of the lower rate to supplies of horses, without differentiating between supplies of animals which are used for foodstuffs and others, contravenes the Directive. This is consistent with the earlier decision in Case C-41/09 (*Commission v Netherlands*).

CJEU (Case C-596/10): *Commission v France*

Member States which charged a reduced rate of less than 5% before 1991 are allowed to retain it but not extend it. France had such a rate for tickets from performances during which drinks could be served. The standard lower rate of 5% was charged from 1997; then in 2007 the super-reduced rate of 2.1% was reintroduced. The Commission applied to the CJEU for a declaration that this was in breach of the Directive, and this was granted. Once it had been removed, the super-reduced rate could not be reintroduced.

CJEU (Case C-119/11): *Commission v France*

4.4.8 Italian waiver of VAT debt

The CJEU has agreed with the Advocate-General's 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 judgment 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 (Case C-500/10): *Ufficio IVA di Piacenza v Belvedere Costruzioni Srl*

4.4.9 Pre-registration tax

Polish law did not allow the deduction of VAT by a partnership in relation to invoices issued in the name of the partners prior to its VAT registration, even if they were purchasing supplies to be used in the partnership's economic activity. The CJEU has held that this is in breach of the Directive; in particular, prohibiting deduction just because of the failure to satisfy the formal requirements of a correctly issued VAT invoice (i.e. in the name of the registered partnership rather than the individual partners), when the substance of the transaction is not in doubt, would breach the principle of fiscal neutrality.

CJEU (Case C-280/10): *Kopalnia Odkrywkowa Polski Trawertyn P. Granatowicz, M. Wasiewicz (a partnership) v Dyrektor Izby Skarbowej w Poznaniu*

4.4.10 Use of open market value

Art.80 of the Principal Directive authorises Member States to substitute the open market value of a supply for the actual consideration in certain circumstances to prevent tax avoidance. These include:

- the obvious case where a supply between connected persons has been carried out at below market value to reduce the irrecoverable input tax for the purchaser who is not entitled to full deduction;
- the less obvious cases where the supply is made above or below market value to distort the partial exemption recovery percentage of the supplier.

The Bulgarian law applied the market value principle to a situation in which a company with a full right of deduction purchased a property from a connected person at above market value. The tax authority ruled that the purchaser could not deduct the input tax on the excess consideration paid. The company appealed, and questions were referred to the CJEU. Advocate-General Sharpston has given an opinion that it is not permitted. Art.80 provides the only circumstances in which a market value rule can be applied, so a rule which goes beyond the situations listed is contrary to the Directive.

The opinion notes that the order for reference does not go into the circumstances in as much detail as might be desired; it is therefore perhaps not possible to see the tax avoidance that the authorities were trying to prevent. However, the opinion concludes that the law itself is not compatible with the Directive, regardless of the circumstances, because it does not reflect the Directive's required conditions for application of the open market rule.

CJEU (A-G) (Case C-621/10): *Balkan & Sea Properties v Direktor na Direktsia 'Obzhalvane I upravlenie na izpalnenieto' (and related appeal)*

4.4.11 Alterations to capital item

A married couple were VAT-registered as a partnership. They purchased a warehouse for the purposes of the business; part of the attic was temporarily used as their residence, and a number of adaptations were carried out in order to make it suitable for occupation. The partnership claimed input tax in relation to the costs of these alterations. The Netherlands authorities disallowed the tax, and questions were referred to the CJEU.

The Advocate-General has considered the situation in detail and examined a number of possible outcomes. Her conclusion is that the dwelling can be regarded as a separate capital item within the warehouse, and it is not necessary for it to be treated in the same way as the warehouse itself – it would be possible for it to be treated as 100% private, even if it was acknowledged that the warehouse was mixed or wholly business use. However, it would also be possible to find that the intention to use the alterations for business purposes later (when the rooms would be used for offices or training facilities) could justify deduction at the time the expenditure was incurred, even if the use was 100% private at that time.

It would be for the national court to determine whether the expenditure constituted a separate capital item, and also to determine whether there was objective evidence of an intention for business use after the private use.

CJEU (A-G) (Case C-334/10): *X; other party v Staatssecretaris van Financiën*

4.4.12 Portuguese farmers

The CJEU has agreed with the Advocate-General and the Commission that the operation of the agricultural flat rate scheme in Portugal is excessively disadvantageous to farmers – no flat rate compensation is given to balance the input tax forgone, and transactions of farmers are exempt from VAT. Although member states are not allowed to give compensation which exceeds the input tax forgone, the judgment rules that member states are allowed to implement a scheme which offers no compensation at all. The background to the flat rate scheme for farmers is examined in considerable detail.

CJEU (Case C-524/10): *Commission v Portuguese Republic*

4.4.13 Supply of staff

A German company supplied the services of self-employed lorry drivers to transport companies. It considered that this was a supply of staff, so it initially did not charge German VAT to an Italian customer. However, the regional VAT authority ruled that a supply of staff only covered employees, and German VAT was therefore due. The company changed its practice, but the Italian customer's claims for a VAT refund were refused by the central German VAT authority. Questions were referred to the CJEU to determine whether this supply ought to be chargeable to German VAT or should have been reverse charged by the customer.

The court ruled that a supply of self-employed contractors could constitute a supply of staff for the purposes of art.9(2)(e) 6th Directive. The correct answer therefore appears to be that the German supplier should refund VAT to the Italian customer and claim it back from the German authorities.

There was a further curious discussion and conclusion on the question of whether a Member State is required to apply a consistent treatment to the supplier and recipient of a supply, even if they are in different jurisdictions. This seems obvious, but it presumably might lead to the conclusion that the Italians should be repaid their intra-community claim because the regional tax authority had ruled that the place of supply was Germany. The court answered the question as follows:

"*Articles 17(1), 17(2)(a), 17(3)(a) and 18(1)(a) of the Sixth Directive must be interpreted as not requiring the Member States to amend their domestic procedural rules in such a way as to ensure that the taxability and liability to VAT of a service are assessed in a consistent way in relation to the provider and in relation to the recipient of that service, even though they fall within the jurisdiction of different tax authorities. However, those provisions require the Member States to adopt the measures that are necessary to ensure that VAT is collected accurately and that the principle of fiscal neutrality is respected.*"

Presumably this means that the Germans should not refuse the repayment of output tax to the German company to correspond with its refund of VAT to the Italian customer.

CJEU (Case C-218/10): *ADV Allround Vermittlungs AG v Finanzamt Hamburg-Bergedorf*

4.4.14 Rules for amending consideration

Art.90 of the Principal Directive allows Member States some discretion in the way in which adjustments to output tax are made in cases of total or partial non-payment (whether as a result of a credit note or a bad debt). The Polish rules required a trader to hold an acknowledgement from the customer that a revised invoice had been received before the output tax could be adjusted. A company appealed against the refusal of output tax reductions, and questions were referred to the CJEU.

The court ruled that such a requirement was not in itself incompatible with the Directive, but it would have to be applied in line with the principles of proportionality, neutrality and effectiveness. It should not be unreasonably difficult for a trader to exercise a right. Where the trader could show that he had taken all possible steps to establish that the customer had received the corrected invoice, and could show that the transaction was carried out in accordance with that corrected invoice, the authorities should be prepared to accept the adjustment even though the formal requirement of a receipt from the customer was not satisfied.

CJEU (Case C-588/10): *Minister Finansow v Kraft Foods Polska SA*

4.4.15 Warehouse-keeper

The CJEU has ruled that the Netherlands was not entitled to make a warehouse-keeper, who was not a customs warehouse-keeper, jointly and severally liable for VAT owed by the owner of the goods on a supply for valuable consideration where the goods had been released from the warehouse by the keeper acting in good faith and without any fault or negligence.

CJEU (Case C-499/10): *Vlaamse Oliemaatschappij NV v FOD Financiën*

4.4.16 Reasoned opinions

The Commission has sent a reasoned opinion to Luxembourg asking for it to change its rules on the exemption for independent groups of non-taxable persons. As the UK is about to introduce similar provisions for the first time, the Commission's objections to the Luxembourg exemption could be relevant here.

Luxembourg allows the exemption to apply where the members of the group have taxable activities amounting to up to 30% (or in some cases 45%) of their annual turnover. The Commission believes that this contravenes the Directive, which requires that the supplies by the group must be directly required for exempt or non-taxable activities. The UK is proposing to have a similar threshold below which taxable activities are ignored, although it is lower at 15%.

IP/12/63

The Commission has also sent a reasoned opinion to Germany asking it to change its application of the lower rate of VAT to all supplies of works of art and collectors' items, including letting. The Commission states that the Directive has a list of items which can qualify for the lower rate and these supplies are not on the list.

IP/12/177

4.4.17 Questions for the CJEU

The following wide range of issues have been referred to the Court of Justice for consideration:

- whether the Italian exemption for healthcare, which differs in scope from the exemption in some other states, is compatible with the Principal VAT Directive (the main concern appears to be entitlement to input tax rather than liability to output tax);

  CJEU (Reference) (Case C-560/11): *Danilo Debiasi v Agenzia delle Entrate - Ufficio di Parma*

- whether an in-house passenger transport service supplied by a TOMS trader should be chargeable at the standard rate (as part of a TOMS supply) or at a lower rate which is applicable to passenger transport in Poland;

  CJEU (Reference) (Case C-557/11): *Maria Kozak v Dyrektor Izby Skarbowej w Lublinie*

- whether "unbuilt land" which results from the demolition of existing buildings is exempt, or whether it is excluded from exemption as "building land" because it is sold with a view to the construction of new buildings;

CJEU (Reference) (Case C-543/11): *Woningstichting Maasdriel, other party: Staatssecretaris van Financiën*

- whether deduction of input tax can be refused where the risk of immediate loss to the revenue arising from a supplier's fraud has been eliminated but the supplier may still intend a fraud (the question for reference does not make the circumstances very clear);

CJEU (Reference) (Case C-572/11): *Menidzharski biznes reshenia OOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto', gr. Veliko Tarnovo, pri Tsentralno Upravlenie na Natsionalna Agentsia po Prihodite*

- how the second-hand margin scheme in Poland should be applied to the resale of cars which were exempt on purchase because the seller was a trader who was not entitled to full input tax deduction on the original purchase of the car;

CJEU (Reference) (Case C-160/11): *Bawaria Motors Spółka z o.o. and Minister Finansów*

- whether a "commercial advertising screening tax", which is levied in Portugal on supplies by television companies, should be included in the taxable amount for those supplies in spite of the fact that it is collected by the television company and handed on to the authorities (this appears to be similar to the car registration tax in *de Danske Bilimportorer*). There seem to have been several references in relation to this issue under different numbers: the number given below is the latest one.

CJEU (Reference) (Case C-17/12): *TVI Televisão Independente SA v Fazenda Pública*

- whether the TOGC rules should apply to a situation where all the shareholders in a company transferred their shares to the same acquirer at the same time, and in particular one 30% shareholder who previously supplied VATable services to the company transferred the shareholding as part of that larger transaction.

CJEU (Reference) (Case C-651/11): *Staatssecretaris van Financiën, other party: X BV*

- whether it is permissible to apply a clawback of input tax on immovable property to someone who was not the person who originally claimed the deduction of that input tax.

CJEU (Reference) (Case C-622/11): *Staatssecretaris van Financiën v Pactor Vastgoed BV*

- in a series of detailed questions from Bulgaria, what the consequences should be if a trader has received a VAT invoice and deducted input tax, but no supply is eventually received.

CJEU (Reference) (Case C-643/11): *LVK-56 EOOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' - grad Varna pri Tsentralno Upravlenie na Natsionalnata Agentsia za Prihodite*

- on a related subject also from Bulgaria, whether it is in accordance with the principles of fiscal neutrality, proportionality and protection of legitimate expectations to have a provision which will deny an input tax deduction to a purchaser if there is no evidence that a supply has taken place, but to require VAT to be paid over to the authorities by the supplier in such a circumstance without any possibility of adjustment.

CJEU (Reference) (Case C-642/11): *EOOD Stroy Trans v Direktor na Direktsia'Obzhalvane i upravlenie na izpalnenieto' - gr. Varna pri Tsentralno Upravlenie na Natsionalnata Agentsia po Prihodite*

- whether it is correct to treat admission charges to public swimming pools as exempt within art.132(1)(m), given that the activities the customers will undertake are not organised or systematic but might be regarded as "sport or physical education".

CJEU (Reference) (Case C-18/12): *Město Žamberk v Finanční ředitelství v Hradci Králové*

- whether the concept of "chargeable event" relates equally to taxable and exempt transactions (i.e. whether an exempt transaction has a tax point). Bulgarian law appears to provide that it does, as does UK law.

CJEU (Reference) (Case C-18/12): *Efir OOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' Plovdiv*

- whether the Regulation on cross-border co-operation and enforcement in civil and commercial matters (Regulation 44/2001) extends to a claim for damages brought by the tax authorities in another member state against a taxpayer who is alleged to have taken part in a VAT fraud (question referred by Denmark).

CJEU (Reference) (Case C-49/12): *HMRC v Sunico ApS, M & B Holding ApS, Sunil Kumar Harwani*

- whether an individual who is registered for VAT as a "private bailiff" must bring within his taxable transactions other, unrelated, one-off services.

CJEU (Reference) (Case C-62/12): *Galin Kostov v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' -grad Varna pri Tsentralno upravlenie na Natsionalna agentsia za prihodite*

- whether cosmetic surgery ought to be covered by the exemption for hospital and medical care, or whether this should be restricted to procedures with the purpose of preventing or treating sicknesses, physical impairments or injuries. There are subsidiary questions about the understanding of the patient and the qualifications of those who decide on and carry out the treatment.

CJEU (Reference) (Case C-91/12): *Skatteverket v PFC Clinic AB*

4.5 Eighth Directive reclaims

Nothing to report.

5. INPUTS

5.1 Economic activity

5.1.1 Abuse questions

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

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

The effect of this was that the advertising was treated as supplied outside the EU and was therefore outside the scope of UK VAT. HMRC argued that the loan broking business was in reality still carried on by the UK individual, and therefore the advertising services were received by him. As a result, there should be a reverse charge, which would be irrecoverable because it was being used for exempt supplies (the assessment was for more than £10m).

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

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

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

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

1. *In circumstances such as those in the present case, what weight should a national court give to contracts in determining the question of which person made a supply of services for the purposes of VAT? In particular, is the contractual position decisive in determining the VAT supply position?*
2. *In circumstances such as those in the present case, if the contractual position is not decisive, in what circumstances should a national court depart from the contractual position?*
3. *In circumstances such as those in the present case, in particular, to what extent is it relevant:*
   - *Whether the person who makes the supply as a matter of contract is under the overall control of another person?*
   - *Whether the business knowledge, commercial relationship and experience rests with a person other than that which enters into the contract?*
   - *Whether all or most of the decisive elements in the supply are performed by a person other than that which enters into the contract?*
   - *Whether the commercial risk of financial and reputational loss arising from the supply rests with someone other than that which enters into the contracts?*
   - *Whether the person making the supply, as a matter of contract, sub-contracts decisive elements necessary for such supply to a person controlling that first person and such sub-contracting arrangements lack certain commercial features?*
4. *In circumstances such as those in the present case, should the national court depart from the contractual analysis?*
5. *If the answer to question 4 is 'no', is the tax result of arrangements such as those in this case a tax advantage the grant of which would be contrary to the purpose of the Sixth Directive within the meaning of paragraphs 74 to 86 of the Judgment in Case C-255/02 Halifax Plc and others v CCE?*
6. *If the answer to question 5 is yes, how should arrangements such as those in the present case be recharacterised?*

Upper Tribunal: *HMRC v P Newey (t/a Ocean Finance)*; CJEU (Reference) (Case C-653/11)

5.1.2 Abuse answers

A group of companies entered into a complex avoidance scheme devised by a firm of accountants which had the effect of allowing them to account for output tax only on the margin achieved on sales of demonstrator vehicles rather than on their full sale price. HMRC raised assessments and misdeclaration penalties on the grounds that the arrangements were an abuse of rights within the *Halifax* principle.

The scheme worked as follows:

- four associated dealership companies sold their demonstrator cars to three associated captive leasing companies under sale and leaseback agreements;
- the captive lessors assigned the benefit of these agreements to a Jersey bank in return for a 45-day loan facility;
- within that period, another associated company acquired the Jersey bank's car business in a transfer of going concern, outside the scope of VAT, and then sold the cars under the second-hand margin scheme.

HMRC's view of what ought to have happened gives further explanation of how the scheme worked:

In the Commissioners' view the Dealership Companies:

- *Should not have accounted for output VAT on selling the cars to the Captive Leasing Companies.*
- *Should not have deducted any VAT on the leaseback transactions either before or after the assignment of the agreements.*
- *Should have accounted for any output VAT on the full value of the sales they made as agent of PDS.*
- *Should have accounted for output VAT on any private use of the "stock in trade" cars on which input VAT has been recovered.*

The Captive Leasing Companies

In the Commissioners' view the Captive Leasing Companies:

- *Should not have deducted any VAT on the purchase of the cars from the Dealership Companies.*
- *Should not have charged any VAT on the leaseback transactions.*

PDS (the company that eventually sold the cars)

In the Commissioners' view PDS should not have accounted for any VAT on the sale of the cars "to customers".

HMRC were convinced that the arrangement was an abusive VAT scheme because of the involvement of the accountants. However, the First Tier Tribunal (TC00147) decided that this was not conclusive. It believed that the principal objective was the obtaining of finance rather than obtaining the VAT advantage, and it allowed the appeal. The concept of abuse and the current state of the doctrine was discussed in detail, but predated the important CJEU decisions in *RBS Deutschland GmbH* and *Weald Leasing Ltd*.

The Upper Tribunal has reversed this decision and allowed HMRC's appeal. After the exposition of the underlying law, the Tribunal begins its discussion by describing the straightforward application of the margin scheme, and makes the following comment:

We recognise that the above examples are uncomplicated and that the special provisions were intended to operate in a number of further circumstances where the underlying transaction could be much more complex. After all, paragraph 8(2) of the 1992 Order contains 5 different sub-paragraphs (though most are irrelevant to this case) and, further, it is to operate in conjunction with the de-supply provisions of the 1995 Order. Nonetheless, the above discussion illustrates how the margin scheme was *intended to operate in one case which was no doubt expected to be of common occurrence.*

This is supportive of HMRC’s case because it suggests that the more convoluted transactions in the case are “artificial”, and also that they subvert the purpose of the law. The Tribunal’s analysis of the transactions agreed that the scheme had the effect which the accountants and taxpayers intended if the principle of abuse did not apply.

The Tribunal then considered several precedents on abuse of law, including the following extract from the CJEU judgment in *Weald*:

26. It should be recalled that the application of EU legislation cannot be extended to cover abusive practices by economic operators, that is to say, transactions carried out, not in the context of normal commercial operations, but solely for the purpose of wrongfully obtaining advantages provided for under EU law and that the principle of prohibiting abusive practices also applies to the sphere of VAT (see Halifax (paras 69 and 70) and Ampliscientifica (para 27).

27. On the other hand, a trader’s choice between exempt transactions and taxable transactions may be based on a range of factors, including tax considerations relating to the VAT system. Where the taxable person chooses one of two transactions, the Sixth Directive does not require him to choose the one which involves paying the higher amount of VAT. On the contrary, taxpayers may choose to structure their business so as to limit their tax liability (see Halifax (para 74), and Part Service (para 47).

28. In that context, the court has held that in the sphere of VAT, finding that an abusive practice exists requires that two conditions be met.

29. First, notwithstanding formal application of the conditions laid down in the relevant provisions of the Sixth Directive and in the national legislation transposing it, the transactions concerned must result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions (see Halifax (para 74), and Part Service (para 42).

30. Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. The prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages (see Halifax (para 75), and Part Service (para 42).

The Upper Tribunal quoted at length from the decision of the First Tier Tribunal, in which the chairman explained his reasoning for determining that the main purpose of the transactions were the obtaining of finance (so the VAT advantage was incidental) and that the arrangements were not contrary to the purpose of the Directive.

HMRC’s arguments in favour of overturning these conclusions were grouped under 5 headings:

(1) the creation of the scheme by KPMG;

(2) the timing of the scheme;

(3) the features of the scheme which were inserted for VAT reasons;

(4) the marketing and pricing of the scheme; and

(5) the implementation of the scheme.

These were contended as 'objective factors' which suggested that the main purpose of the scheme was the VAT advantage, and the FTT had therefore come to an unreasonable conclusion. Both sides put forward arguments in some detail about the correctness of the FTT's decision, the purpose underlying the margin scheme rules in art.26a 6th Directive, and the way in which the transactions could be recharacterised if a finding of abuse was upheld.

The Upper Tribunal found support for HMRC's view of the purpose of the second-hand scheme in the preamble to the Directive which introduced it (Council Directive 94/5/EC) and in recent decisions of the CJEU (*Forvaltnings AB Stenholmen v Riksskatteverket*, *Jyske Finans A/S v Skatteministeriert* and most recently *Direktsia – Varna v Auto Nikolovi OOD*). It is intended to avoid double taxation and to prevent distortion of competition. The result of the Pendragon scheme therefore appeared to be contrary to that purpose, as it avoided taxation altogether on some of the value paid by final consumers.

The Upper Tribunal then considered the 'objective factors' which would enable it to determine the essential purpose of the transactions. The evidence of the finance director of the company had to be discounted: that would be at best subjective evidence, rather than objective, and would in any case be likely to emphasise the alternative benefits of the scheme in a self-serving manner. The Tribunal preferred to examine sales documentation which appeared to show that output tax was not charged on any of the value of the car, rather than on the full value of the car – in effect, saving £3,500 of VAT on a £20,000 net selling price.

The FTT had taken and relied on a considerable amount of evidence from the finance director. The FTT decision stated that it had tried to exclude subjective factors and considered only objective indications of the purpose of the transactions, but the Upper Tribunal noted that this was a very difficult exercise. It therefore reconsidered all the FD's evidence as recorded in the FTT decision, and concluded that the decision of the FTT was 'plainly wrong'.

The Upper Tribunal then had to justify overruling the FTT on what appeared to be a finding of fact (that the essential purpose of the transactions was finance rather than the VAT advantage). The decision explains that the judges believe that the FTT decision is a mixture of fact and law, and that the 'plainly wrong' answer could only have been arrived at by misapplying the law to the evidence.

Lastly, the Upper Tribunal had to rule on how the scheme should be recharacterised. The FTT had concluded that it was perhaps 'short-term leasing', but the judges disagreed. Short-term leasing was only a feature of the abusive transactions, not the essential underlying business. HMRC's redefinition was the correct one: all the steps between the dealerships and the final consumers should be ignored, and output tax would be due on the full sale price.

Upper Tribunal: *HMRC v Pendragon plc*

5.1.3 No business

A chartered accountant formed a company, registered it for VAT and bought a yacht. The company reclaimed input tax of £85,000. HMRC then decided that the company was not carrying on a business, cancelled the registration and raised an assessment to recover the VAT. The company appealed.

The Tribunal examined the background and decided that the company was not in business. A long-standing friend of the accountant had decided to take up sailing; he suggested the creation of the company as a good way to hold the investment. Most of the hirings were to the friend or his companies, and the friend provided the finance to buy the yacht.

The way in which the company operated did not satisfy the badges of a business as set out in the *Lord Fisher* case. The Tribunal did not believe that it was representative of the way in which a chartered accountant would undertake a business venture. Before the decision to deregister there was only a single charter; afterwards, there was a greater degree of continuity and substance, but there were still only six charters for a total of less than 7 weeks in a season of 5 months. In the context of the relationship between the parties, this was not an economic activity. Accordingly, HMRC were correct to cancel the registration.

First-Tier Tribunal (TC01688): *Ocean Charters Ltd*

5.1.4 Business intention

A company was incorporated in 1999. It purchased a large estate which included an 18th century Grade 1 listed mansion as well as a number of other buildings. In October 2007 it applied for VAT registration, to be backdated to October 2004, and made an option to tax covering the whole estate with effect from March 2008. It reclaimed input tax on works carried out to the estate on the basis that it intended to use the mansion for a hotel trade. HMRC disputed the existence of this intention and issued an assessment to claw back some VAT it had repaid (for periods 06/08 and 09/08), as well as refusing later claims to input tax (for periods 12/08 to 03/10). The total VAT in dispute was £420,000.

One of the issues was that the company had made an exempt grant of its reversionary interest in the estate to the three controlling shareholders in 2005. This meant that an option to tax needed prior permission from HMRC in order to be valid (or HMRC's waiver of the need for permission). The exempt grant was not notified to HMRC in 2008, and they only found out about it in March 2009.

The Tribunal decided that this was not a fatal flaw for the input tax claim. The technical defect in the March 2008 option did not mean that it was impossible for the company to use the property to make taxable supplies – either operating a hotel itself, or making supplies of the property following a validly-made option. The question was whether and when it had formed an intention to make such taxable supplies. If it had such an intention, the technical problem with the existing paperwork could have been rectified at a later date. The Tribunal rejected HMRC's argument that the October 2004 registration date was invalid because the option to tax was also invalid.

The Tribunal considered that it was necessary to assess an intention to carry on a business on the basis of objective evidence. That objective evidence included correspondence with planning advisers which suggested to the Tribunal that such an intention existed in relation to a stable block from before October 2004, but in relation to the main house only from 1 January 2006.

HMRC argued that allowing registration and VAT recovery on the basis of this intention, when the viability of the business was in doubt (described as ‘pie in the sky’ by their counsel), imposed no pressure on the company actually to start a business. The Tribunal did not consider this an overpowering argument: it was satisfied that there was a genuine business intention, and the *INZO* case suggested that the failure to realise that intention would not invalidate the entitlement to input tax.

The decision was therefore that the VAT registration was valid from October 2004; the intention to use the stable block in business existed at that date, and therefore presumably validated input tax claims in respect of the stable block from 6 months before the EDR; and the intention to use the main house for business purposes existed from 1 January 2006. The parties were invited to agree on the amount of VAT that was recoverable on the basis of this decision in principle.

First-Tier Tribunal (TC01863): *Macaw Properties Ltd*

5.2 Who receives the supply?

5.2.1 Connected businesses

A not-for-profit company (GS) provided sports facilities on a 54-acre site. It had a subsidiary (GL) which provided bar and catering facilities. The directors of GS decided that GL would finance the construction of a new facility. GL reclaimed input tax on the costs of the project. HMRC ruled that the supplies had in fact been received by GS, and the VAT could therefore not be recovered by GL.

The separation of the commercial subsidiary had been required many years before by the Charity Commissioners (GS is a company limited by guarantee and owned by a charitable trust). GS makes exempt supplies of sporting facilities and taxable supplies of management services to GL (e.g. on secondment of staff to run its operations); as GL is a wholly taxable business, it is able to recover all the output tax charged to it by GS.

The new facility included a number of activities which were not strictly sport (spa pool and steam rooms) as well as a gym with a number of exercise machines. The directors decided that it was more sensible for the project to be organised as follows:

- GS would borrow the cost from a bank and introduce it as new capital into GL;
- GL would carry out the project and claim VAT on the costs;
- GL would operate the non-sporting activities in the new facility, receiving the gross revenues, under a licence to occupy which was implicitly granted by GS;
- GS would buy the exercise machines for the new gym and would operate those sporting facilities under an implicit licence back to it from GL.

HMRC considered that the reality was that GS had borrowed the money in tranches to meet payments due to the contractors; it was party to the construction contracts; and it showed the new facilities as assets in its accounts. It had therefore received the supplies.

It seems that the connected companies did not produce formal documentation for many of the transactions between them at the time, so the FTT had to assess what had been the intention and the reality of the transactions on the basis of incomplete evidence.

There were also some unusual administrative problems in the conduct of the appeal. HMRC had originally allowed a 75% deduction by GL on the basis of floor area used for taxable supplies, but had then decided that this was wrong and issued a decision that none was allowable. GL appealed this decision before an assessment was raised; HMRC then issued a cheque for the remaining 25% (no explanation could be given for this) and issued an assessment to claw back the whole amount, shortly before the deadline for doing so. As a result there were some subsidiary issues about the administrative consequences (including the question of whether a valid assessment had been issued in time) as well as the point of principle as to whether the inputs were linked to taxable supplies by GL.

One striking (but sadly unexplained) comment in the decision states that:

48. The Respondents [i.e. HMRC] *also contended that, whilst the UK domestic statute had provided that certain supplies under leases "and licences" might be exempt for VAT purposes, recent ECJ case law had clarified that supplies under licences were always taxable, or that at the very least, were the Appellant to succeed in claiming an input deduction for the construction costs, any provision of any form of vague licence back to GSP over the gym area would not be an exempt supply for VAT purposes.*

This is the opposite of what HMRC often argue where they wish to deny an input tax deduction where one connected party has incurred input tax on a property which is used by another connected party. The usual (successful) HMRC argument is that the 'informal licence' between them is exempt in the absence of an option to tax, which has not been made because no-one realised that a licence was being supplied. The FTT commented that the point had not been fully argued by HMRC, but it was not satisfied that it was correct. The Tribunal considered in some detail the possible consequences of the CJEU decisions in *Temco* and *Walderdorff*, and concluded that there was nothing in them to suggest that there could not be in the current case an exempt licence from GS to GL and an exempt sub-licence back from GL to GS.

HMRS argued that GS was supplying all the services and that GL was simply managing the activities for GS. The Tribunal held that this view of the situation was 'simply untenable'. GL was clearly supplying the 'non-sporting' or 'lifestyle' services, which were taxable. There was a direct and immediate link between the inputs and the VAT incurred on the project. It would be necessary to agree a disallowance of some VAT on the basis of the exempt licence of the gym to GS; again, the details of this had not been argued, but the Tribunal suggested that a pure turnover-based method would not be fair because the rent for the licence might not be at arm's length and GL's income from the sauna had been disappointingly low. Some other apportionment ought to be sought based on the costs actually incurred in different parts of the building project.

Finally, there is a discussion of costs, which was complicated by the administrative mix-up in the handling of the dispute. The appeal against the first assessment had been made in March 2009, but it was not clear that the hearing related to that appeal. The Tribunal decided to award costs on the basis that the appellant might qualify under the transitional rules and might also have applied under the new rules to have the appeal classified as "complex".

First-Tier Tribunal (TC01866): *Gosling Leisure Ltd*

5.3 Partial exemption

5.3.1 Directly attributable

Lord Harewood owned an estate from which he generated taxable income (farming, holding concerts, providing facilities for film and television companies, commercial rents) and exempt income (residential rents). He was registered for VAT. He incurred substantial expenditure on repairs to a Grade 1 listed castle on the estate. These repairs were necessary because the castle was in a dangerous condition. He recovered input tax on the works, but HMRC questioned this deduction. Initially they considered that there was no business use and no input tax could be recovered; by the time of the hearing, they had accepted that the castle was an asset of the estate, but contended that the input tax was residual and should be apportioned. There had been no taxable supplies yet and there was no clear business plan for what the castle would be used for once it was safe, so there was no direct link to taxable supplies.

The Tribunal accepted the evidence of the owner and his agent that they had a number of potential business uses for the castle, all of which would generate taxable rather than exempt income. The estate could only incur such a large cost if it intended to generate revenue from it; there was therefore a sufficient link to justify full input tax recovery. The visiting officer had noted an intention to rent the restored castle to the charitable trust which managed access to the stately home on the estate, but the Tribunal was satisfied that this had been a misunderstanding. The various uses of the castle – including use as a film set – would all be taxable. The appeal was allowed.

First-Tier Tribunal (TC01789): *Lord Harewood (t/a The Harewood Estate)*

5.3.2 Deductible proportion

The Portuguese partial exemption rules required a trader to include non-taxable subsidies in the denominator of the overhead recovery calculation. The subsidies were amounts retained by the trader, from levies remitted to the government in respect of gambling activities, in recognition of the trader carrying out certain cultural and tourism promotion obligations. In effect, this “outside the scope” income was treated as if it was exempt. The CJEU had ruled that this is not permitted – where a trader, or a sector of a trade, only makes taxable supplies, the receipt of non-taxable subsidies cannot lead to a restriction of input tax recovery.

The Portuguese government argued that the question for reference had been inadequately worded (in that it did not set out the national provisions which were alleged to be incompatible with the Directive) and was therefore inadmissible. The court considered this argument in detail but decided that it was clear enough what was being asked. The earlier case of *Commission v France* (Case C-243/03) confirmed that subsidies could not be treated as exempt income for partial exemption purposes.

CJEU (Case C-25/11): *Varzim Sol-Turismo, Jogo & Animaçao SA v Fazenda Pública*

5.4 Cars

Nothing to report.

5.5 Business entertainment

5.5.1 Updated notice

HMRC have issued a new version of the notice on *Business entertainment*, replacing the November 2011 version. It has been rewritten to improve readability, but the section on private use benefits has also been expanded and clarified with new examples. This now states the following:

2.6 What about business entertainment to 'overseas customers'?

The term 'overseas customer' means any customer not ordinarily resident or carrying on a business in the UK, including the Isle of Man.

VAT incurred on the entertainment of overseas customers may be recoverable when incurred for the purpose of the business if it is reasonable in scale and character. However, there will be an output tax charge if there is a "private benefit" to the individual enjoying the entertainment which will cancel out any recoverable input tax.

There is usually a private benefit when business entertainment is provided. However, in cases where the expenditure is necessary and for strict business purposes the private use may be ignored. Hospitality provided because it would be polite, because it is expected, or because it would improve relationships is not for strict business purposes.

Examples of the treatment of business entertainment;

Meetings:

If normal basic food and refreshments such as sandwiches and soft drinks are provided in your office during a meeting to enable the meeting to proceed without interruption, then a private use charge will not apply.

If there is no other alternative than to hold a meeting outside the office, only similar basic provisions would be allowable. Hospitality provided following a meeting will not meet the strict business purpose test and neither will hospitality involving the provision of alcohol. Taking a customer to a restaurant is very likely to lead to a private use charge.

Corporate hospitality events:

Many businesses offer their customers or potential customers general entertainment and hospitality. Examples include:

- *golf days*
- *track days*
- *trips to sporting events*
- *evening meals*
- *trips to nightclubs*

Where the related expenditure is incurred for the purpose of the business, and recovered, an output tax charge will be due. This is because such events are unlikely to have a strict business purpose or are necessary for the business to make its supplies.

Further information about when a private use charge may apply can be found in Revenue & Customs Brief 44/10 on our website.

If the entertainment provided triggers a private use charge the business can treat the VAT incurred as non-deductible rather than deducting the input tax and offsetting with an output tax charge.

Notice 700/65

5.6 Non-business use of supplies

Nothing to report.

5.7 Bad debt relief

5.7.1 Surprising decision?

HMRC assessed a firm of solicitors to £322,843 in overclaimed bad debt relief over the three-year period to April 2007. The amount was later reduced to £216,862. The firm's practice was mainly concerned with acting for insurance companies in relation to claims. They are instructed by the company, but also have a professional responsibility to the insured person.

In 1985 the Law Society of Scotland publicised an agreement with HMRC that VAT-registered insurance claimants could claim as input tax the VAT incurred on legal fees in relation to claims, whether the instructions were given by the policyholder or by the insurer on his behalf. As a result, the insurer usually indemnifies the policyholder for a net-of-VAT amount, because that is the measure of the policyholder's loss. If the policyholder is partially or fully exempt, the loss will be greater and the insurer will have to pay more. The insurance company will not in any case be entitled to recover any of the input tax.

Following this, the firm changed its practice in relation to invoicing. It sent an invoice for the fee to the insurance company and an invoice for the VAT only to the policyholder. If this was not paid, the firm claimed bad debt relief. Each VAT return would have a schedule of the invoices which supported the bad debt claim for that quarter. HMRC visited the firm several times between 1985 and 2007 and did not raise any problem with this.

In June 2007, an officer visited the firm again and at last noticed that the firm was claiming the whole of the VAT on the VAT-only invoices, where 40/47 of the bill would have been paid by the insurance company. Notice 700/18 explains that, in this circumstance, only 7/47 of the VAT element would be eligible for relief. The original assessment was for 40/47 of the last three years' bad debt claims; this was subsequently reduced because the firm managed to recover significant sums from various parties and adjusted its VAT account accordingly.

The firm appealed, contending that the assessment would give rise to an unjustified windfall for HMRC. If the insured persons had paid the fees they would have been entitled to full input tax recovery, so HMRC were in fact in a neutral position following the bad debt claim. The firm also raised arguments based on the Human Rights Act and legitimate expectations (as previous visiting officers had never noticed a problem).

The First Tier Tribunal did not consider that these arguments were well-founded, and as a result did not have to conclude on whether it had jurisdiction to consider them. The earlier compliance visits could not be relied on as an assurance that everything was well with the VAT accounting; the 2007 visit had only identified the problem because the officer had noticed an increase in Box 4 and tried to find out what had caused it. In the view of the FTT, there was no doubt that the claims should have been restricted to 7/47 of the "outstanding amount", which took into account the payment of the net figure by the insurance company. The appeal was dismissed.

The Upper Tribunal has overturned this decision and allowed the taxpayer's appeal. This is perhaps surprising – the application of fairness and "common sense" over the apparently clear wording of the legislation. HMRC may appeal further.

The judge considered that the way in which the consideration was invoiced meant that it was separated into two parts: the net amount, paid by the insurance company, and the VAT, due to be collected from the customer. The invoices to the customer, raised in accordance with instructions from HMRC, were therefore "only VAT". If they were not paid, it was clear that the bad debt related only to VAT. According to the purpose of s.36, that should be eligible for a bad debt relief claim.

The judge also distinguished between a "literal" construction of the legislation (on which basis HMRC would win) and a "strict" construction. Although they are often the same, a "strict" construction must also have regard to the purpose of the legislation and the context of the provision in dispute. Where the result of a literal construction is manifestly unfair and unsatisfactory, it is necessary to look further.

European case law has emphasised that only the final consumer is supposed to bear the cost of VAT; taxable persons are supposed to be able to recover input tax in full and therefore are neither advantaged nor disadvantaged by the tax which flows through their hands. The judge extended this principle to apply to output tax and bad debts. If the solicitors had to pay VAT to HMRC which they then did not collect from their customer, they bore a burden which was contrary to the purpose of the legislation. That had to be wrong. This was based on an application of the CJEU decision in *Elida Gibbs*.

The judge considered the European Convention on Human Rights and decided that it did not assist the appellant. He said that it was necessary to be cautious before applying human rights principles to taxation; he concluded that the charge would not be disproportionate, nor would it fail to strike a fair balance between the taxpayer and HMRC. However, he ruled that the technical argument based on the VAT Directive succeeded instead.

Upper Tribunal: *Simpson & Marwick v HMRC*

5.7.2 Revised Manual

HMRC have revised the online manual on "VAT Refunds" to include the following example of the operation of the time limit for bad debt relief claims:

Claims for bad debt relief can be made once six months have passed since the later of the date on which:

- *the consideration for the supply was due and payable; or*
- *the time of supply.*

However, claims cannot be made later than four years and six months after the later of the two dates mentioned above.

For example, Aiya Ltd makes a supply on 25 January 2010 and the consideration falls due on 14 February. If, by 14 August 2010, the consideration has not been paid and the supply falls within the bad debt provisions, the business will have until 14 August 2014 to make the claim for relief.

www.hmrc.gov.uk/manuals/vrmanual/vr7420.htm

5.8 Other input tax problems

5.8.1 Carousel round-up

There has been the usual selection of hearings on missing trader fraud, with the addition of three Upper Tribunal appeals (all won by HMRC) and the unusual feature of a trader winning a case before the First-Tier Tribunal.

A company had traded honestly for many years and had a substantial warehouse full of genuine goods. Nevertheless it became caught up in a carousel fraud in 2006 and was denied input tax of £300,000 in respect of its 08/06 period. The due diligence undertaken was considered by the FTT to be a "low hurdle to be jumped" rather than a genuine commercial exercise. There were also references in recorded MSN messages that suggested the appellant knew the trade was fraudulent. The trader appealed to the Upper Tribunal, putting forward six separate criticisms of the FTT's decision. The judge dismissed the appeal, holding that the FTT had been entitled to reach the conclusions that it did and fully explained its reasons in the decision it handed down.

Upper Tribunal: *A One Distribution (UK) Ltd v HMRC*

A trader was held by the FTT to have "had the means of knowing" that transactions were connected with fraud. The FTT concluded that the directors "*went into what [they] knew was an artificial market intending to profit from it. They may well not have been participants in the fraud, but as the courts have pointed out, in Kittel and elsewhere, a trader in PJL's position aids the fraudsters by making the transactions possible*."

The FTT noted the appellant's argument that HMRC's approach was discriminatory: they generally allow the offset of input tax against output tax in "buffer" companies in a missing trader chain, and only "go for" the "broker" company who makes the zero-rated sale and reclaims money from HMRC. The argument to disallow input tax would be the same in a broker or a buffer. The FTT did not accept that this was a disproportionate or inappropriate action by HMRC in the circumstances.

The company appealed to the Upper Tribunal. It argued that the UK courts have misunderstood the CJEU judgment in *Kittel* because of the nuances of translation of the expression "implique dans" as "involved in". The judge did not agree that there was a problem: similar words were used in the *Teleos* decision, where the original language of the case was English. He declined to make a reference to the CJEU on this point.

The FTT decision was reached before the Court of Appeal set out the proper test to be applied in the *Mobilx* case. One of the grounds for appeal was that the FTT had stated that the test was whether the trader knew, on a balance of probabilities, that the transactions were connected with fraud. *Mobilx* established a higher standard of proof: there must be no other reasonable explanation. The judge concluded that the reference to the wrong test in the FTT decision was not enough to undermine its correctness, because it was clear that the FTT had been satisfied at the higher standard of proof as well.

The company advanced 7 further criticisms of the FTT decision, but the judge dismissed them all. The overriding conclusion of the FTT had been based on the test that subsequently was approved in *Mobilx*, and the FTT had been entitled to come to its decision on the basis of the evidence before it.

Upper Tribunal: *Powa (Jersey) Ltd v HMRC*

Another company had succeeded before the FTT with the argument that fraud was not the only possible explanation for the transactions. It secured a repayment of £176,000. It had been acknowledged that an agent acting on behalf of the company had been aware of the fraud, but the FTT did not consider that it was appropriate to impute the agent's knowledge to the company.

HMRC appealed to the Upper Tribunal and were successful. The judge considered in detail a number of precedent cases about the attribution of an agent's knowledge to his principal and decided that it should be so attributed in this case. The FTT had identified the test correctly but had not been entitled to draw the conclusion that it did on the basis of the evidence: it had regarded the company as a victim of the fraud, but it had not suffered as a result.

The judge also considered a long list of further criticisms of the FTT's decision by the HMRC representative, and agreed that they made it likely that the FTT's decision was unsafe. This consideration was only necessary if the UT decision on the attribution of the agent's knowledge was challenged; for this reason, the judge did not draw a final conclusion, admitting that he had not examined all the evidence from the original four day hearing so as to be able to substitute his own judgment for that of the FTT. He considered that the correct approach, if it had been necessary, was perhaps to have remitted the case to the FTT for reconsideration in the light of guidance issued in response to the HMRC criticisms. However, as the appeal was upheld on the other ground, this would not be necessary.

Upper Tribunal: *HMRC v Greener Solutions Ltd*

Another Upper Tribunal hearing involved cross-appeals by both HMRC and the taxpayer against the FTT decision (TC0076). The FTT was satisfied that the trader had not carried out the appropriate due diligence procedures, and would have been aware of the connection with fraud if the appropriate procedures had been carried out. The decision included a detailed consideration of the tests the Tribunal chairman thought were appropriate in determining whether the *Kittel* principles applied, and ruled that the taxpayer should have known that the transactions 'were likely to be connected with fraud'. However, the disallowance of input tax should be restricted to the tax actually lost as a result of the fraud.

The Upper Tribunal agreed with HMRC that a trader who is held to fail the *Kittel* test forfeits the right to any input tax deduction at all. However, it also agreed with the taxpayer that the FTT had applied the wrong legal test – it should have considered whether the taxpayer ought to have known that the transactions were connected with fraud, not 'were likely to be'.

The trader's counsel (who has appeared for a number of MTIC appellants, including *Mobilx* in the Court of Appeal and *Powa* above) argued the same point about the translation of "implique dans". The UT considered this argument but decided that it was bound to follow the Court of Appeal's precedent. The judge also agreed with the judge in *Powa* that the difference in wording was not as important as the lawyer contended.

The case was remitted to the FTT to reconsider the question of the extent of the taxpayer's means of knowledge. As the original hearing lasted about 14 days, and took place 3 years ago, this may not be a straightforward exercise.

Upper Tribunal: *HMRC v S & I Electronics Ltd*

An unusual successful appellant claimed back about £700,000 of VAT in relation to the periods June, July and August 2006. The company had been involved in farming from its registration in 1975 until 2004, when it changed to "any other wholesale activity" and began to deal in mobile phones. The Tribunal examined a series of over 30 deal chains which were alleged to have resulted in a fraudulent VAT loss. The director who was regarded as "the controlling mind of the company" was found to have relied on a good working relationship with a helpful HMRC officer; the Tribunal decided that he could reasonably have believed that he was doing all that he was expected to do and honestly thought that HMRC would be satisfied with his due diligence. He did not have actual knowledge of the fraud. The Tribunal also decided that HMRC had not shown that fraud was the only possible explanation for the transactions: "*the evidence regarding the onward losses in two of the cases under appeal, the timing of the payments to and from the appellant, the variations in the deal mark-ups, the satisfactory explanation of the third party payment to the reputable 20/20 Solutions, and the significant role allowed to the* *appellant's obviously honest employee Mr Craker, all suggest to us that this is a case in which the objective evidence cannot lead to a finding that the appellant should have known that the only reasonable explanation of matters was that its trading was connected to fraud.*" The appeal was allowed in full.

First-Tier Tribunal (TC01694): *H T Purser Ltd*

Other traders were less successful. A broker in a contra-trading chain was denied a claim for £1.125m in relation to a 3 month period to July 2006. The fact that a mark-up of exactly 7% was achieved in a number of deals suggested artificiality to the Tribunal; it concluded that the director actually knew that there was a fraud.

First-Tier Tribunal (TC01661): *DI & GI Electronics Ltd*

Another pair of connected companies claimed £5.7m in relation to 34 deals between February and May 2006. After a 12 day hearing, the Tribunal concluded that the main director was an unreliable witness and the directors knew that their transactions were connected with fraud. A long list of reasons for this finding was given.

First-Tier Tribunal (TC01672): *Crotek Ltd; Crotek Systems Ltd*

Another trader was refused £1.5m in respect of April to June 2006. Its representative submitted a skeleton argument but then e-mailed an apology to the Tribunal because the trader could not afford to pay any fees. The director himself did not attend, considering that he would stand little chance against a high-powered legal team. The Tribunal nevertheless spent four days examining the evidence and arguments, and concluded that the director had actual knowledge that the company's transactions were connected with fraud. The appeal was dismissed.

First-Tier Tribunal (TC01781): *Tarlo Worldwide Ltd*

Two companies were denied input tax of £2.2m each in relation to purchases of razor blades in April and May 2006. The companies were established traders which dealt in a range of household goods, so the transactions were not in themselves unusual. However, there were factors that were suspicious, including the size of the deals and the fact that the companies had been approached by unsolicited customers wanting large quantities of the same product at the same time. The companies had been involved in other deals in the previous year which had resulted in follow-up visits and warnings from HMRC, and as a result they had asked the customers for declarations that they were not involved in MTIC fraud.

The company's counsel put forward over 60 pages of detailed submissions, summarised in the following questions:

(1) what could/should the Appellants have done differently?

(2) What would additional/alternative actions have revealed?

(3) Why would such additional/alternative steps have caused the Appellants to realise that the only reasonable explanation for the transactions was fraud?

(4) How were HMRC's allegations sustainable when all the "indices" of fraud which HMRC pointed could just as easily be characterised as the usual incidences of international trade?

The Tribunal discussed the meaning of the "only reasonable explanation" test and gave detailed reasons for finding that the traders ought to have known that their transactions were connected with fraud. Among these was the fact that the deals involved 159% of the global sales of the razor blades for the month concerned – it was surely impossible that these were normal commercial transactions. The razor blades were sold to a Spanish customer but shipped on its instructions to a French company which was registered as "Wholesalers of wood, construction materials and sanitary equipment". Given that the company was on notice that it might be involved in MTIC fraud, the Tribunal concluded that these and other factors should have alerted it to the extreme risk it was taking.

First-Tier Tribunal (TC01752): *Davis & Dann Ltd, Precis (1080) Ltd*

A company was denied input tax of £340,000 in relation to March and June 2006. The Tribunal considered that the director had a "cavalier" approach to due diligence, summed up by "*his absolute trust in Mr Maginn and Mr Erry which in the case of Mr Maginn was explained by a shared Irish heritage and with Mr Erry that he was 'very keen and smooth and convinced me'.*" The appeal was dismissed with costs awarded to HMRC.

First-Tier Tribunal (TC01741): *Bays Revert Ltd*

A variation on the normal "*Kittel/Mobilx*" dispute arose in a case where HMRC argued that the transactions in question never took place and the invoices had been manufactured. The Tribunal was not satisfied with the evidence put forward by the appellant, which mainly consisted of the invoices themselves and the recollections of a director. There was an absence of other supporting evidence which might have been expected to exist if the transactions had been real. The appeal was dismissed with costs awarded to HMRC.

First-Tier Tribunal (TC01744): *Reddrock Ltd*

A company was denied £1m of input tax in relation to purchases of iPods and satnavs in July 2006. The Tribunal considered that actual knowledge of the fraud was not proven, but listed the following features as supportive of its conclusion that the directors ought to have known that the only reasonable explanation was fraud:

(1) the removal of the goods to the UK from a seller in Spain and immediately out again to a buyer in Portugal at significant cost to no obvious advantage,

(2) the fact that SB's customer (with whom there was no long established course of dealing) was prepared to make payments of millions of pounds to SB (a company which had made losses since its incorporation and could not, on any view, be regarded as a sound credit risk) without any real certainty that the goods for which it was paying would indeed be supplied to it,

(3) the fact that (at least in relation to deals 1 to 4) Pateo was prepared to pay in full for the goods before they had even been inspected,

(4) the fact that lack of clarity or actual changes in the specifications of the goods supplied did not seem to concern Pateo,

(5) the fact that (in relation to deals 1 to 4) the required "urgent" delivery was not in fact actioned until nine days after the deal (and payment in full) and yet Pateo appeared unconcerned,

(6) the fact that 4A was apparently achieving major success in generating significant volumes of business in a matter of months operating out of Mr Morton's home, while SB had been trying to generate such activity working from a much more businesslike operation for three years without any real success,

(7) the fact that Mr Chester was well aware from his own experience that VAT fraud was rife, not just in the area of mobile phones and computer parts.

The appeal was therefore dismissed. No reference was made to costs.

First-Tier Tribunal (TC01799): *Spearmint Blue Ltd*

A claim was made by a sole trader and two companies he owned in relation to a total of nearly £3m in 06/06. The Tribunal did not find the trader a credible witness, and concluded that he 'took opportunities offered to him by fraudsters'. His appeal was dismissed.

First-Tier Tribunal (TC01889): *Haroon Younas t/a Micromedia and related appeal*

A company was denied a total of over £10m in relation to the three monthly periods 04/06, 05/06 and 06/06. The Tribunal concluded that the director knew, as well as having the means of knowing, that the transactions were connected with fraud.

First-Tier Tribunal (TC01897): *Vantage Link Corporation Ltd*

Another company was denied input tax of £183,000 in relation to two despatches of mobile phones to Denmark in July 2006. The appellant had earlier applied for an interim release of £100,000 of the VAT at issue, which the FTT had declined to authorise. In the substantive hearing, the FTT concluded that the only reasonable explanation for the deals was that they were facilitating a fraud, and the company knew all the facts that led to that conclusion at the time it entered into the transactions. It was therefore not entitled to claim input tax.

First-Tier Tribunal (TC01798): *Fonecomp Ltd*

5.8.2 Invalid invoices

A trader appealed against a decision to disallow £110,000 of input tax on the grounds that the invoices did not show a VAT registration number and had been issued by a deregistered trader. The company appealed to the FTT (TC00591), arguing that the transactions had actually taken place and the supplier was a taxable person throughout – initially because it was actually registered (HMRC appeared to accept this and allow input tax on transactions during this period) and later because its turnover remained above the registration threshold. HMRC had classified it as a "missing trader" which was responsible for a VAT loss of some £36m.

Unusually, the Tribunal considered that HMRC had acted unreasonably in the way in which they had reached the decision to refuse to accept alternative evidence to support the input tax claim. The reviewing officer had failed to take proper account of the material provided by the company. However, the Tribunal also concluded that the decision would have inevitably been the same if the review had been carried out properly, so the appeal was dismissed anyway.

The company appealed to the Upper Tribunal, arguing that the FTT had misdirected itself in deciding that its jurisdiction was supervisory. If that was the case, it was inappropriate to draw the conclusion that it should dismiss the appeal if it was satisfied that the decision would inevitably have been the same. If it had not misdirected itself, the company argued that its conclusion was perverse and not justified by the facts, given that the FTT had been satisfied that the transactions had taken place. In response, HMRC argued that the conclusion about the transactions was perverse as it was contrary to the weight of the evidence.

The judge ruled that the FTT normally has an appellate jurisdiction on disputes about the deductibility of input tax (and can therefore substitute its own judgement for the judgement of the Commissioners). However, the acceptance of alternative evidence under reg.29 is a matter over which the Commissioners have discretion, so the jurisdiction of the FTT is properly supervisory (i.e. the FTT can only consider whether the Commissioners' decision to refuse to accept the alternative evidence was a reasonable one).

He then examined the FTT chairman's decision, and a scan of the chairman's notes which had been obtained by HMRC (but which were "difficult to read with any confidence"). He decided that the basis for the chairman's conclusions were not sufficiently clear; it was necessary to remit the case to the same FTT for clarification, with further evidence if necessary, to be sure whether the result was sound.

Upper Tribunal: *Best Buys Supplies Ltd v HMRC*

5.8.3 Lack of evidence

A company claimed input tax of £54,000 on the purchase of the goodwill of a restaurant business. HMRC initially disallowed it on the basis that there had been a TOGC; they then accepted that there had been no TOGC, but concluded that there was no evidence that the transaction had actually taken place.

The appellant's counsel commented that "*the shareholders of the relevant companies were all resident overseas and that he did not know in which country they were resident. He had not been instructed as to their identity or as to the identity of the directors of the companies in question*". There seemed to be equally little evidence of the purchase transaction, and the alleged vendor had not filed VAT returns for the quarter in question. The mere fact that the vendor had not accounted for output tax would not prevent an input tax deduction, but the lack of any corroborative evidence meant that the appellant had not discharged the burden of proof. The appeal was dismissed.

First-Tier Tribunal (TC01896): *Yeastfield Ltd*

5.8.4 Input tax optimism

A trader explained to the Tribunal that his approach was to claim VAT on all items of expenditure and rely on his accountant subsequently to adjust for anything that was not deductible. This was not accepted as a valid approach, and the Tribunal agreed with HMRC that not enough had been adjusted – a further £9,000 was disallowed in relation to cars, general expenditure which included children's meals and grown-up clothing, and the purchase of two All Terrain Vehicles which were for the taxpayer's children. In addition, fuel scale charges in relation to two vehicles were confirmed.

The most striking item was a hot tub which the trader claimed had been installed in a limousine which was hired to customers. At the time of HMRC's visit it was set up in the trader's back garden surrounded by wooden panels. The supplier said it would take 6 people to move it into a car. The Tribunal decided that there was no evidence of business use.

First-Tier Tribunal (TC01761): *Graeme King*

5.8.5 Pre-registration VAT

A sole trader bought two vans for his courier business. He later incorporated the business and registered the new company for VAT. After calling the National Advice Service, he concluded that he was entitled to deduct the VAT on the two vans on the company's first VAT return. HMRC disallowed it.

The FTT ruled that this was the correct application of reg.111 SI 1995/2518. The conditions were not met: the vans had not been purchased for the company, but had been used in the sole trade for nearly two years before incorporation; the lesser condition that the company must reimburse the person who paid for the supply was also not met.

The Tribunal only had access to a garbled account of the phone call to the NAS. The chairman commented that the call would not in any case have assisted the appellant; it would have been relevant to an appeal about a penalty, but HMRC had decided already to drop their original penalty assessment. The appeal concerning the tax itself was dismissed.

First-Tier Tribunal (TC01809): *SF Express Courier Ltd*

Where a trader de-registers, it is necessary to account for output tax on a deemed supply of all goods held at the time on which input tax had been recovered (unless the total VAT involved does not exceed £1,000). If the trader subsequently re-registers, this can become pre-registration VAT eligible for a reg.111 claim if the goods are still on hand at that later date.

HMRC used to regard this as within the spirit rather than the letter of the law, because there would be no VAT invoice to evidence the receipt of the (self-)supply. They operated an informal concession to allow such claims. They have now decided that the discretion to accept alternative evidence within reg.111 applies to proof of payment of the deregistration charge, so they no longer regard the situation as covered by a concession – it is covered by the law. There is therefore no change in the outcome, only in the legal basis of HMRC allowing it.

HMRC say that such a deduction will not be available if outside the time limit specified (four years for goods) or if the goods were not intended for business use at the time of the deemed self-supply on de-registration. The most likely reason for this is that the business ceased altogether at this point.

Reg.111 also does not apply if the item is covered by the Capital Goods Scheme. Instead, adjustments should be made under the CGS for any adjustment intervals which have not expired by the date of the re-registration.

HMRC subsequently issued a correction of the Brief, which had originally misstated the CGS limit for computers, ships and aircraft as £100,000 rather than £50,000.

R & C Brief 01/2012

5.8.6 No goods?

The FTT has distinguished a case from the old decision in *Pennystar Ltd* that the victim of a fraud cannot claim input tax deduction where goods have not been delivered in spite of being invoiced and paid for. In the present case, it appeared that the vendor had carried out a fraud by selling the same goods to several different people. It went into liquidation, and the purchasers were unable to obtain all the assets that they had paid for.

The Tribunal examined the facts underlying the transactions. The director of the purchaser had visited the vendor and selected the plant. An unconditional contract for the sale of ascertained goods was entered into. The goods were in a deliverable state. Under the Sale of Goods Act, the effect of the payment of the invoices was therefore to transfer ownership, even if not possession, of the goods. This was not the same as *Pennystar*, where the vendor absconded with the money before any goods had been allocated to the contract.

As a result, there had been a supply, and the purchaser was entitled to input tax deduction.

First-Tier Tribunal (TC01819): *David Peters Ltd*

5.8.7 Refunds to NHS bodies

The Budget included the announcement that, following changes to be introduced by the Health and Social Care Bill, legislation is to be included in Finance Bill 2013 which will allow certain NHS bodies to make claims for refunds of VAT under VATA 1994 s 41.

Outline of Tax Legislation and Rates 2.50

5.8.8 Advisory fuel rates

The fuel-only advisory mileage rates have in recent times changed twice a year, but after changes in March, June September and December 2011, HMRC announced another revision to operate from 1 March 2012. As in December, the only changes are very small (a 1p increase in the lowest and highest rates for diesel cars, against in December a 1p reduction in the rate for the lowest rate for LPG cars) so it is not clear why they bothered.

The rates from 1 March 2012 (1 December 2011 in brackets) are:

Engine size	Petrol	LPG
1400cc or less	15p (15p)	10p (10p)
1401cc – 2000cc	18p (18p)	12p (12p)
Over 2000cc	26p (26p)	18p (18p)

Engine size	Diesel
1600cc or less	13p (12p)
1601cc – 2000cc	15p (15p)
Over 2000cc	19p (18p)

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

5.8.9 Manual update

HMRC have extensively revised their online manual on “Input Tax”, covering updates on *Lennartz* accounting, the treatment of holding companies and business entertainment and a description of the key points from case law which has now been moved to a separate section.

www.hmrc.gov.uk/manuals/vitmanual/VIT10000.htm

5.8.10 Reader’s Query

A Reader’s Query in *Taxation* raised the issue of claiming input tax on parking charges at a railway station. The trader purchased a monthly ticket for both travel and parking, but the ticket office did not issue a VAT receipt. The amount exceeded the £25 for which no receipt is required.

The responses considered various possible solutions, and also the possibility that the rail company was not making the supply of parking to the customer but merely arranging it. The most practical suggestion appeared to be to write to HMRC asking them to accept alternative evidence of the receipt of a taxable supply.

Taxation, 16 February 2012

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Confirmation of legislation

The Budget included confirmation that the Finance Bill 2012 will contain legislation to enact the long-standing concession which applies where a group which includes a foreign company purchases services outside the EU and supplies them intra-group. A reverse charge is triggered, but it should only be levied on the external cost incurred overseas, rather than on any internal costs added to the charge made to the UK group member. Until the legislation is passed, this treatment will continue to apply by extra-statutory concession.

www.hmrc.gov.uk/tiin/tiin764.htm

6.2 Other registration rules

6.2.1 Registration thresholds

The Budget included the announcement that, with effect from 1 April 2012, the registration and deregistration thresholds under Sch.1 VATA 1994 rise from £73,000 and £71,000 to £77,000 and £75,000. The acquisitions threshold under Sch.3 also rises from £73,000 t0 £77,000.

Outline of Tax Legislation and Rates 1.48, SI 2012/883

6.2.2 Registration rules

The Budget confirmed that registration and amendments to registrations will be "digital by default" from October 2012. From December 2012, non-UK established businesses will not enjoy the Sch.1 registration threshold, and will have to register for VAT if they make any supplies in the UK which cannot be reverse charged by the customer.

HMRC have published the results of a consultation exercise into the Digital by Default change and appear to be receptive to the suggestion that online interaction should not be mandatory but should be encouraged. They will be considering this further during 2012.

www.hmrc.gov.uk/tiin/tiin760.htm

6.2.3 Business splitting

A married couple were partners in a farm business which also provided self-catering accommodation in a converted outbuilding as well as a haulage business. The wife ran a separate business offering bed and breakfast in the farmhouse. HMRC issued a direction under Sch.1 para.2 VATA 1994 to treat the two businesses as one going forward. It was sent on 22 January 2010, nearly a year after a control visit which led to it, and was to take effect on 22 February 2010. The couple appealed to the Tribunal.

The officer explained the features which led him to conclude that the businesses were closely linked:

(1) The bank accounts for the farm partnership and B&B are both joint accounts in the name of H & J Patrick although the B&B account is "T/A East Hook B&B".

(2) Putting the holiday cottage into the partnership keeps the B&B below the VAT registration limit.

(3) Although separate records are kept, the same bookkeeper is employed for both businesses.

(4) Money is sometimes transferred from the B&B bank account to the farm account to ease cash flow and is then transferred back (Mr Harrison did however accept when asked by the Tribunal that he would not necessarily expect to see formal arrangements in place where, as in this case, the parties concerned were husband and wife and that he had taken this into account when considering whether a direction was appropriate).

(5) The self-catering cottage and B&B were included on the same website where they are presented as one business.

(6) Although advertised in separate sections of the Farm Stay website and brochure they appear to a potential customer to be part of the same business.

(7) The same building (a converted outbuilding) is used for both B&B and self-catering.

(8) There is a combined insurance policy in the names of both partners which specifically mentions the B&B.

(9) The farm/haulage business is loss making and would not be viable without the holiday business.

(10) The properties are all owned jointly by Mr and Mrs Patrick and there are no charges for rent or for the use of fixtures and fittings by Mrs Patrick (However, when giving evidence Mrs Patrick told us that she did pay rent to the farm partnership for the use by the B&B of the two rooms which are in the same outbuilding as the self-catering cottage).

(11) The purchase of the farm and refurbishment of the farmhouse to make it suitable for B&B was financed by mortgages in the joint names of Mr and Mrs Patrick together with the proceeds of sale of their previous property.

(12) Mrs Patrick deals with all the bookings for the B&B and self-catering.

(13) The same invoice book is used for the B&B and self-catering.

The Tribunal decision does not go into great detail: it notes that an appeal against a direction can only be upheld if it is shown that HMRC have reached an unreasonable decision, and this will generally involve them having ignored relevant material or taken into account irrelevant material. The Tribunal concluded that neither of these factors applied, so the appeal had to fail.

First-Tier Tribunal (TC01699): *Howard Rowland Patrick and Jennifer Rosemary Patrick*

6.2.4 No business

A qualified barrister who did not carry on a practice worked as a part-time immigration tribunal judge. In 1999, HMRC ruled that he should be treated as an employee of the Department of Constitutional Affairs. He disputed this, wanting to claim extra expenses incurred in the work on account of his total blindness; in 2004 HMRC accepted his claim to be treated as self-employed for income tax purposes. They then ruled that he should have registered for VAT from 1 February 2006 to 30 June 2007, and imposed a penalty for failing to do so.

There was a disagreement between the parties about why the request for self-employment was granted. The appellant considered that it had been an exceptional decision based on his disability and the extra costs he had to incur in working from home as a result of it (he had to use the services of a reader); HMRC stated that it had been a decision based on the facts, and was not by way of a concession. It was based on the level of control which the judge had over the way he worked.

The Tribunal observed that income tax is applied in the same way to “employees” and to “office holders”. Even if the judge was not an employee, it was clear that his appointment to the Immigration Tribunal constituted an “office”, so it was not clear why HMRC were willing to charge him to income tax on a self-employed basis. The Tribunal considered that he was not “independently carrying on a business” as required by the Directive, and allowed his appeal against the requirement to register for VAT.

The Tribunal commented that many of the documents on which it would have sought to rely were not included in the bundles of evidence. Rather they were referred to in HMRC’s statement of case. This was just acceptable, given that the appellant did not object to the descriptions of the correspondence as given there, but was not satisfactory. In particular, the letters giving the decision on self-employed status and confirming the result of the review of the VAT decision were significant and should have been presented to the Tribunal.

First-Tier Tribunal (TC01839): *Dr AA Majid*

6.2.5 Reader’s Queries

A Reader’s Query in *Taxation* described a wedding venue business run by a limited company in a stately home owned by the company shareholder’s brother. The company charged for providing catering and other facilities and treated these services as standard rated, but no VAT was added to the rent of the building because it was collected on behalf of the property owner.

The replies considered that there were various possible ways in which HMRC could attack the arrangements, either by issuing a business splitting direction or by arguing that the rents were excluded from exemption under Sch.9 Group 1.

Taxation, 9 February 2012

Another Reader's Query asked whether a self-employed trader with turnover of £71,000 would be liable to registration because HMRC had agreed that certain employment income should be dealt with through the self-employed accounts by issuing a NT code. The answers commented that s.94 VATA 1994 can bring the emoluments of an "office" within the scope of VAT, but the Principal Directive excludes anything earned by an employee. It seemed likely that HMRC would eventually pick the situation up because the self-assessment returns would show turnover over the threshold – so it would be important for the trader to justify exclusion.

Taxation, 12 January 2012

Another (possibly humorous) Reader's Query purported to be from a self-employed drummer who was approaching the registration threshold. He wondered whether transferring the business to a limited company, then back again, and alternating between the two, would avoid the requirement for registration.

The answers confirmed that the turnover history is not transferred for registration liability if the transferor business is not a taxable person. However, HMRC would have a number of other possible ways of attacking the avoidance, including the issue of a business splitting direction. It would also be complicated to continually incorporate and disincorporate the business, and might have commercial consequences that were worse than charging VAT.

Taxation, 5 January 2012

6.3 Payments and returns

6.3.1 E-filing

A statutory instrument has amended the General VAT Regulations to provide for mandatory electronic filing of returns from 1 April 2012 onwards.

SI 2012/33

HMRC issued two press releases to remind businesses of their obligations, and has also sent letters to all VAT-registered traders.

HMRC Press Releases 24 January 2012, 26 March 2012

Further draft regulations have been to cover a number of other "specified communications" which HMRC will be able to require in electronic form in future. The regulations will among other things remove Schedule 1 of the General Regulations, which contained the VAT 1 registration form. This will no longer be available on paper.

Amendments are also made to the VAT Act to remove references to paper forms which formerly appeared in the VAT Regulations.

The amendments also make sure that appropriate reference is made to foreign established businesses which will in future have to register in the UK if they make any supplies here, regardless of value.

SI 2012/Draft – The VAT (Amendment) (No.X) Regulations 2012; HM Treasury Press Release 31 January 2012 with draft Sch.1 FB 2012

6.3.2 Flat rate scheme

In an article in *Taxation*, Neil Warren celebrates the tenth anniversary of the Flat Rate Scheme by reviewing the rules which allow input tax claims within the FRS in certain circumstances (capital goods purchased for at least £2,000 gross). Adjustments are not required for partially exempt use or later private use, but a claim is not allowed if the asset is purchased for letting on hire, even if it meets the other criteria. Pre-registration expenditure can also be claimed under reg.111, even if post-registration the trader joins the FRS.

Taxation 29 March 2012

A Reader's Query in *Taxation* asked what would happen to a trader who had operated the FRS since 2007 without formally applying to join it. The answers suggested that immediate disclosure of all the circumstances should be made, hoping that HMRC would allow retrospective authorisation to use the scheme (given that they are empowered to do so in certain circumstances).

Taxation 29 March 2012

6.4 Repayment claims

6.4.1 Compound interest rejected by Advocate-General

Littlewoods were entitled to recovery of output tax wrongly charged on sales to agents from 1973 to October 2004. Where the agent was the final consumer of the goods, and did not sell them on at a mark-up, the discount allowed to the agent should have reduced the VATable consideration on Littlewoods' sale; instead it had been treated as consideration for a supply of services by the agent (i.e. the transaction had been grossed up by the amount of the discount). HMRC paid interest in accordance with s.78 VATA 1994, calculated at the prescribed statutory rates and on a "simple" rather than "compound" basis. Littlewoods appealed, arguing that this was unfair and incompatible with EU law. They should have been compensated for the loss of use of the money, which required compounding and market rates. The Court of Appeal referred the following questions to the CJEU:

1. Where a taxable person has overpaid VAT which was collected by the Member State contrary to the requirements of EU VAT legislation, does the remedy provided by a Member State accord with EU law if that remedy provides only for (a) reimbursement of the principal sums overpaid, and (b) simple interest on those sums in accordance with national legislation, such as section 78 of the VATA 1994?

2. If not, does EU law require that the remedy provided by a Member State should provide for (a) reimbursement of the principal sums overpaid, and (b) payment of compound interest as the measure of the use value of the sums overpaid in the hands of the Member State and/or the loss of the use value of the money in the hands of the taxpayer?

3. If the answer to both questions 1 and 2 is in the negative, what must the remedy that EU law requires the Member State to provide include, in addition to reimbursement of the principal sums overpaid, in respect of the use value of the overpayment and/or interest?

4. If the answer to question 1 is in the negative, does the EU law principle of effectiveness require a Member State to disapply national law restrictions (such as sections 78 and 80 of the VATA 1994) on any domestic claims or remedies that would otherwise be available to the taxable person to vindicate the EU law right established in the Court of Justice"s answer to the first 3 questions, or is it sufficient that the national court disapplies such restrictions only in respect of one of these domestic claims or remedies?

What other principles should guide the national court in giving effect to this EU law right so as to accord with the EU law principle of effectiveness?

The Advocate-General (Trstenjak) has now given an opinion that s.78 does not contravene EU law. She reviews the concept of "procedural autonomy" granted to member states (which suggests that this sort of rule is within the discretion of the state), and also the recent line of case law which suggests that taxpayers are entitled to interest to compensate them where tax was collected in breach of EU law (in particular joined cases C-397/98 and C-410/98 *Metallgesellschaft and Others, aka Sempra Metals*). She interprets s.78 as the UK's fulfilment of its duty to introduce rules for granting interest as compensation; the question is then whether it breaches the principle of effectiveness in that the compensation it offers is inadequate. The Advocate-General considered that the fact that the interest awarded (£268.2m) exceeded the principal sum (£204.8m) meant that it was not a derisory award which deprived the interest claim of substance.

She also considers whether the principle of equivalence might be infringed. This might be the case if other types of claim were more favourably treated in the UK; however, it is not necessary to extend the most favourable treatment to all actions brought in a certain field of law. The first three questions are all answered together by the opinion, which is that:

"*under European Union law a taxable person who has overpaid VAT which was collected by the Member State contrary to the requirements of EU VAT legislation has a right to reimbursement of the VAT collected in breach of EU law and a right to payment of interest on the principal sum to be reimbursed. The question whether the interest on the principal sum to be reimbursed is to be paid on the basis of a system of „simple interest" or a system of „compound interest" concerns the detailed rules governing the interest claim stemming from European Union law, which are to be determined by the Member States in accordance with the principles of effectiveness and equivalence.*"

The opinion goes on to consider the fourth question, which it does not dismiss as irrelevant on the basis of the answer to the first three. The overall conclusion is:

"*If the referring court should conclude that the detailed rules governing payment of interest on VAT collected in breach of EU law at issue in the main proceedings are less favourable than the detailed rules governing similar domestic interest claims and that there is therefore a breach of the principle of equivalence, it is obliged to interpret and apply the national rules in such a way that interest is paid on the VAT collected in breach of EU law in accordance with the more favourable rules which apply to similar domestic claims.*"

There is therefore still hope for Littlewoods, Grattan and similar claimants, but it depends on either the full court disagreeing with the Advocate-General's opinion on the first three questions, or the domestic court applying the answer to the fourth question in the taxpayer's favour.

CJEU (A-G) (Case C-591/10): *Littlewoods Retail Ltd v HMRC*

Meanwhile, the *Grattan* case has been given a CJEU reference number. The questions, reported in the last update, are:

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?

If the full court agrees with the Advocate-General on *Littlewoods*, it appears that it is not necessary to answer these questions.

CJEU (Reference) (Case C-606/11): *Grattan plc v HMRC*

6.4.2 *Fleming* claims accepted

A golf professional registered in 1979 in respect of sales of golf equipment and golf tuition. In February 2009 he was contacted by a business which helped traders make *Fleming* claims and alerted to the likelihood that his golf tuition fees should have been exempt. The advisor submitted a claim on 28 March 2009.

HMRC were overwhelmed, and did not respond until 30 November 2009. Their first letter asked for further information and a 64-8. It also stated that the schedule of VAT overpayments, which was supposed to be attached to the March 2009 letter, was missing. In March 2010 the advisor sent a revised schedule of claim and supporting information, including accounts for several of the years in issue.

HMRC rejected the claim on the basis that the original letter (submitted by the *Fleming* deadline) did not contain the required information to be a "claim" within reg.37; the subsequent letter was submitted outside the deadline.

The Tribunal was critical both of HMRC (who had not indicated that the first letter was not adequate until they rejected the claim – they engaged in correspondence initially on the basis only that further information was required) and the advisor, who appeared to have let the taxpayer down. However, the Tribunal considered that the original letter constituted a reg.37 claim even without the schedule – it was in writing, it quantified the claim and it stated the method by which it was calculated. HMRC were entitled to ask for further information, but not to deny that the claim had been made by the time limit. The appeal against the refusal of the claim was allowed.

First-Tier Tribunal (TC01696): *Graham Laing*

A company made a *Fleming* claim for £17,000 in respect of the VAT element in mileage allowances paid to employees from 1973 to 1997. HMRC accepted that the claim had been made within the time limit and contained sufficient information to satisfy reg.37, but they did not accept that the appellant had provided sufficient evidence that the VAT had not already been claimed. There were some records from a control visit in 1979 which showed that the deductibility of VAT in mileage allowances had been discussed; HMRC argued that it was likely that this had then happened, so the claim was (without evidence to the contrary) likely to give double relief.

The company countered with the established fact that it was not claiming input tax on mileage allowances by 2001. The claim was based on extrapolation back from the figures for 2005 and for 2001 to 2004, taking into account changes in the number of employees during the relevant years. HMRC accepted the reasonableness of the calculations.

The Tribunal agreed with the company that it was very unlikely that the company would have made the claim in 1979 and subsequent years, and then for some reason stopped claiming such a deduction. It was more likely that the discussion at the meeting in 1979 had not been followed up by the company and no relief had ever been claimed. As this was the only point at issue, and the level of proof required was the balance of probabilities, the appeal was allowed. Unusually, the decision was given at the hearing itself and confirmed in writing later.

First-Tier Tribunal (TC01668): *Alberto-Culver (UK) Ltd*

6.4.3 Possible claim by end consumers

Following the CJEU judgment in *JP Morgan Fleming Claverhouse,* HMRC made repayments of VAT charged by investment managers to investment trust companies. This would have been subject to the principles of unjust enrichment – i.e. the managers would have had to pay the money back to their clients, the ITCs – and also subject to capping, in that only 3 years' worth would be repaid.

A group of ITCs are claiming compensation directly from HMRC in respect of the amounts which were not repaid because of the cap. The High Court has considered that the issues are similar to those in a group action brought by other companies in respect of corporation tax (the "FII Group Litigation"). In that case, the Court of Appeal has held that the claims were time-barred because they were made more than 6 years after the periods concerned. This has been appealed to the Supreme Court.

The judge decided to hold over the current litigation pending consideration of the FII Group case by the Supreme Court.

High Court: *Investment Trust Companies v HMRC*

6.4.4 Possible ex gratia payment

A company operated as a franchisee in a business carrying out legal searches and supplying the results to lawyers. In 2002, another franchisee was told by a Customs officer that the cost of obtaining a particular form could not be recharged to customers as a disbursement: VAT was due. The franchisor circulated this advice to all franchisees, and all were required to apply the same VAT treatment.

Some time later, the franchisee which had received the visit concluded that the advice might be wrong. It persuaded HMRC to accept a voluntary disclosure and to make an ex gratia payment for VAT overpaid more than 3 years before that disclosure, i.e. effectively disapplying the cap. HMRC appear to have done this with some reluctance, but they accepted that their officer's incorrect decision had caused financial damage.

The appellant in the current case heard of the other franchisee's success and made its own voluntary disclosure. HMRC repaid 3 years' worth, but would not make an ex gratia payment for the balance. The company appealed; the FTT expressed some sympathy, and recorded all the details in its decision to encourage HMRC to act fairly between taxpayers, but could only dismiss the appeal. It did not have jurisdiction to require HMRC to make an ex gratia payment, and there was no basis in the law for disapplying the cap.

First-Tier Tribunal (TC01886): *Spectrum Legal Services Ltd*

6.4.5 Old claim rejected

A trader appealed against the refusal of a claim for VAT on some equipment he purchased while VAT registered in 1998. The trade had ceased in 1999. There was some evidence that a claim for this input tax had been made by an associated business in 2004 and rejected at that time; the matter had then apparently been lost in the accountancy firm’s files, and then literally lost in a burglary, and reappeared before the Tribunal only in 2011.

The claim had to fail, both on the grounds that it was clearly time-barred, and also on the burden of proof. There was insufficient evidence to conclude that the trader had not in fact claimed and been allowed the input tax through the VAT return for the period in the normal way. Given the length of time since the facts, it would be necessary to have much more complete and convincing evidence to draw firm enough conclusions to allow an appeal.

First-Tier Tribunal (TC01796): *Lewis Johnson t/a The Point Night Club*

6.4.6 Corporation tax on VAT reclaims

The First Tier Tribunal has heard appeals by four companies which were each representative member of a group of retailers which had received large VAT repayments (running in total into hundreds of millions of pounds) together with statutory interest under s.78 VATA 1994. The companies had all treated the receipts as outside the scope of corporation tax, and HMRC had raised assessments on the repayments as trading receipts and the interest as a “credit on a loan relationship”.

The case was made more complicated by the fact that these included *Marks & Spencer* claims, and in the period between the original VAT payment and the repayment, some of the companies had been transferred from one group to another. The Tribunal therefore had to consider the mechanism by which groups account for VAT between themselves, and the consequences of transferring a member of a VAT group to another holding company. The Tribunal concluded that intra-group payments in respect of VAT recognised an obligation that existed within the group, even if that obligation was disregarded for the purposes of the VAT return.

The Tribunal rejected the argument that the accounting treatment was determinative of whether a receipt was a trading receipt or not. The fact that the VAT repayments had been credited to the companies’ P&L accounts was suggestive but not conclusive. Once it had been determined whether they were trading receipts, the timing of any charge to CT would follow the accounting treatment.

The appellants’ arguments on this issue were summarised as follows:

(1) Where there is a statutory right to a sum of money and money is received pursuant to that right, the source of the money is the statute and not something else.

(2) Whilst it is accepted that some receipts of a trader which are not directly derived from his basic trading activities may be regarded as trading receipts, in order for that to be so they must be paid to the trader for some specific trading purpose.

(3) Where a recovery is attributable to a trading activity in an earlier period, and the profits of that earlier period have been correctly computed, it is inherently unlikely that the recovery can be taxed in a later period as a receipt of a trade.

(4) Just because a sum is included in a company's accounts, it does not follow that it is liable to tax.

The Tribunal examined the arguments of the counsel for each side in relation to each of these propositions. In respect of the first, the Tribunal commented that the repayments were not attributable to a "statutory right" under s.80 VATA 1994 – that was merely the mechanism for obtaining the repayment. It was quite different from the cases cited to support the proposition, which related to a statutory right to compensation on termination of a lease. The underlying right to the money certainly derived from the trading activities of the companies.

In respect of the second, the Tribunal examined a number of precedent cases on the nature of "borderline" receipts, including voluntary payments, and concluded that there was no such principle – the circumstances of each receipt must be considered in its context, but there is no presumption that a specific trading purpose is necessary for a receipt to be chargeable as part of the trade.

Again, in respect of the third proposition, the Tribunal considered the precedents and rejected the appellants' argument. The starting point and the end point is the source of the profit, and there is no inherent likelihood or unlikelihood of the result that can be based on the fact that a recovery is attributable to a trading activity in an earlier period. The question is whether the actual receipt or accrual arose from the trade.

The fourth proposition was accepted.

The Tribunal concluded that the true purpose of the VAT repayments was to compensate for depletions in the trading results of the various companies whose supplies had given rise to the VAT overpayments, and in most cases the payments were directed to the companies that were carrying on those trades or had succeeded to them. They therefore had the nature of trading receipts.

Where the person who had originally carried on the trade had ceased to do so, the Tribunal was satisfied that a charge to CT still arose on "post-cessation receipts" in the hands of whoever was beneficially entitled to the repayments. However, this did not apply if a different person was now carrying on the trade as a successor – there appeared to be a gap in the post-cessation rules in that unusual circumstance (i.e. trader A has ceased to carry on the trade and transferred it to trader B, but person C receives the VAT repayment). This gap did not apply in any of the cases under review, so all the repayments were correctly assessed either as trading receipts or as post-cessation receipts.

Turning to the statutory interest, the Tribunal concluded that the amounts had all the characteristics of interest on a money debt, even if there had not been an original "lending of money" on which the interest accrued. The existence of a money debt was enough to bring the interest within the corporation tax "loan relationship" rules, and it was therefore taxable. The appeals were dismissed on all counts.

First-Tier Tribunal (TC01823): *Shop Direct Group and related appeals*

6.5 Timing issues

6.5.1 Registration test and timing

A company provided training courses for post-graduate doctors. It received payments for the courses in advance. If its turnover was calculated on a cash basis, it exceeded the registration threshold in the 12 months to 31 July 2008; if its turnover was calculated on the basis of courses delivered, it did not exceed the threshold until the 12 months to 30 September 2008.

HMRC ruled that the company had to be registered with effect from 1 September 2008. The Tribunal agreed that s.6(4) VATA 1994 fixed the time of supply for the purposes of the registration test. HMRC accepted that the deposits received in July and August for courses after 1 September were not taxable.

First-Tier Tribunal (TC01728): *Bromley Emergency Training and Development Ltd*

6.6 Records

6.6.1 Invoicing rules

The Budget included confirmation that changes will be made by Statutory Instrument to the invoicing rules. Amendments, described as simplifications, are required by the EU Invoicing Directive, and will take effect from 1 January 2013.

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6.7 Assessments

6.7.1 DIY corrections

A restaurant owner’s records were examined by HMRC in January 2010. The officers were satisfied that the records were accurate, but could not understand why the submitted VAT returns were different from the figures produced by the SAGE accounting system. The trader explained that in submitting his quarterly returns, he made estimates, generally erring on the side of HMRC to avoid being penalised for underpaying VAT. His accountant carried out a reconciliation at the end of the year when preparing the annual accounts. He therefore only knew the correct figures some 12 – 18 months after submitting the returns.

By February 2006 he had built up a “credit” of over £5,000. Over the next few years, he started to make adjustments to the output tax figures in successive returns to recover this overpayment.

HMRC ruled that he should not have done this. At the time, the limit for corrections was £2,000. He could only have made a voluntary disclosure in February 2006 to recover an overpayment of this size.

The Tribunal agreed with this. There is no basis in law for making and correcting deliberate errors. Reg.34 allows for the correction of errors “discovered” by the trader – these must necessarily be accidental. The Tribunal dismissed an appeal against the assessments HMRC made to reverse the deliberate errors made for the 4 years leading up to the date of the assessment in July 2010. The first return on which an adjustment had been made (05/06) appeared to be out of time for an assessment.

First-Tier Tribunal (TC01850): *HO Chan*

6.7.2 Underdeclaration

A trader appeared to have understated his output tax in that his records showed the purchase of £200,000 of standard rated goods but sales of only £80,000. He claimed that a large amount had been stolen, pilfered or damaged by water leaks, but the Tribunal confirmed an assessment as being raised to best judgement on the basis of the evidence available. Assessments on private use of fuel bought for two cars were also confirmed, and a misdeclaration penalty mitigated by 40%.

First-Tier Tribunal (TC01802): *Benson Sunday Eyin*

6.8 Penalties and appeals

6.8.1 Default surcharges

Jurisdiction

HMRC applied for a trader’s appeal against a surcharge to be struck out because it was based solely on the defence that it was disproportionate. HMRC argued that the Tribunal had no jurisdiction to hear such an appeal; the chairman (Rachel Short) considered the question in detail and decided that she did. The application for strike-out was rejected and the appeal should be re-listed for hearing of the substantive arguments.

HMRC argued that the question of fairness was a public law question that could only be considered by the High Court on an application for judicial review. The Tribunal viewed the matter differently, based on its interpretation of the High Court judgment in the *Oxfam* case. Provided the basic subject matter of the appeal was within the jurisdiction of the Tribunal (as default surcharge was), the Tribunal could consider arguments based on public law concepts such as disproportionality. The fact that s.59 VATA 1994 did not allow mitigation of the surcharge did not rule out such a defence: it only meant that the Tribunal would have to strike out the penalty altogether if it considered the defence made out.

First-Tier Tribunal (TC01736): *Westward Group Ltd*

Successful appeals

A trader submitted the returns for 12/09, 03/10 and 06/10 late, but no surcharges were levied at the 2% or 5% rates because the amounts were below £400. A 10% surcharge for the 12/10 period was appealed.

The trader submitted a series of factors which had contributed to its difficulties. These included the loss of an important customer, a bridge closure which had lasted for a year and caused access difficulties, an injury to the main director which put him in hospital for 3 months, and the withdrawal of credit by an important supplier. The Tribunal considered that none of these individually would constitute a reasonable excuse, but the combination was enough to qualify.

Although the returns had also been submitted late, the Tribunal accepted the bookkeeper’s evidence that she had believed the return and payment had to be submitted together.

First-Tier Tribunal (TC01768): *Craighill Services Ltd*

A trader’s account of late payments by two large, valued and normally reliable customers was accepted as the underlying reason for late payment of a quarter’s VAT. The Tribunal agreed that the *Steptoe* principle applied: in chasing the late payments, the trader had to balance the importance of collecting the funds to pay HMRC against the importance of not offending two significant customers. Even though he had not contacted HMRC to discuss time to pay – he had believed that the customers would pay right up to the last minute – he had acted in a reasonable manner. His appeal was allowed.

First-Tier Tribunal (TC01768): *Ian Greer t/a Rainbow Signs and Maintenance*

Unsuccessful appeals

A firm of solicitors appealed against a default surcharge of £1,467 at 5% on the basis that it was “disproportionate”. The firm had made several late payments but HMRC had accepted that some of them were subject to reasonable excuse, because the firm had been unaware that its bank delayed payments for more than £10,000.

The Tribunal (J Blewitt) considered that the warnings that had been given to the firm in accepting reasonable excuses for previous defaults meant that it did not have a reasonable excuse for this one. It should have been aware of the different methods of payment and the length of time they took. The chairman then considered that he did have jurisdiction to hear an argument based on proportionality, but did not agree that this was a similar case to *Enersys Ltd*. The penalty was not so large, and the firm not so blameless, that the surcharge was manifestly unfair. The appeal was dismissed.

First-Tier Tribunal (TC01705): *French & Co Solicitors*

A trader claimed a reasonable excuse arising from extra responsibilities he had to take on in respect of a different company because his sister, who managed it, had personal problems at the time. The Tribunal did not accept that this constituted a reasonable excuse, not least because the surcharges were levied at 15% – clearly the problems with VAT compliance had started before the period in which the excuse was alleged to have commenced.

First-Tier Tribunal (TC01717): *Altcross Business Consultants Ltd*

A trader appealed against 3 successive surcharges levied at 5%, 10% and 15% for the periods ending August 2010, November 2010 and February 2011. The total amount was £6,934. The trader’s accountant declined to represent him at the last minute and advised him to withdraw; he was offered the opportunity to represent himself, but he did not attend.

In his absence, the Tribunal considered the possible arguments that might have been raised, but decided that the late payments arose from general cash flow problems which could not be a reasonable excuse. The trader had negotiated time to pay agreements, but these appeared to have been entered into after the due dates. They therefore did not suspend default surcharges.

First-Tier Tribunal (TC01646): *Keith Brown Engineering Limited t/a Glenaber Brown Engineers*

A similar result arose in another case where the trader did not appear. In correspondence he had claimed to have been advised by HMRC representatives on the telephone that he would not be subjected to surcharges if he agreed Time to Pay; however, for the period in which there was an agreement it was entered into late, and for the second period there was no such agreement. The appeal was dismissed.

First-Tier Tribunal (TC01647): *R J MacPherson and D MacPherson t/a Robert’s Floorcoverings*

A third trader also pleaded that Time to Pay arrangements had been entered into which should cancel surcharges for six successive periods. At the hearing, it appeared that this had been accepted by HMRC for two of the periods because those surcharges were reduced to nil; but there were either no agreements, or they had been entered into late. The surcharges were confirmed.

First-Tier Tribunal (TC01641): *Sliderobes (NI) Ltd*

A company received no relief from the Tribunal in respect of a penalty for making a payment which arrived one day late. The trader had been warned that BACS payments take 3 days to clear and had been put on notice of the requirement to meet the deadline.

First-Tier Tribunal (TC01810): *Vale Concrete Products Ltd*

A trader appealed against surcharges in relation to 8 defaults in 10 successive periods. The first 3 did not give rise to surcharges – the first caused a liability notice to be issued, and the second and third triggered surcharges which were not collected because they did not exceed £400. The following five returns triggered surcharges at 10% and 15% totalling £4,800.

The trader argued that he was doing everything he could to meet his VAT obligations in difficult financial circumstances, but he could not point to any particular reason for the cash flow problems of the business – it was simply suffering in the economic downturn. In the circumstances, the Tribunal could not find that there was a reasonable excuse. The HMRC representative undertook to put the appellant in contact with the correct department to deal with the VAT difficulties – presumably the Business Payment Support Service.

First-Tier Tribunal (TC01812): *B & B Tree Specialists*

A trader appealed against two surcharges levied for successive quarters at 5% and 10%. The first was appealed on the grounds of reasonable excuse (illness of the only director authorised to make a payment); the second on the grounds of disproportionality (although the company agreed to withdraw the appeal if the first appeal was allowed and the rate was therefore reduced to 5%).

There was insufficient evidence about the director's illness, and no evidence at all of a conversation alleged to have taken place between a bookkeeper and HMRC in which it was suggested HMRC had agreed not to charge a penalty for the first quarter because the payment was only a single day late.

In respect of the second quarter, the surcharge was considered proportionate in the circumstances: the payment had been made over an extended period (£101,345.78 within 14 days of the due date of 7/1/11; a further £81,697.12 on 8/2/11; a further £70,000) on 17/2/11; and the balance (£40,000) on 17/3/11). The Tribunal dismissed the appeal on both grounds.

First-Tier Tribunal (TC01831): *Mad Dog Casting Ltd*

A recruitment appealed against a surcharge levied at the 2% rate in respect of a payment of over £60,000 that was 43 days late. It argued that the reason for the late payment was the excessive length of time taken by two major customers, both NHS Primary Care Trusts, to settle their bills. Although this bore superficial similarities to the *Steptoe* case, the Tribunal was not satisfied that the business had done everything that it might reasonably have done to meet its VAT obligations – it had not explored alternative sources of finance, extending its banking facilities or factoring.

It had also been late with other returns before and after the period under appeal, which suggested that it was not compliant with its VAT obligations on a regular basis and this was not due to unforeseen and uncontrollable circumstances.

First-Tier Tribunal (TC01836): *Fylde Office Service Bureau Ltd*

A trader was late with five out of six returns and was therefore liable to a 15% surcharge. It claimed that HMRC's failure to operate "Faster Payments" constituted a reasonable excuse, but it had instigated a BACS transfer on the due date of 7/6/11. The Tribunal dismissed its appeal.

First-Tier Tribunal (TC01845): *Assiette*

A company's belief that a payment made electronically on 6/5/11 would arrive by the deadline of 7/5 was rejected as a reasonable excuse. The company had received several warnings about late payments and should have investigated why its attempts to pay on time were not regarded as adequate by HMRC.

First-Tier Tribunal (TC01847): *Claughton (Office Equipment) Ltd*

A company suffered a bad debt of £48,000 when a major client went into administration in April 2011. It paid half its 03/11 liability of £42,000 on 7/5/11 (the payment arrived 2 days late, but HMRC decided not to levy a surcharge) and the balance on 25/5/11. The company appealed against the imposition of a surcharge on the balance, arguing that the loss of the expected receipt from the customer was a reasonable excuse.

The Tribunal held that it was not. The company had been late with previous returns and payments, and there was insufficient evidence that it had done everything that a reasonable trader could do to make sure that it met its obligations on time.

First-Tier Tribunal (TC01848): *Warrens Display Ltd*

A trader claimed in his notice of appeal that he had not received surcharge notices and that he had paid his VAT electronically on time. He did not attend the hearing, so he could not back up these assertions with further evidence. The Tribunal accepted HMRC's argument that he must have received the surcharge notices as they were sent to the same address as the VAT returns which had been completed and submitted. The history showed that the money had arrived late for 12 out of 18 periods between 07/05 and 04/11. The appeal was dismissed.

First-Tier Tribunal (TC01849): *Karl Badamchi Zadeh*

A company employed a new accountant on 17 February 2011 and immediately sacked the rest of the accounts department for incompetence. She represented the trader in a reasonable excuse appeal, arguing that the default of four previously reliable customers had led to the late payment of VAT due for 31 December 2010. The Tribunal considered that the failure of the company to pay anything at all on time was indicative of the incompetence of the accounts department rather than a special circumstance, and dismissed the appeal.

First-Tier Tribunal (TC01851): *The London Kitchen Ltd*

A company paid a liability in two instalments of £85,906.70 (1 day late) and £100,000 (18 days late). It was charged a 10% surcharge of £18,590.

It disputed the £8,590 relating to the first instalment, arguing that it was disproportionate for a single day's delay.

Unusually, HMRC chose to argue that the penalty was "proportionate", rather than disputing the Tribunal's right to hear such an argument. The Tribunal agreed that it was harsh but not manifestly unfair in the terms of the *Enersys* decision. It was also clear that the trader had only taken action in relation to the payment – contacting HMRC about a time to pay arrangement and making a CHAPS transfer of the first instalment – on the day after the due date, 8 September. There was therefore no unfairness and no reasonable excuse.

First-Tier Tribunal (TC01854): *On Demand Communications Ltd*

A company changed banks and expected that the new bank would manage to make a BACS payment quicker than the previous bank – but without any positive evidence to back up this expectation. The instruction was given on a Thursday when the due date was the Sunday following; the payment was received by HMRC on the Monday. The Tribunal did not accept that there was a reasonable excuse.

First-Tier Tribunal (TC01855): *Makespace Architects Ltd*

A partnership had a poor record of compliance from 2005 to 2010. It eventually appealed against a default surcharge in 10/10, arguing that cash flow difficulties arising from a change of arrangements with a major customer in 2005 had created problems throughout the period, and the illness of the firm's bookkeeper had exacerbated these. The Tribunal did not believe that these factors constituted a reasonable excuse in this case.

First-Tier Tribunal (TC01861): *Controlled Security Management*

6.8.2 Other late filing and payment penalties

While HMRC seem to be more successful than ever in sustaining default surcharges before the Tribunal, they are finding it more difficult to enforce penalties for late payment of PAYE and late filing of PAYE returns. These were introduced for the first time in 2010/11, and the first cases on them have come before the Tribunal in the last few months. The chairmen (particularly, but not exclusively, Geraint Jones QC) have criticised the way in which HMRC levy the penalties, and have regularly struck them out for unfairness. One particular criticism arises where the penalty is greater after a long delay – if HMRC have not told the taxpayer that a default has arisen until after the penalty has increased, the Tribunal is likely to find that HMRC have contributed to the penalty and it will be reduced.

One company was unsuccessful in disputing a tax-geared penalty of £7,000 for late filing of its corporation tax return; however, the case is interesting because of the chairman's comments on HMRC's interpretation of the expression "reasonable excuse". In another case (*HMD Response International*) the Tribunal had criticised HMRC for going beyond the statutory language in asserting that a reasonable excuse had to involve "exceptional circumstances beyond the taxpayer's reasonable control". This chairman took the view that these words do no more than reflect the everyday meaning of the expression – any excuse suggests something out of the ordinary, and it would be unlikely to constitute an excuse if it was within the control of the taxpayer.

First-Tier Tribunal (TC01556): *World of Enterprise Ltd*

An employer was notified of a failure to file the end-of-year P35 return (due 19 April 2010) on 27 September 2010. The taxpayer thought he had filed online on 25 May, but admitted that he might have made a mistake because it was the first time he had tried to file online. The chairman (Mr Jones) ruled that the honest belief that nothing was wrong constituted a reasonable excuse; that excuse subsisted from 25 May (when the late filing penalty would have been £100) to 27 September 2010, by which time the penalty had increased to £500.

The chairman also commented that the HMRC computer sends out VAT default surcharge notices very quickly; VAT surcharges do not increase based on the length of time in default. He even speculated that the HMRC system might have been programmed deliberately to delay sending out the PAYE penalty notices because this would increase the penalty yield. Whether or not it was deliberate, he ruled that it was “conspicuously unfair” and reduced the penalty to £100.

First-Tier Tribunal (TC01684): *Brian Purveur*

Mr Jones gave an identical decision (including apparent cutting and pasting) in another case where the trader believed it did not have to file a P35 and had written to HMRC before the deadline in order to say so. That was wrong, but it had an honest belief that the letter had been accepted until the penalty notice arrived in September. Again, the penalty was reduced to £100.

First-Tier Tribunal (TC01637): *Talkabout Publishing*

A similar decision was given by the same chairman in another case involving honest belief of filing of a P35 and a penalty notice sent out on 27 September 2010. It appeared that the agent filing the return had been confused by the HMRC system which allows for “test submissions” – and confirms receipt of them – but requires a “live submission” as well. The chairman made the same comments about conspicuous unfairness and honest belief. In this case the penalty was cancelled altogether.

First-Tier Tribunal (TC01673): *Gavin Alexander Partnership*

Mr Jones produced a different variation in another case in which the taxpayer honestly believed that he had filed online on time, only to receive a £400 penalty notice dated 27 September 2010. He appears to have tried to clarify whether the return had in fact been filed, but did not rectify the situation until January 2011. The chairman decided that the basic penalty of £100 should be levied, but also increased in relation to the failure to act promptly once a problem had been notified. The total penalty was reduced to £331 (from the £800 which would normally be charged on filing in January).

First-Tier Tribunal (TC01726): *Peter Stump*

Mr Jones further criticised HMRC in a case in which a recreational shooting club failed to submit a P35 because the person responsible had let the club down. Another officer discovered a number of unopened letters, including a penalty notice issued in September, and tried to put the situation right; however, she received either no reply to her attempts or misleading replies, and this increased the delay and therefore the penalty.

The chairman discussed in detail the jurisdiction of the Tribunal to consider “fairness” and common law principles in determining tax appeals. His conclusion was that he could take such arguments into account, as long as the basic subject-matter of the appeal was within his jurisdiction.

However, he only reduced the penalty from £900 to £700. Even if HMRC had behaved more fairly, it appeared that the officer would not have discovered the situation before November, when the penalty would already have been at that level. HMRC’s failings had therefore not contributed to a penalty of that amount. A prompt and accurate reply to the officer in November would have enabled her to restrict the penalty to £700.

First-Tier Tribunal (TC01725): *Hilltop Syndicate Shoot*

A company succeeded with a variation of the *Steptoe* defence to a penalty for late payment of PAYE throughout the tax year 2010/11. The penalty increases depending on the number of months in the year which are settled late; the company was on the maximum rate, 4%, because it had settled 11 months late. The chairman accepted that the refusal by a major customer to pay a bill, eventually settling for far less than expected, was a reasonable excuse. It created an extreme cash flow difficulty that was out of the company’s control.

First-Tier Tribunal (TC01686): *HCM Electrical Ltd*

A company persuaded a Tribunal that a late filing penalty of £500 was disproportionate because the total PAYE liability for the year was only £1,045, which had all been settled on time. The chairman (Kevin Poole) applied the *Enersys* expression (“not merely harsh but plainly unfair”) and set the penalty aside in full.

First-Tier Tribunal (TC01638): *AST Systems Ltd*

A trader claimed that a delayed repayment of input tax had caused late payment of PAYE. The Tribunal did not accept that this was a reasonable excuse, but stood over the appeal until the question of whether the penalties might be “disproportionate” should be settled. Oddly, the chairman refers to this depending on “*the outcome of the litigation in the Enersys case which is currently under appeal*”. *Enersys* itself was not appealed by HMRC, but other cases on the issue are likely to be – these may settle the question of whether the Tribunal has jurisdiction to allow an appeal on those grounds.

It appears that this chairman at least (Richard Barlow) did not think that “disproportionality” is a purely VAT-related argument.

First-Tier Tribunal (TC01716): *Compass Royston Travel Ltd*

6.8.3 Error penalties

A trader did not appear before the Tribunal to defend against error penalties levied at 47.5% on VAT of £76,500 which should have been accounted for on the transfer of a property between associated companies. There was e-mail evidence before the Tribunal that the director had taken advice from accountants about the VAT treatment on the day he signed the VAT return for the period; they had advised that he ought to include the output tax, but he had not done so. The Tribunal could only conclude that this was a deliberate omission. It was attributable to the actions of a specific director, who was therefore properly chargeable as well as the company. The Tribunal saw no reason to interfere with the rate of penalty for a prompted disclosure of a deliberate error.

First-Tier Tribunal (TC01772): *Astoria Properties Ltd and another*

A company was assessed to a dishonest evasion penalty under s.60 VATA 1994. As the company was in liquidation, HMRC sought to collect the penalty from a director under s.61. Although he did not deny that the company had been guilty of dishonest evasion, the director disputed whether this had been attributable to his dishonesty.

There was a preliminary dispute about whether the appeal should be entertained, as the formal appeal had been made some 14 months late. The Tribunal decided that the circumstances were sufficiently exceptional to allow this considerable delay, based on the following facts:

(1) The appellant's advisers had specifically stated in their first letter dated 6 April 2009 that it was the appellant's wish to appeal the decision.

(2) The time limit for appealing had been reached at about the same time as the whole system of appeals and reviews was being fundamentally changed – and indeed even HMRC had clearly not taken on the board the new arrangements, as seen by the reference in their letter dated 23 April 2009 to the VAT Tribunal (whose name had been changed some time before to the VAT and Duties Tribunal, and which had been abolished on 1 April 2009).

(3) There was no evidence that HMRC had done anything in terms of enforcement of the March 2009 decision until the summer of 2010; it was just possible that the appellant might have considered this lack of enforcement action meant that his appeal was under consideration in some way.

(4) HMRC had not even mentioned the issue of the late appeal at the December 2010 case management hearing, suggesting they had dropped the matter (and possibly thereby barring themselves from bringing it up again at a future stage).

As a second preliminary issue, the Tribunal decided to admit evidence relating to VAT defaults in other businesses with which the appellant had been associated. The judge said that the Tribunal would be mindful of the distinction between such evidence casting light on the present dispute and merely being prejudicial.

Three previous businesses had been liquidated owing HMRC money. All had failed to file VAT returns when due. The latest business also failed to file returns and accepted centrally issued assessments which turned out to be considerably lower than the true liabilities. The director stated on oath that he had been unaware of the problems this business was having with its

VAT accounting, claiming that he had relied on his wife who did the bookkeeping. He stated that the problems were due to her incompetence. She did not attend the Tribunal to give evidence, but she had also been responsible for bookkeeping in the previous businesses; the Tribunal did not accept that the director was unaware of the problems.

The Tribunal concluded: "*We reject the appellant's evidence that he had no knowledge of the intentional withholding of VAT returns and payments due to HMRC. We consider his evidence both flies in the face of the documentary evidence before us and is also inherently implausible. Having seen the appellant give evidence, we have little doubt that he either instructed his wife to withhold the returns and payments or he was well aware that she was doing so, acquiesced in that conduct and deliberately did nothing to put matters right*." This satisfied the interpretation of "dishonest conduct" in precedent cases. His appeal against the s.61 allocation of liability was dismissed.

First-Tier Tribunal (TC01869): *James Edward Roxburgh*

6.8.4 Late registration

A trader's accountant prepared his accounts for the year to 5 April 2009 which showed that his turnover had exceeded the VAT registration threshold. The accountant failed to explain the consequences of this; as a result the trader did not realise that he ought to have registered in March 2009 until he was contacted by HMRC in July 2010. In the meantime, the accountant had died. The trader's new accountants helped him to regularise his VAT position, but this cooperation only led to a halving of the penalty from 30% to 15%. The Tribunal agreed with HMRC that his ignorance of the law, and his reliance on his former accountant, could not constitute reasonable excuses. The mitigated penalty of £2,353 was confirmed.

First-Tier Tribunal (TC01833): *Roy Scott t/a Roy Scott Joinery*

6.8.5 Late appeals

A club claimed back £13,600 in respect of a gaming machine in December 2006. It was refused by letter of 17 January 2007, and an appeal was not made until 5 July 2011. The grounds for making an appeal out of time included the fact that the original refusal letter had not included reference to a time limit for appealing, and the club officials were "not sophisticated in legal matters but relied on the Commissioners to act properly". The Tribunal chairman noted that "the letter making the original claim refers to the claim as a voluntary disclosure and refers to the legal basis for making the claim and was accompanied by a spreadsheet calculation; none of which seem likely to have been things that would be known to a person who had no knowledge of the subject".

The appellant also argued that the case should have been reconsidered in the light of the *Rank* appeal. As the Tribunal had decided in Rank's favour in 2008 and 2009, the chairman considered that this did not give any further justification for the club's late appeal. Leave to appeal out of time was refused.

First-Tier Tribunal (TC01718): *North Reddish Working Men's Club*

A similar decision was reached in another case about a *Rank* claim for over £500,000. The original claim had been made under the *Fleming* rules on 20 March 2009. The Tribunal report states that HMRC responded with a holding letter on 12 March – this is probably a misprint for 12 May. The claim was refused by letter to the company's accountants on 9 July. They claimed never to have received this letter or to have been aware of the decision it contained until 2010. The practice was taken over by another firm, and the company asked the other firm to follow up the claim that they thought was ongoing in May 2011.

The Tribunal decided that failing to follow up a claim for £500,000 for two years represented serious culpability on the part of the claimant. Leave to appeal out of time was refused.

First-Tier Tribunal (TC01612): *Jem Leisure Ltd*

A company made a voluntary disclosure in respect of gaming machine income from 1989 to 2006 on 28 December 2006. HMRC rejected the claim on 17 January 2007, stating that the trader could appeal, but not specifying any time limit for doing so.

As the *Rank* case progressed through the courts, the trader (according to its representative) wrote to HMRC in July 2009, May 2010 and June 2010, but did not receive a reply until July 2010, when HMRC suggested it might make a late appeal to the Tribunal. The company claimed that it had not realised that anything more was required than a protective claim.

The Tribunal judge (D Demack) set out the factors he would consider in an application to allow an appeal to proceed out of time, derived from The Civil Procedure Rules:

a. The interests of the administration of justice

b. Whether the application for relief had been made properly

c. Whether the failure to comply was intentional

d. Whether there was any good explanation for the failure

e. Whether there had been non-compliance with other rules, practice directions, etc.

f. Whether the failure was caused by the party or its legal representative

g. Whether any fixed date could still be met

h. The effect which the failure to comply had on each party

i. The effect which the granting of relief would have on each party.

The judge did not accept that the absence of a time limit in HMRC's decision letter was a valid reason for not pursuing the claim for two and a half years. He considered that to be a deliberate decision without any good reason. After taking into account a number of precedent cases on late appeals, he dismissed the application to admit this one, holding that this was in the interests of legal certainty.

First-Tier Tribunal (TC01820): *Status Investments Ltd*

A similar decision was reached in a case about a taxpayer which made a voluntary disclosure on 12 May 2006, refused by HMRC on 15 November 2006. No action was taken by the taxpayer in response until 15 June 2011. The taxpayer claimed that it had misunderstood HMRC's comments about the procedure to be followed in disputing the decision, but there was no evidence that it had done anything at all for such a long period that the Tribunal considered it to be too long a delay with no reasonable excuse.

First-Tier Tribunal (TC01901): *South Devon Inns Ltd*

Another company asked to jump on a different bandwagon – appealing out of time against a default surcharge on the basis of disproportionality. Surcharges of £69,022 at 2% and £195,351 at 5% had been levied for the periods ended 30 June 2008 and 30 June 2009. The company asked for reconsideration of the second surcharge, but HMRC ruled that there was no reasonable excuse. The *Enersys* decision was released by the Tribunal on 11 January 2010, and the company wrote to HMRC asking for reconsideration in the light of it on 2 August 2010. HMRC did not reply until 9 November 2010, when they pointed out that they could only carry out one review. The company submitted a notice of appeal on 10 December 2010; HMRC wrote a detailed reply arguing that *Enersys* had been wrongly decided in January 2011; then HMRC applied for strike-out in their statement of case dated 27 May 2011, mentioning for the first time that the appeal was being made out of time.

The chairman decided to refuse the application, which was made over two years late for the first surcharge and a year late for the second one: "*TNT is a very large company with, it is reasonable to assume, access to excellent legal and accountancy expertise and I regard that as a relevant factor in considering whether it is fair and just to refuse the application for an extension of time. Both parties' interests and the interests of the administration of justice all come into consideration.*"

First-Tier Tribunal (TC01663): *TNT GRS 2008 Ltd*

6.8.6 Assignment of appeal

A company appealed against a refusal by HMRC to pay it compound interest in relation to a repayment of VAT. A deed of assignment was then executed to transfer the benefit of the appeal to a creditor. It was the intention that the company should be dissolved. HMRC said that it was for the Tribunal to decide how this should be dealt with. The chairman noted that there were several similar cases, so the importance of the case was wider than the effect on the immediate appeal.

The chairman examined the facts and the precedent case of *Midlands Co-Operative Society*, which was decided under the old Tribunals Rules. He decided that:

- the subject matter of the appeal was capable of assignment;
- the deed executed by the parties was effective in assigning the appeal;
- rule 9(1) of the new Tribunals Rules allowed the substitution of one party for another where it became necessary because of a change in circumstances. These words were wide enough to encompass an assignment.

The appeal could proceed with the creditor substituted for the company.

First-Tier Tribunal (TC01731): *New Miles Ltd and B Hilton-Foster*

6.8.7 Costs

A trader was assessed to underdeclared output tax of some £40,000 after a control visit revealed substantial discrepancies between his bank statement receipts and his declared sales. The trader disputed the assessment and applied for an appeal to proceed without payment of the VAT due to hardship. The appeal was made late, and a formal hardship application was not made because the trader decided to accept a reduced assessment of about £23,500. He then applied for costs against HMRC on the basis that the original assessment was "without merit", and because they had initially refused, then accepted, the postponement application.

The Tribunal did not agree that HMRC had acted unreasonably, and dismissed the application.

First-Tier Tribunal (TC01906): *Mohammed Afzal t/a Kingston Furniture*

6.8.8 Which appeals rules?

In a MTIC case, HMRC applied for a direction that the pre-2009 costs rules would apply. The appellant objected, arguing that the 2009 rules were appropriate (and they would therefore not suffer a costs order, as the case fell in the "standard" category). HMRC asked for the transitional direction in October 2010, although the question of costs had been mentioned in some earlier correspondence and legal documents.

The FTT agreed with the appellant that it would be wrong to apply the 1986 rules when the application came so long after 1 April 2009. The appellant was entitled to expect that the new rules would apply, particularly as most of the costs were incurred after 1 April 2009. In another case in which HMRC had successfully applied for the old rules to apply, *Pars Technology*, the appeal was much further advanced when the rules changed.

The Upper Tribunal has confirmed that the FTT was entitled to reach this decision. The judge commented that it ought to be possible to make a "split costs order", requiring the old rules to apply to costs incurred up to 31 March 2009 and the new rules to apply to costs incurred after that; this had never been done, but he encouraged future chairmen to consider it (although the number of cases where it would be relevant must be declining). He agreed that the chairman had been right to refuse the order that HMRC sought.

Upper Tribunal: *HMRC v Atlantic Electronics Ltd*

6.8.9 Procedure

In a MTIC dispute, the appellant applied for a stay of proceedings pending the CJEU decision in the case of *Bonik* (Case C-285/11). The judge ruled that the CJEU was very likely to have given judgment in that case by the time the present appeal came to the Tribunal, because that was unlikely to happen before 2013. There was therefore no prejudice to the appellant in refusing a stay. The judge also considered the CJEU case of only marginal relevance to the current appeal.

Two other applications by the appellant found more favour. One of HMRC's expert witnesses would be required to make a statement that he had complied with the Civil Procedure Rules for expert witnesses; and a large part of another expert witness's statement was agreed to be inadmissible as containing opinion and hearsay. As the inadmissible parts were longer than the admissible ones, the judge considered that it was correct to exclude it altogether.

There were also disputes about the rights of the appellant to see a large volume of material from the First Curacao International Bank. The judge decided that for reasons of practicality this would have to be carried out at HMRC's offices, and the costs of copying would be borne by the appellant.

First-Tier Tribunal (TC01883): *Arjan Chandanmal and others t/a C Narain Bros*

6.9 Other administration issues

6.9.1 Concessions

HMRC have published two updated versions (February 2012 and March 2012) of the notice which contains all current extra-statutory concessions. Since the last edition, the following VAT concessions have been withdrawn:

3.4 VAT: misunderstanding by a VAT trader

3.16 VAT: connection to the gas or electricity mains supply

3.22 VAT: valuation of the refurbishment or fitting out of a building for the purposes of the capital goods scheme

3.33 VAT: supplies formerly made by the Post Office

Notice 48 2 February 2012

6.9.2 Fraud and contractual disclosure

HMRC have published an updated version of Code of Practice 9 on investigations where serious tax fraud is suspected. It includes reference to the new Contractual Disclosure Facility (CDF) for cases of serious fraud. The COP sets out the three choices available to someone who receives the notice – CDF, denial, and non-co-operation. The procedures to be followed and the consequences are set out in detail.

www.hmrc.gov.uk/admittingfraud/cop9.pdf

HMRC have made available an interim version of its Fraud (Civil) Investigation Manual, containing guidance applicable from 1 January 2012 on the CDF. It describes in detail the procedures to be followed by officers in agreeing and settling liabilities in such investigations.

HMRC Release 1 February 2012

6.9.3 Dishonest conduct by tax agents

The Budget contained details of the proposed new measures for penalising dishonest conduct by tax agents. The present law relates only to direct taxes: HMRC may call for the papers of a tax accountant under s.20A TMA 1970 where the accountant has either been convicted of a tax offence in a UK court or has been penalised under s.99 TMA 1970 for assisting in the preparation of an incorrect return.

These provisions will be replaced by a new power. Where HMRC have determined that an agent who assists clients in the course of business has engaged in dishonest conduct, they will be able to issue a notice to that agent requiring production of the working papers. The notice will be subject to prior approval by the First-Tier Tax Tribunal. Where working papers are no longer in the power or possession of the tax agent, HMRC will be able to request them from a third party.

There will be a civil penalty for dishonest conduct of up to £50,000.

In cases where the working papers reveal that full disclosure was not made, HMRC will be able to publish details of the penalised tax agent. A third party organisation whose details HMRC intends to publish to identify the agent penalised has the right to make representations.

It is intended that the new power will come into force from 1 April 2013, and it will only affect dishonest conduct from that date onwards.

www.hmrc.gov.uk/tiin/tiin678.pdf ; Outline of Tax Legislation and Rates 1.68

6.9.4 Timetable for review of powers

HMRC have updated the summary of legislation arising from the department's review of powers, deterrents and safeguards (penalties, compliance checks, time limits and interest) and the date these measures come into effect. The most recent changes relevant to VAT relate to data-gathering powers; the remainder are concerned with other taxes.

HMRC Release 31 January 2012

6.9.5 Data-gathering powers

Sch.23 FA 2011 replaced more than 25 separate HMRC powers to require the production of information with a single power to require data holders to produce it. This is brought into effect from 1 April 2012 by a Statutory Instrument which details the data that are affected by the new power.

SI 2012/847

The Tribunal had to consider one of the old powers to require information (in an income tax enquiry) under Sch.36 FA 2008. The taxpayer's representative tried to show that the information notice was unlawful because it was too widely drafted, but the Tribunal agreed with HMRC that it accorded with the law. A point of interest is that the Tribunal placed the onus of proof on HMRC to show on the balance of probabilities that their notice was lawful.

First-Tier Tribunal (TC01905): *Karl D'Souza*

6.9.6 Compliance manual

HMRC have published an updated version of their online Compliance Handbook. It includes new guidance on reasonable excuse, VAT extended time limits and VAT failure to notify, and additional guidance on deliberate behaviour and publishing details of deliberate defaulters. There is also new guidance for when there is more than one penalty or surcharge, cross-tax working and new information on adjustments for other penalties.

www.hmrc.gov.uk/manuals/chmanual/updates/update%20index.htm

6.9.7 Business records checks

HMRC will postpone any new SME business record checks until the department has formulated a new approach to these interventions targeted more at high-risk businesses. Responding to pressure from the representative bodies, HMRC agreed in December to review the entire BRC project. New visits will not resume until HMRC announces the detail of a 'revamped' approach, expected at some time after April 2012.

HMRC Release 3 February 2012

A Reader's Query in *Taxation* raised the issue of a client who receives regular compliance visits. This appeared to be a result of a seasonal trade – although the trader was in an overall payment position, each year some of the returns claimed repayments. The visits never found errors, but took up management time. The replies suggested ways in which the trader could attempt to reduce the likelihood of future visits, possibly by asking for 'pre-visit credibility verification queries' instead.

Taxation, 8 March 2012

6.9.8 New campaigns

HMRC have announced another "time-limited disclosure opportunity" for a business sector to put its tax affairs in order – in this case, the "Electricians Safe Tax Plan" to follow on from last year's plumbing initiative. Electricians who wish to take advantage of the offer of reduced penalties have until 15 May to declare that they will make a disclosure, then until 14 August to provide full details. The notice explaining withdrawal does not explain what procedure now applies.

HMRC Release 14 February 2012

Further campaigns are planned for later in the year on missing returns, home improvement trades and direct selling.

NAT 14/12

A new "e-markets disclosure opportunity" runs from 14 March to 14 June, with disclosure to be completed by 14 September 2012. HMRC ran a Twitter Q&A session for online traders on 28 March to try to clarify how they could bring their tax affairs up to date.

NAT 27/12, 29/12

6.9.9 Disclosure of tax avoidance schemes

HMRC have issued an updated and consolidated set of guidance on the disclosure of tax avoidance schemes rules as they apply to direct taxes. VAT guidance is available in Notice 700/8.

www.hmrc.gov.uk/aiu/dotas.pdf; www.hmrc.gov.uk/aiu/guidance.htm

6.9.10 Confidentiality

HMRC have withdrawn Notice 700/47 *Confidentiality in VAT matters (tax advisers) - statement of practice* with effect from 14 February 2012. Up to that date, it outlined the legal powers and practice of HMRC concerning access to business records and information and dealt with the position of tax advisers' confidential advice and opinion.

HMRC Release 14 February 2012

6.9.11 Alternative dispute resolution

HMRC have announced that the trial of the ADR system for small and medium enterprises has been extended to the additional regions of North Wales and the North West, London, South Wales and South West England. A map has been included to show all the areas included in the ADR trial, along with Welsh-language equivalent documents.

The trial is available where there is a tax dispute which has not yet reached the stage of an appealable decision or assessment. One of the announcements provides the following guidelines:

Cases potentially suitable for this pilot may involve any of the following features:

- *Facts that are capable of further clarification*
- *Disputes that might benefit from obtaining more suitable evidence*
- *Factual and/or technical matters in which there is legitimate scope for any party to obtain a better understanding of the other's arguments*
- *Issues which are capable of further mediation and settlement by agreement within the framework of the Litigation and Settlements Strategy*

Cases not suitable for this pilot may involve any of the following features:

- *Cases which cannot be legitimately settled within the parameters of the LSS other than by litigation*
- *Issues which require clarification in the wider public interest. These might include matters of industry-wide application*
- *Issues linked to or involving co-ordinated appeals issues ("Stood behind" cases) e.g. 'Compound Interest' type disputes*
- *Cases that could only be resolved by an HMRC departure from its established technical or policy view.*

HMRC Release 11 January 2012 (SPEC 01/12); 17 February 2012; www.hmrc.gov.uk/adr/index.htm

6.9.12 Large business engagement

HMRC have published new information on their approach towards engaging with large businesses through its Large Business Strategy. HMRC also explains here the "customer relationship model", who to contact for general and specialist enquiries as well as providing information on Senior Accounting Officers, Tax Compliance Risk Management, forums and surveys.

HMRC have identified a number of key objectives that they hope to deliver by 2015:

1. HMRC will continue to invest in a resource-intensive, relationship-managed service for the largest customers, because the money and complexity involved make this the most cost-effective way of getting the right tax agreed early.

2. All parts of HMRC will work with a common set of risk priorities to focus on the highest risks. HMRC will allocate resources according to risk by customers' behaviour, by threats to regimes and by size and complexity.

3. In dealing with those who bend the rules, HMRC will prioritise upstream effort to resolve the problem at source: first aiming to change behaviour through policy design and disclosure, then through rigorous case work and where possible within established relationships, and finally, where appropriate, through litigation.

4. HMRC will always seek to work through issues in real-time with all customers no matter what their tax strategy. This provides earlier certainty for the customer but also allows HMRC to detect avoidance more quickly.

5. HMRC customers should have or buy in the skills to fulfil their ordinary day to day tax compliance requirements. HMRC will provide assistance to resolve uncertainty around complex or significant issues and commercial transactions.

6. All processing for large business customers will be via the normal channels. All contact, compliance interventions and exceptions will be co-ordinated through the Customer Relationship Manager and Customer Co-ordinators, ensuring a coherent approach to customer management.

The document sets out what effect HMRC believe these achievements will have on their "customers" when they have been implemented.

HMRC Release 15 February 2012

6.9.13 Small business review

The Office of Tax Simplification has published recommendations for simplifying the taxation of small businesses. At present, these concentrate on certain aspects of tax administration, the computation of profits for income tax purposes, and the specific issue of disincorporation of a small company.

There are no major recommendations in relation to VAT, possibly because many of the small businesses with which the review is concerned will not be registered: it starts with HMRC's estimate that there are approximately 2 million businesses in the UK with turnover below £20,000 a year. However, some of the income tax proposals (mentioned in the Budget speech as subject to further consideration and consultation) are familiar from VAT: cash accounting and the use of flat rate allowances.

There is a separate report on the possible improvement of tax administration. This contains the following points specifically about VAT:

6.6 A particular issue seems to be obtaining confirmation of the VAT status of a new or unfamiliar product. We were often told that attempts to get advice were simply met with an instruction to refer to the HMRC VAT guides. There is every chance that the business, and/or its adviser, has already done that and the call is prompted by the fact that the guide does not cover, or does not seem to cover, the point. Such an enquiry can be a serious matter for a small business which needs to know how to price a product or service.

6.7 The OTS believes HMRC needs to be able to give clear guidance on such enquiries, which can be relied on by the business. We recognise that HMRC will be concerned about advising when it may not have been given full facts. This can be addressed by HMRC writing to the business to set out its understanding of the facts and the ruling and explaining that if the facts as understood are wrong in any way the ruling may be invalid, in which case the business should apply for a revised ruling.

6.8 If the VAT treatment of the supply is queried later, the business will have a ruling on which to rely. If HMRC changes its mind about something on which it has ruled, any change should only apply from the *time that the change in view was communicated to the business. Thus the business gets protection and certainty.*

The reports contain a number of interesting survey results from interested groups such as tax agents and different categories of small businesses. One other VAT-specific recommendation was to allow small businesses to choose their VAT stagger group.

HM Treasury Release 28 February 2012

6.9.14 Security

Appeals against the issue of a notice requiring a deposit of security have been surprisingly rare recently. They almost always fail, but HMRC do not generally enforce the notice (or the criminal sanctions which back it up) while an appeal is heard. The reason for the likely failure is that the appellant has to show that the decision to require security was unreasonable; the appeal is usually based instead on the dire effect the requirement will have on the precarious finances of the business, which only proves that HMRC's decision was entirely reasonable.

The introduction of the statutory review has had an interesting effect on security appeals. A decision of HMRC can only be "reasonable" if the reasons for giving it are clear – it must be based on some evidence which justifies the decision. This applies both to the original ruling and to any review decision which confirms it. In a recent case, accountants for the appellant disputed the accuracy of the information on which the decision was based. If they could prove that, the decision would surely be unreasonable.

This was a more detailed examination of the facts and the precedent law than was usual. The Tribunal noted that a decision which failed to take into account relevant information was likely to be unreasonable, but the Tribunal could still dismiss the appeal if it concluded that the decision would inevitably have been the same had the relevant material been considered by the Commissioners at the time.

The Tribunal examined a "chain chart" of connected companies that the officer had considered relevant to the risk posed to the revenue by the appellant. The directors of the appellant were involved in some way with many of the companies on the chart, several of which owed substantial amounts of VAT. The Tribunal concluded that the reasoning of the officer in relation to the chain chart was sound.

However, the reviewing officer did not give evidence to the Tribunal. The HMRC representative sought instead to rely on her decision letter as giving sufficient reasons for its confirmation of the original ruling. The Tribunal did not agree that it did so; in particular, she had refused to discuss a number of companies on the chain chart because of confidentiality issues, which meant that it was not possible to know what weight she had given to their involvement in confirming the notice. The Tribunal decided that it was not possible to conclude that the review decision had been reasonable.

However, on the facts presented by the officer who made the original decision, it was clear that the review decision would inevitably have been the same had it been properly arrived at. The original decision was reasonable, so the review would have had to agree with it. The appeal was dismissed.

First-Tier Tribunal (TC01740): *Premier Telecom Solutions Ltd*

A second appeal was a more routine case in which the directors and shareholders had been involved in a number of businesses which failed to file returns and pay their VAT on time. The company's accountant protested that HMRC had contributed to the non-compliance of one of these companies by effectively closing it down before it had had a chance to pay off its VAT debt, but the Tribunal agreed with the officers that they had taken a reasonable decision based on fair consideration of the relevant information.

First-Tier Tribunal (TC01739): *Burgess Recycling Ltd*

Another pair of companies had acquired their businesses from a predecessor which had failed in 2009 owing over £550,000 in VAT. The company's agent – a chartered accountant specialising in company turnarounds – protested that there were no common shareholders or directors, and that the successor had only taken over one of the restaurants of the predecessor, which had traded from several sites.

The decision appears to have been reviewed twice, which is not strictly allowed under the statutory procedure. The first notice requiring security gave no reasons at all, so the first "review" was effectively an initial statement of grounds following a protest by the taxpayer. The second appears to have been the formal statutory review.

The Tribunal criticised the parties for failing to communicate with each other over a long period – HMRC's reasons for issuing the notice only became fully clear on presentation of their skeleton argument for the hearing, and this revealed a number of inconsistencies and fallacies in their reasoning. Nevertheless, the Tribunal was satisfied that the decision was inevitable, based on the size of the default of the predecessor business and the substantial connections between the people running the two businesses. These appeared to have been concealed by the use of spouses as directors, which increased the impression of a risk to the revenue. The appeal was dismissed.

First-Tier Tribunal (TC01742): *Watermargin (Portsmouth) Ltd and another*

The fourth case in the quarter was more routine. An individual had been involved in running about 19 hotel or restaurant businesses over the last 15 years, either as a sole trader or as a director of a company or in conjunction with a family member who was an owner or director. Most of these businesses had become insolvent owing VAT of between £13,000 and £155,000. The current business was in arrears with its VAT payments. Not surprisingly, the Tribunal ruled that the issue of the notice was amply justified.

First-Tier Tribunal (TC01787): *Bert d'Agostino*

6.9.15 Sentencing

A group of convicted MTIC fraudsters appealed against the severity of their prison sentences (between 6.5 and 15 years) and disqualifications from holding the office of director (between 10 and 14 years), arguing that the judges had failed to take into account their previous good character and other mitigating factors. The Court of Appeal held that the judges were entitled to take into account the amount of VAT reclaimed and had not erred in passing sentences. Minor adjustments were made in order to make the sentences more comparable within the group.

Court of Appeal: *R v Randhawa and others*

In another appeal which carries the same name, but deals with a different issue, the Court of Appeal ruled that a conviction was not rendered unsafe by a judge's ruling that certain material produced by a co-defendant in the fraud trial was not discloseable by the prosecution to this defendant. The material was not relevant to the defence offered, so it had no effect on the conviction.

Court of Appeal: *R v Randhawa*

6.9.16 Confiscation

Two directors of a MTIC company appealed against a confiscation order which was based on the assumption that the whole proceeds of the fraudulent trading were "proceeds of crime" susceptible to forfeiture. The Court of Appeal decided that this could not be the case: the loss to the public revenue had been the VAT, not the gross amount, and the confiscation order could only reflect that. Orders confiscating £92m were quashed and replaced with orders confiscating £16m.

Court of Appeal: *R v Ahmad and another*

6.9.17 Tax receipts

HMRC statistics show that the total tax revenue collected by HMRC in 2010/11 rose 10% to £447bn. The increase in the VAT rate contributed to a rise in VAT from £70bn to £85bn, but this is still less than income tax (£153bn) and NICs (£97bn).