VAT UPDATE
APRIL 2014

Covering material from January – March 2014

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VAT Update April 2014

Contents

1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The HMRC website section says that it will be updated monthly, but it appears to be less frequent or regular than that. The latest update appeared on 20 March 2014 after a gap since 20 January, but the previous update was on 20 June 2013. There seems to have been very little change to the list between January and March, apart from changing the date at the bottom: it includes as unresolved some hearings on which the decision was certainly announced before 20 March (*Brockenhurst College*, *European Tour Operators*).

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

Awaiting the CJEU:

- *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 – in a preliminary decision, the UT decided not to refer questions to the CJEU but to proceed with a substantive hearing; one issue will now be referred to the CJEU (Case C-589/12), with questions for reference being agreed (and HMRC are considering whether to appeal further on the others, once the CJEU has given its judgment)

UK appeals awaiting hearing (or announcement of decision):

- *British Film Institute*: HMRC have appealed against the FTT's decision that tickets qualified for exemption before the UK had implemented the cultural services exemption (hearing scheduled for 12/13 May 2014)
- *Colaingrove Ltd*: HMRC's list includes separate entries for

- TC02715 (removable contents/definition – UT hearing listed ¾ March 2014).
- TC02701 (removable contents/apportionment – appeal stayed pending decision in TC02715).
- TC02534 (fuel – UT hearing listed 18/19June 2014).
- TC02701 (verandahs – UT hearing listed 10/11November 2014).

- *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 – hearing date set as 12 – 13 February 2014
- *Davis & Dann Ltd and Precis (1080) Ltd*: HMRC are seeking leave to appeal to the Court of Appeal against the Upper Tribunal's decision that the companies did not have the means of knowing that their transactions were connected with fraud
- *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 date to be confirmed)
- *DPAS Ltd*: HMRC have applied for leave to appeal to the Upper Tribunal after the FTT accepted that a VAT planning arrangement to circumvent the *AXA* judgment was effective and not abusive
- *GB Housley Ltd*: HMRC have appealed against the FTT's decision that they had effectively approved a self-billing system by conduct (hearing scheduled for 4/5 March 2014)
- *Investment Trust Companies*: HMRC have appealed to the Court of Appeal against the High Court's ruling that claimants had a direct cause of action against HMRC where they cannot recover overcharged output tax from the trader who made the supply to them (hearing not before October 2014; discussed in R&C Brief 15/2013)
- *John Wilkins Ltd and others*: Supreme Court refused HMRC permission to appeal one aspect of the case, in which the Court of Appeal decided that motor dealers were entitled in principle to claim compound interest on VAT repayments. Substantive issue stayed pending the *Littlewoods* decision in the High Court (which will in 2014 consider the effect of the CJEU's judgment in Case C-591/10)
- *Lok'n'Store Group plc*: FTT approved a special method which gave the self-storage company 99.98% input tax recovery; HMRC have been granted leave to appeal to the Upper Tribunal (hearing 11 December 2013 – decision awaited)
- *Longridge on the Thames*: HMRC have appealed to the UT against the FTT's ruling that a charity was not in business and could receive building services zero-rated (hearing listed October 2014)
- *National Exhibition Centre Ltd*: HMRC have been granted leave to appeal to the Upper Tribunal against the FTT's ruling that services were exempt payment processing (no hearing date set)

- *Newey (t/a Ocean Finance)*: HMRC appealed to the Upper Tribunal after the FTT held that a scheme was effective in reducing irrecoverable VAT on advertising costs by moving a loan broking business to the Channel Islands – HMRC regard the CJEU judgment (Case C-653/11) as being 'in their favour'; UT to reconsider the case in the light of the judgment (listed for hearing 4/5 November 2014)
- *Pendragon plc v HMRC*: HMRC have applied to the Supreme Court for leave to appeal against the Court of Appeal's ruling that the Upper Tribunal had incorrectly overturned the FTT's decision that the company's arrangements were not abusive. The Supreme Court gave leave to appeal on 30 January 2014, but no hearing date yet.
- *The 'Spotting the Ball' Partnership & Others*: HMRC have appealed to the UT against the FTT's ruling that the company ran a game of chance which would be exempt from VAT (hearing listed for 29/30 April 2014)
- *University of Huddersfield Higher Education Corporation*: HMRC have appealed against the FTT's long-delayed decision that the university's planning arrangements were not abusive (hearing listed for July 2014)

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

- *AN Checker Heating & Service Engineers*: the taxpayer will appeal to the UT against the FTT's decision that none of its supplies of boiler installation qualified for the lower rate as the installation of energy-saving materials
- *Birmingham Hippodrome Theatre Trust Ltd v HMRC*: taxpayer is appealing against Upper Tribunal's and FTT's decision that HMRC were entitled to offset the effect of overclaimed input tax from different periods against overpaid output tax which the company was claiming back (Court of Appeal hearing commences in May 2014)
- *Finance and Business Training Ltd v HMRC*: taxpayer is applying for leave to Court of Appeal against UT's upholding of FTT's decision that it was not an "eligible body" by being so closely connected with the University of Wales that it became a "college of the university".
- *Fonecomp Ltd v HMRC*: in a MTIC case, the taxpayer has applied for leave to appeal to the Court of Appeal against the UT's upholding of the FTT's finding that the company had the means of knowing that its transactions were connected with fraud.
- *HMRC v Atlantic Electronics Ltd*: the Court of Appeal has reserved judgment in a dispute about the admissibility of evidence in a MTIC fraud case
- *Leeds City Council v HMRC*: taxpayer council has applied for leave to appeal to the Court of Appeal against the UT's decision that the three-year cap validly blocked a number of claims for repayment.
- *Marcus Webb Golf Professional v HMRC*: the taxpayer applied to the Court of Appeal for leave to appeal against the UT decision that he was not assisted by the concept of fiscal neutrality (hearing was scheduled to commence 3 October 2013; no judgment yet)

- *R v Ahmad and another*: dispute over the extent to which HMRC are entitled to confiscation of proceeds of MTIC fraud – the judge at first instance decided that the gross proceeds of the fraudulent sales could be confiscated, but the Court of Appeal ruled that only the VAT was property obtained as a result of or in connection with the commission of the offence. Supreme Court is scheduled to start hearing HMRC's appeal on 10 February 2014.
- *R (on the application of Rouse) v HMRC*: HMRC appealing against Upper Tribunal's decision that they were not entitled to set off a credit against money owing from the taxpayer under s.130 FA 2008.
- *Sub One Ltd (trading as Subway) v HMRC*: taxpayer has appealed to Court of Appeal against rulings by the FTT and UT that it was not entitled to zero-rate certain sandwiches; UT confirmed the FTT's decision, even though the judge ruled that the FTT had applied the wrong legal test. Hearing concluded on 13 March, but judgment was reserved.
- *Volkswagen Financial Services (UK) Ltd v HMRC*: CA has given taxpayer leave to appeal against the Upper Tribunal's decision in favour of HMRC, overturning the FTT's decision that the company's suggested partial exemption special method was more fair and reasonable than HMRC's

The current list also contains the following information about cases which are decided:

- *Bridport & West Dorset Golf Club Ltd*: HMRC will issue an updated R&C Brief 'in due course'

The following cases have moved from the list (or previous lists from the update) into this quarter's update:

- *Brockenhurst College*: Upper Tribunal dismissed HMRC's appeal against FTT's decision that certain supplies were incidental to the education of students and therefore exempt. HMRC are applying for leave to appeal to the Court of Appeal.
- *Edgeskill Ltd v HMRC*: the Upper Tribunal's decision is in this update, upholding the FTT's ruling that the company had actual knowledge of a MTIC fraud and dismissing the company's appeal. The company has applied for leave to appeal to the Court of Appeal.
- *Esporta Ltd*: Court of Appeal hearing in February 2014 – taxpayer appealing against Upper Tribunal's reversal of FTT's decision that subscriptions during cancellation period were not subject to VAT because no supply had been made
- *European Tour Operators Association*: Upper Tribunal remitted case back to First-Tier Tribunal for further consideration of the facts in relation to the exemption for the association's subscriptions; FTT found in favour of the appellant
- *Secret Hotels2 Ltd v HMRC*: the Supreme Court has allowed the company's appeal against the Court of Appeal's decision that its website supplies were subject to TOMS

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Compensation or membership fees?

A company operated a chain of 63 commercial fitness clubs. Some new members were required to sign up for twelve months or 2 years. Some paid upfront; others agreed to make monthly payments. After the initial commitment period, membership could be terminated by giving three months' notice. If a member missed a payment, they were barred from using the facilities after five days (by means of their electronic keycards becoming ineffective). If they paid their arrears, they were allowed back into the club; but 99% of those who missed a payment chose never to re-start their membership, so they never received any further services.

After a further period, the company engaged debt collectors to enforce the debt. When the money was collected, the company initially accounted for output tax on the basis that it remained a taxable membership subscription. It later claimed the VAT back (some £1.3m) on the basis that the fees were not consideration for a taxable supply but rather compensation for breach of contract. Because the amounts recovered by debt collectors were only from those who did not continue their membership, those who paid these amounts had not used the facilities at all after their exclusion from access.

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

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

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

The FTT commented that it was not necessary for a contract to be terminated for a payment to be taken outside the scope of VAT. The

barring of access was enough to break the link between payment and the supply of any service. An innocent party such as the company was entitled not to terminate the contract which the customer had broken, but could still enforce payment in the nature of compensation for breach.

Upper Tribunal

HMRC succeeded in an appeal to the Upper Tribunal. The judges considered that the starting point for determining what the payments related to was the contracts it entered into. This was in line with the FTT's approach in *Reed Employment Ltd v HMRC*, and with the CJEU decision in *MacDonald Resorts*. The judges therefore examined the standard membership terms and conditions.

The judges concluded that the FTT was wrong to consider that each monthly payment was made in relation to services to be provided and received in the following month. Those members who paid an annual subscription might not use the facilities at all for the whole year, but there was no dispute that their fees were VATable in full; similarly, where a monthly payment was made by direct debit by a member who did not use the facilities during that month, it was still VATable. The club's representative had argued successfully in the FTT that it was not possible to grant access to the facilities retrospectively once the outstanding payments had been made; those months would always have been months in which the member could not use the facilities. The Upper Tribunal did not agree that there was a significant difference where the club excluded the member from access because a monthly payment had been missed.

Rather, the monthly payments during the commitment period were instalments of a single sum which was due in return for the services to be supplied in accordance with the membership agreement. Payment of those instalments in advance, on time or late did not change their nature, nor did it break the link between the contractually agreed sum and the services that were provided in the months in which access was allowed.

Court of Appeal

The taxpayer appealed further, arguing that:

- the Upper Tribunal had failed properly to consider the situation where the member defaulted after the end of the commitment period;
- the Upper Tribunal had not considered whether the taxpayer had supplied any services to its members in return for the overdue payments that fell due after the end of the commitment period, and if so, what those services were.

The CA agreed that the UT had not directly considered defaults after the commitment period, and this posed a significant problem for the UT's analysis. However, it is settled case law that the economic realities and all the circumstances surrounding the transaction have to be considered in determining its proper VAT treatment. The contractual terms were the starting point for the court in determining the nature of the supply and the link to the consideration, and those contractual terms should be examined to determine whether they reflected the commercial and economic reality.

The Court's interpretation of the contract was that the club granted access to its facilities in return for payment of instalments, both during the commitment period and afterwards until termination. The right of access

was conditional on keeping up the payments, but was certainly linked to them. Where the member failed to pay on time and was excluded, that did not change the contract: payments made under the contract were still for the right to use the facilities. The taxpayer's appeal was dismissed.

Court of Appeal: *Esporta Ltd v HMRC*

2.1.2 Sickness insurance payments

A nursing home received lump sum payments from the national sickness insurance scheme in France. It considered this to be outside the scope of VAT, rather than exempt income, so it did not include it in its partial exemption calculations. The tax authorities ruled that it was consideration for the supply of healthcare – a subsidy linked to the price of supply of services – and was therefore exempt. Questions were referred to the CJEU.

The company argued that the services rendered to residents are neither defined in advance nor personalised and the residents are not made aware of the price of those services. Next, since the national legislature has established the principle that medical care should be provided free of charge in RCHEs, the residents are guaranteed to receive that care free of charge regardless of the amount of the subsidy granted to the home and how far it meets the costs it is intended to cover. Finally, the amount of the subsidy received by a given home does not coincide with the actual cost of the healthcare.

The CJEU did not agree that these conditions were necessary for the payments to be consideration. The amounts were calculated in accordance with a formula relating to services to be provided and likely needs of the individual, and they resulted in a contractual obligation of the company to provide services. It was not necessary for the recipient of the service to pay anything for it, as long as the provider of the service was making the supply in return for the third party consideration.

CJEU (Case C-151/13): *Le Rayon d'Or SARL v Ministre de l'Économie et des Finances*

2.1.3 Article

In an article in *Taxation*, Neil Warren reviews the difference between charities making supplies for a consideration and receiving grants which are outside the scope of VAT. This is particularly important where the payer of the consideration or grant can recover VAT, either as a business or as a government body under s.33 VATA 1994.

Taxation, 26 March 2014

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Third party warranties

The French courts have referred the following question to the CJEU:

Must Article 2 and Article 13(B)(a) 6th Directive be interpreted as meaning that the service whereby an economic operator which is independent of a second-hand motor vehicle dealer provides, in return for payment of a lump sum, a warranty covering mechanical breakdowns which may affect certain parts of the second-hand vehicle falls within the category of insurance transactions exempt from value added tax or, on the contrary, as meaning that such a supply falls within the category of 'supply of services'?

The answer in the UK has always been that such warranties are treated as exempt supplies of insurance.

CJEU (Reference) (Case C-584/13): *Directeur général des finances publiques, Mapfre Warranty SpA v Mapfre asistencia compania internacional de seguros y reaseguros, Directeur général des finances publiques*

2.3.2 *Rank* response

HMRC have issued a Brief to celebrate the Court of Appeal's decision in *The Rank Group plc* case. They recall that '*R&C Brief 11/10 advised that HMRC would pay any valid claims submitted by businesses in respect of the net amount of VAT paid on gaming machine takings during that period. The Brief also made clear that protective assessments would be issued under s.80(4A) VATA 1994 to allow HMRC to recover these amounts if we were successful at a later stage in the litigation and claims were paid on this basis in 2010 and 2011.*'

They also point out that, since the Upper Tribunal remitted part of a second strand of litigation back to the FTT in October 2012, there are 'no adverse decisions against HMRC in respect of gaming machines.' They therefore propose to recover the amounts paid out in claims in accordance with Brief 11/10.

It is interesting that the Brief goes on as follows:

All businesses that made a claim and received a repayment from HMRC in accordance with R&C Brief 11/10 will be asked to repay the amount they received.

HMRC will write to all affected businesses individually setting out the amounts they received from HMRC. The letter will include guidance about how to repay the money. If you are unable to make the full payment by the due date you should contact HMRC and explain why you are unable to pay on time. HMRC will then discuss your circumstances with you.

It does not refer to 'enforcing the protective assessments that were issued' – it makes no further reference to them. It is possible that this glosses over the possibility that protective assessments were not issued in every case. If they were not issued, HMRC would now be out of time to raise new clawback assessments – the time limit in s.80(4C) is two years from the end of the return period in which HMRC had sufficient information to

raise the assessment, which in this case would be the period in which they made the repayment. The *DFS* case established in 2004 that a judicial decision cannot be 'evidence of facts' that will start the two years running in HMRC's favour – they would have fought the case because they expected to win, so winning should not be a new fact.

Some of the protective assessments that were raised were accompanied by letters stating that the assessments will be enforced when the litigation is complete. As one strand has been remitted to the FTT and the other strand is subject to an appeal to the Supreme Court, there may be some scope for arguing that the money should not be collected yet.

Revenue & Customs Brief 1/2014

2.3.3 Pension scheme management

Following the failure of *Wheels Common Investment Fund* to obtain exemption for services relating to a defined benefit pension scheme, the CJEU has given a different ruling on the application of the same law to a defined contribution scheme.

The appellant supplies advisory services to a pension scheme which include maintenance and development of the pension fund platform, administrative and advisory services and services as to the payment into and disbursement out of the retirement schemes. The Danish authorities accepted that services relating to payments out of the scheme could be exempted under the *Sparekassernes Datacenter* principle, but refused to exempt most supplies relating to inward payments.

The Danish court referred detailed questions to the CJEU covering both significant aspects of the dispute: first, whether a defined contribution scheme could be a "special investment fund" under EU law, and second, whether the disputed services constituted "management". A third question asked for guidance on whether the services were a single supply or mixed.

The Advocate-General noted that the exemptions for financial services are subject to review by the Commission, and any changes may affect the scope of the exemption for pension funds. However, agreement on the changes has not been reached, and implementation is unlikely in the near future. Possible changes should therefore be disregarded, and only the current law should be considered in reaching a decision in this case.

Denmark, supported by the UK, argued that defined contribution schemes are different from "special investment funds", just as defined benefit schemes were held to be different in *Wheels*. However, the Advocate-General rejected these arguments. He considered that a defined contribution scheme did not have the features that ruled out final salary schemes from being in competition with or similar to UCITS. In his opinion, "*the term 'special investment funds as defined by Member States' has to include occupational pension funds where such funds pool the assets of several beneficiaries, and allow the spreading of the risk over a range of securities. This is only the case where the beneficiaries bear the risk of the investment. The fact that the contributions are made by their employers for their benefit under a collective agreement between organisations representing employees and employers and that payments out of the fund are only made upon retirement is irrelevant, as long as the*

beneficiary has a secure legal position with respect to her or his assets. Whether a fund fulfils these requirements is for the national courts to decide."

The Advocate-General was of the opinion that the existing case law of the CJEU was enough to deal with the other issues (management and compound/multiple). He therefore did not consider those questions or offer an opinion on them.

The full court considered that the fundamental characteristics of a 'special investment fund', drawn from the UCITS Directive, are "collective investment in transferable securities and/or in other liquid financial assets of capital raised from the public and which operates on the principle of risk-spreading and the units of which are, at the request of holders, re-purchased or redeemed, directly or indirectly, out of that undertaking's assets". The court distinguished between a defined contribution scheme, where the scheme members bear the investment risk, and a defined benefit scheme, where it is the employer who bears it. This was more important than the source of the contributions; the existence of different ways in which the benefits could be drawn (pensions, lump sums etc.); the fact that income tax relief was given for contributions; or the possibility of adding an incidental insurance element which is ancillary to the scheme benefits. If the scheme in question had the fundamental characteristics of pooling and risk-spreading, and the customers bore the risk, they were capable of falling within the definition of SIFs.

The full court also considered and answered the other questions. It noted that transactions crediting contributions to accounts are essential to the management of a SIF; where such essential parts of the management function are sub-contracted, they are covered by the exemption. However, it would be for the referring court, which had the full analysis of the transactions available to it, to decide whether they constituted "management".

Lastly, the full court considered the application of *SKD* to contributions into the scheme – the possibility that processing contribution payments could be exempt under art.132(1)(d) ("transactions concerning payments") as well as under (1)(g) ("management of special investment funds"). The principle to be applied was whether the activity changed the legal rights of the parties; it was for the national court, considering the full analysis of the transactions, to determine this, but the CJEU considered that it appeared to be satisfied. Any services that were ancillary to the establishment of the pension customers' rights within the records of the pension company would also be exempt.

CJEU (Case C-464/12): *ATP Pension Service A/S v Skatteministeriet*

2.3.4 Status of vouchers

A group of companies operated licensed lap dancing or table dancing clubs in London under the trading name 'Secrets'. A dispute arose as to the correct VAT treatment of vouchers called 'Secrets money'. A patron who had run out of cash could buy a voucher using a debit or credit card. The company charged a 20% commission on top of the face value (so £100 in 'Secrets money' cost £120); if the voucher was given to a dancer in consideration of her services, she could cash it in at the end of the

evening, and would be charged another 20% by the club – so she would receive only £80.

It was agreed that the 20% commission on the sale of the voucher was consideration for a taxable supply to the patron – it was a face value voucher issued at more than face value.

It was also agreed that the 20% charged to the dancer was consideration for a supply of services made by the company to the dancer. The club claimed that it was consideration for a 'dealing in credit guarantees or any other security for money' within Item 1 Group 5 Sch.9 VATA 1994. In 2009, it made a claim for repayment of just over £500,000 in VAT accounted for in the preceding 3 years. HMRC raised an assessment for just over £40,000 in respect of two return periods in 2009 in which they believed the companies had treated the income as exempt. It is not clear how the vouchers were treated after that.

HMRC considered it to be a standard taxable supply. The company was not a dealer in financial instruments, and the vouchers were not in the nature of the securities that were referred to in Group 5; the commercial reality was that the company provided the dancers with the opportunity to carry on their activities, and the vouchers were a means of enabling that service to be provided.

The Tribunal examined the way in which the business operated, including the contracts between the companies and the dancers, the terms and conditions attaching to Secrets money, and the extent to which customers disputed that they had bought it (the company suffered chargebacks of only £16,000 on £22.5m over a 3 year period – less than 0.1%).

The company argued that precedent cases, including *Dyrham Park Country Club* (VTD 700) and *Kingfisher plc v C&E* (HC 2000) suggested that 'security for money' should be given a wide meaning; and others such as *Sparkassernes Datacenter v Skatteministeriet* (Case C-2/95) and *HMRC v AXA UK plc* (Case C-175/09) suggested that the exemption should not be restricted to financial institutions.

The Tribunal accepted that 'security' has a wide meaning, and that the vouchers were 'securities for money'. It also accepted that a security for money can be issued by someone other than the persons listed in Note 4 Group 5 ('a person carrying on a credit card, charge card or similar payment card operation'). The company extended credit by paying cash to the dancers before the credit or debit card company would pay them; the minimal nature of the exposure to the risk of chargebacks was irrelevant.

The Tribunal went on to examine whether the discount on redemption of the vouchers was in reality consideration for a financial transaction, or was consideration for some other service provided by the company to the dancers. The company's representative argued that there was no link between that discount and the opportunity to dance: dancers could refuse to accept Secrets money by declining an invitation to dance at a customer's table, and might only be paid in cash for the evening. They also paid the company an 'entry fee' for the opportunity to dance.

HMRC argued that there was a composite supply of services by the company to the dancers for a composite consideration, and the discount on the vouchers was part of that consideration. It could not be looked on in

isolation, but must be examined in the wider context. The entry fee was consideration for the opportunity to dance, and the discount was consideration for access to a wider 'market' – customers who did not have enough cash, but had Secrets money to spend.

The Tribunal accepted this contention. The discounts were not consideration for a separate financial supply. The appeals were dismissed.

First Tier Tribunal (TC03255): *Wiltonpark Ltd and related appeals*

2.3.5 Education or entertainment?

The Tribunal has considered the meaning of 'ordinarily taught in a school or university' in the context of the exemption for private tuition. The appellant ran a school offering courses in belly dancing. HMRC had issued a notice of compulsory registration and an assessment for VAT of £52,921. She accepted that she should be registered in respect of classes run by self-employed instructors engaged by the school, but argued that courses taken by herself personally should be exempt.

HMRC argued that belly dancing is not a subject ordinarily taught in schools and universities. The appellant relied on the observation of the CJEU in *Haderer* (Case C-445/05) that the concept of 'school and university education' '*is not limited only to education which leads to examinations for the purpose of obtaining qualifications or which provides training for the purpose of carrying out a professional or trade activity, but includes other activities which are taught in schools or universities in order to develop pupils' or students' knowledge and skills, provided that those activities are not purely recreational.*'

HMRC's guidance suggests that '*A reasonable test for "ordinarily" is whether the subject is taught in a number of schools or universities on a regular basis. In practice, the vast majority of structured courses delivered by an individual teacher are likely to meet this criterion.*' In their view, the subject of 'dance' is part of school and university courses, but not 'belly dancing' as such; her courses were only 10 weeks in duration, were not subject to any externally set standard or curriculum, and contained no written work or assessment. In HMRC's view, the courses were not educational but recreational.

The Tribunal agreed with HMRC. It characterised the study of dance as carried out in schools and universities as including such matters as '*the history of dance companies, the concept of transposing and transmitting the dance idea by choreography, the study of the works of influential choreographers, the critical analysis and appraisal of specific major dance works identified in the syllabus, and description in written form to communicate the experience of a dance performance*.' That was quite different from the appellant's activities, which were likely to be for the recreational purposes of the customers.

The conclusion gives a useful indication of the scope of the education exemption as applied to subjects taught by private tutors: '*This is not a case where a tutor is teaching privately a subject which his or her student might otherwise be taught at school or at university. It is not even a case where a tutor is teaching a facet of the wider subject taught at school or at university.*' The question still remains whether HMRC are correct to

exempt sports tuition, which seems to fall foul of the same possible analysis.

First-Tier Tribunal (TC03148): *A Cheruvier (t/a Fleur Estelle Belly Dance School)*

2.3.6 Incidental to education

A college of further education ran courses in catering and hospitality. To provide experience to its students it ran a restaurant at which members of the public could buy meals, on the understanding that they were prepared and served by trainees. The college subsidised the meals, charging a price which represented 80% of the cost of the food. Similar arrangements existed in relation to concerts and performances which were put on as part of relevant courses and charged to members of the public.

The college accounted for output tax on these supplies as catering, but in 2009 claimed repayment of £79,900 of output tax and £103,750 of overpaid input tax on the grounds that the supplies should properly have been regarded as exempt. The FTT decision did not make it clear how incorrectly treating exempt supplies as taxable could lead to a repayment of input tax.

The appellants argued that the meals were supplied as an essential part of the students' education. They were therefore within Art.132(1)(i) Principal VAT Directive, which exempts: "*Children's or young people's education, school or university education, vocational training or retraining, including the supply of services and of goods closely related thereto, by bodies governed by public law having such as their aim or by other organisations recognised by the Member State concerned as having similar objects.*" It was common ground that the college was an "eligible body" within Group 6 Sch.9 VATA 1994.

Art.134 restricts the exemptions under art.132 where:

(a) the supply is not essential to the transactions exempted; or

(b) the basic purpose of the supply is to obtain additional income of the body in question through transactions which are in direct competition with those of commercial enterprises subject to VAT.

The UK law requires that "services and goods closely related" to education, the goods or services must be for the direct use of the pupil, student or trainee (as the case may be) receiving the principal supply. HMRC ruled that this condition was reasonable and was not met; the college argued that it was too restrictive and not in accordance with the Directive.

The FTT examined the facts and the underlying law in detail, and came to a surprising conclusion. First, it did not agree with the appellant's argument about the compliance of the "direct use of the pupil" condition with the Directive. However, it also concluded that it was not proper to consider only the money transaction, nor to view the supply in the abstract: in its context, it was an essential part of the education of the students, and clearly did not generate extra income for the college because it was supplied at a loss.

The points made by the FTT in reaching its decision were:

- the VAT Act must be construed in a manner which is consistent with the purpose of the VAT Directive;
- the closely related activity has to be essential to the main supply of education;
- the related supplies were integral to the main supply of education – they were not an end in themselves, but a means of providing the students with a better education, as part of the course;
- if there was an intention to generate extra income, the operation would have been organised on more commercial lines.

The students directly benefited from the activity, even though the paying customers "received a supply" in the common understanding of the terms for VAT. The FTT concluded that the supplies to the customers were an essential and integral part of a supply of education, and were therefore within the exemption at art.132(1)(i).

HMRC appealed to the Upper Tribunal. Judge Berner examined a number of relevant precedents and set out the following principles that he derived from them:

(1) As a general principle, the exemption must be construed so as to be consistent with its objective and so as to ensure its intended effect (see, for example, PFC Clinic AB, para 23).

(2) An especially narrow interpretation of the exception for activities closely related to a principal exempt supply of education is not appropriate, since the exemption is designed to ensure that the benefits of the principal supply are not hindered by the increased costs of providing it that would follow if the principal supply, or the closely related activities, were subject to VAT (EC Commission v Federal Republic of Germany, para 47).

(3) To be closely related to a principal exempt supply, the service in question must be an ancillary supply, that is one that does not constitute an end in itself, but is a means for better enjoying the principal service supplied (Horizon College, paras 28 and 29).

(4) The closely related supply must be essential to attain the objective of the principal supply (Article 134(a)). In order to satisfy that requirement, the ancillary supply should be of a nature and quality such that, without it, there could be no assurance that the education from which the students benefit would have an equivalent value (Horizon College, para 39).

(5) There is no requirement that the closely related supply be made to the same recipients as the principal supply. To be services closely related to education it is not necessary for those services to be supplied directly to those students (Horizon College, para 32).

The Tribunal rejected HMRC's argument that the students would have to benefit from the subject matter of the supply (the meals and entertainment), rather than benefiting from taking part in the provision of the supply. Rather, the question was whether the supply – regardless of its subject matter or its direct recipient – was ancillary to the supply of education to the students, in that it was a means of better enjoying the principal service.

The FTT had found that the catering and entertainment services were essential to the education of the students, were not an aim in themselves but were a means of providing a better education, and were for the direct benefit of the students even though the supplies were made to third parties. They were therefore exempt as supplies of services and goods closely related to the provision of education by the college. HMRC's appeal was dismissed.

It was not necessary for the UT to rule on whether the UK's provision on 'direct use' complied with the Directive. It could be interpreted in a manner consistent with the Directive, in that the direct benefit to the student's education was 'direct use'. If that was not a correct construction, it would still have been necessary to interpret the law in that way in order to comply with the Directive (the *Marleasing* principle).

Upper Tribunal: *HMRC v Brockenhurst College*

2.3.7 More education

The FTT has allowed an appeal by a commercial company which claimed the status of 'eligible body' by reason of its close links with Middlesex University. The Tribunal examined the principles established by the precedent cases of *HIBT* and *School of Finance & Management* (*SFM*), which succeeded in winning 'eligible' status in the courts, and the more recent decisions in *London College of Computing* and *Finance & Business Training*, both of which have been decided by the FTT and confirmed by the UT as not qualifying. The following principles were drawn from the precedents:

(1) The SFM factors may be helpful in determining whether a body is a college of a university, but that list of factors is not exhaustive and factors within that list may not always be relevant;

(2) It is necessary to consider the particular circumstances and specific facts of each individual case, which may involve considering factors other than those listed in SFM;

(3) In considering any particular factor, it must be determined whether that factor is compliant with EU law. If it is not, that factor must be put aside and not taken into account in reviewing the evidence;

(4) The "fundamental purpose" test does not replace the similar objects test, but has something in common with SFM factor (ix) (having a similar purpose to that of the university);

(5) There must be at least some degree of integration of the body with the university concerned;

(6) It is inappropriate to follow a "check list" or "tick box" approach. The cumulative effect of the relevant factors must be assessed to derive an overall impression, weighing the factors in the balance: some factors may carry more weight than others.

The 'SFM factors' are matters identified in that case which should be considered in determining whether the links between the bodies are close enough to regard the company as a college of the university. The Tribunal considered the evidence under headings (a) – (o) in detail, and concluded that the following carried the greatest weight:

(1) Status of Associated College, combined from September 2010 with status of Accredited Institution.

(2) Long-term links between SAE Institute and MU. Similar purposes to those of a university, namely the provision of higher education of a university standard.

(3) Courses leading to a degree from MU, such courses being supervised by MU, which regulated their quality standards.

(4) Conferment of degrees by MU, received by SAE students at MU degree ceremonies.

The appeal hearing took longer than the initial time estimates of the parties (three days). In spite of the Tribunal extending the hearing time each day and making available a fourth day, it was not possible to complete it; there was therefore an adjournment until further court time could be found, which meant that four months passed. After the second part of the hearing, the Upper Tribunal gave its decision in *Finance & Business Training*, which led to further submissions being made to the FTT in this case. The Tribunal decided that that decision (which is binding on the FTT) did not mean that 100% of a company's activities had to be covered by the 'college of a university' umbrella; it had decided that 90% of this company's activities were so covered, and that was enough.

The company's appeal was allowed.

First Tier Tribunal (TC03358): *SAE Education Ltd*

2.3.8 Incidental to healthcare

Art.13A(1)(b) and (c) 6th Directive (now art.132(1)(b) and (c) PVD) exempt the following:

(b) hospital and medical care and closely related activities undertaken by bodies governed by public law or, under social conditions comparable to those applicable to bodies governed by public law, by hospitals, centres for medical treatment or diagnosis and other duly recognised establishments of a similar nature;

(c) the provision of medical care in the exercise of the medical and paramedical professions as defined by the Member State concerned;

A company managed a hospital. It supplied drugs from its pharmacy both to its own inpatients and to outpatients who were being treated at the hospital by independent doctors. The German tax authority ruled that the second category of supplies did not qualify for exemption. Questions were referred to the CJEU.

Advocate-General Sharpston gave an opinion that the supply of goods which are closely related to hospital care can qualify for exemption under (b) above. The expression 'closely related activities' can cover supplies of goods as well as supplies of services.

Exemption can apply even if the goods and the care are supplied by different persons. However, supplies of goods which are not related to hospital care within (b), but are supplied in connection with medical care within (c), will not be covered by the exemption if their supply is

'physically and economically dissociable' from the provision of care. The A-G recognised that this might run counter to the principle of fiscal neutrality; however, that is only a principle of interpretation where the legislation is not clear. It cannot be used to read into the legislation words that are missing. The A-G also observed that there are various solutions to preserve fiscal neutrality offered by the current legislation; however, they would tend to operate by restricting the existing exemption, imposing VAT where none is currently levied.

The full court agreed with the A-G, but the way in which the judgment is given appears to change the emphasis slightly: the supply of the drugs to outpatients cannot be covered by an exemption unless it is physically and economically dissociable from the principal supply of medical care, which is appears not to be if the supplies are being made by different people. The concept of 'closely related activities' was confirmed as irrelevant to exemption under art.132(1)(c).

CJEU (Case C-366/12): *Finanzamt Dortmund-West v Klinikum Dortmund GmbH*

2.3.9 Healthcare or information?

Background – the Brief

R&C Brief 16/2013 confirmed HMRC's view that the supply of laboratory pathology services related to the provision of healthcare for individual patients is exempt from VAT. This applies to all state-regulated pathology laboratories, including where they supply services to non-NHS hospitals.

The Brief explained that some suppliers have challenged that view, presumably wishing to charge VAT on their outputs so that they can recover input tax on the purchase of equipment. The challenges are based on the following arguments:

(a) the supplies do not amount to diagnostic services, but merely provide information a third party to enable it to make a diagnosis, or

(b) the providers are not state-regulated institutions or are not making their supplies in a state-regulated institution.

HMRC cited the case of *LuP* (Case C-106/05) as authority for the proposition that laboratory pathology services that directly relate to the provision of healthcare for individual patients is exempt from VAT. This applies to all businesses that are state-regulated and supply laboratory pathology testing services, whether they supply the services to the NHS or to independent hospitals.

Exemption does not apply when the services are not:

(a) concerned with the protection, maintenance or restoration of the health of specific patients, for example, the analysis of samples for general research purposes or for autopsies.

(b) performed primarily for the protection, maintenance or restoration of the health of the person concerned but are done solely to provide a third party with information necessary for taking a decision on non-medical matters such as insurance claims, or for legal purposes.

Background – the injunction

In 2007, some NHS Trust considered entering into a joint venture with a pathology laboratory to provide pathology testing services. The joint venturers asked HMRC for a view on the liability of the supplies, and were told in 2008 that they would be standard rated. This meant that:

- the joint venture would be able to recover input tax on the purchase of expensive diagnostic equipment;
- the NHS Trusts would be able to claim back the VAT charged to them because it related to outsourced services.

If a NHS Trust bought the capital equipment itself, it would not be able to claim the VAT back.

When another Trust joined the venture in 2010, HMRC confirmed their earlier ruling. Then in January 2013 HMRC issued a new ruling that the supplies made by the laboratory were exempt. The laboratory company appealed to the FTT, and the joint venturers issued judicial review proceedings to delay the implementation of HMRC's decision to change its policy until 3 months after the FTT's decision might be handed down.

The court had to consider whether to grant interim relief or to give the judicial review decision at this hearing (normally, the first hearing only permits a case to go forward for judicial review). The judge concluded that such full bundles had been provided that the merits of the application could be considered.

In arguing that HMRC should be held to a ruling, the principles were as set out in the case of *R v IRC, ex p MFK Underwriting Agents Ltd* [1990]. The applicant must have placed all of their cards face upwards on the table, the ruling must be unequivocal and clear, and the expectation must be legitimate. The court was satisfied that all these factors were present. It would be unreasonable to expect the traders to restructure their businesses before the FTT had ruled on the technical merits of HMRC's change of view.

Lastly, the balance of convenience favoured granting an injunction, because it would preserve the current tax treatment and give the traders time to reorganise their business if necessary.

High Court: *R (on the application of GSTS Pathology LLP and others) v HMRC*

Technical issue

The challenge to the validity of the view expressed in Brief 16/2013 has now been heard by the FTT, which agreed with HMRC. The judge (Nicholas Paines QC) expresses regret over the unfortunate consequences of the decision, and notes that the judicial review decision allows the appellants to maintain the "status quo" for a "reasonable time" following the release of the decision.

The company argued that it was providing information, not medical care; and that it was not a "recognised body" operating under "comparable social conditions" for the purposes of the exemption. It also argued that, if it was held to be exempt under art.132 PVD, it should be excluded from exemption either under art.133, or else to give effect to the purpose of the

provisions – to reduce the cost of medical care. Treating the company as taxable would have the opposite effect to that purpose.

Article 133 provides so far as material that:

Member States may make the granting to bodies other than those governed by public law of each exemption provided for in points (b), (g) ... of Article 132(1) subject in each individual case to one or more of the following conditions:

(a) the bodies in question must not aim systematically to make a profit, and any surpluses nevertheless arising must not be distributed, but must be assigned to the continuance or improvement of the services supplied;

(b) those bodies must be managed and administered on an essentially voluntary basis by persons who have no direct or indirect interest, either themselves or through intermediaries, in the results of the activities concerned;

(c) those bodies must charge prices which are approved by the public authorities or which do not exceed such approved prices or, in respect of those services not subject to approval, prices lower than those charged for similar services by commercial enterprises subject to VAT;

(d) the exemptions must not be likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT.

The company contended that it would not satisfy conditions (a), (b) or (c).

The judge examined a wide range of case law precedent, from *d'Ambrumenil* through *CopyGene* to *LuP, Verigen Transplantation Service International* and *Klinikum Dortmund*. He concluded that "upstream" supplies of pathology services are medical care, because they are provided with the intention that the results are used for protecting the health of individual patients:

"*In short, pathology is an activity closely connected with a patient's health, provided – in the cases we are considering – for the purpose of maintaining or restoring the patient's health and characterised by at least the possibility of the exercise of medical skill and judgement in matters of interpretation. It certainly involves, in our view, more than the provision of information. We would not, we think, have had difficulty in characterising it as medical care.*"

As regards "recognised body", it was agreed that the company was "state regulated" in that it had appropriate licences. It was not "similar to a hospital", but it was nevertheless a "centre for medical diagnosis and treatment". The judge was satisfied that it was the right sort of body to satisfy the legislation.

On the issue of purpose, the judge held that the aim of reducing the cost of medical care was incorporated by Parliament in the VAT Act 1994 provisions. HMRC did not have any residual discretion to ignore the provisions of that Act in order to vary its consequences. EU law does not in any event impose a duty on Member States to make exemption unavailable to a taxpayer on the grounds that standard-rated treatment would be more advantageous for it.

This is a long and closely-reasoned decision which examines a wide range of precedents. However, the most significant point seems to be the very close similarity between the appellant and *LuP* – HMRC changed their policy following that case, and it appears that they were right to do so.

First Tier Tribunal (TC03351): *GSTS Pathology Services LLP*

2.3.10 Civic objects

The chief lodge of freemasons claimed exemption for its membership subscriptions under art.132(1)(l) PVD on the basis that it was a body with aims of a philosophical, philanthropic, religious or civic nature. It was common ground that it was a non-profit making institution whose supplies were in its members' common interest in return for subscriptions fixed in accordance with its rules, and no argument was advanced that the exemption of its membership services would distort competition.

The judge considered the precedents of *Expert Witness Institute* and *British Association for Shooting and Conservation*. He derived the principle that the aims of an organisation are at least prima facie to be found its constitutional documents "tested against the reality of what it does".

The judge examined the history and practice of freemasonry in some detail in order to assess what the aims of the body were. He derived a list of these aims, which he tested in turn against the statutory words that conferred exemption. He concluded that several of the body's aims would qualify for exemption, but some would not – in particular, the aims of fellowship and self-improvement were not within art.132(1)(l). These non-qualifying aims were too significant to be ignored, with the result that the subscriptions could not qualify for exemption.

First Tier Tribunal (TC03302): *United Grand Lodge of England*

2.3.11 Professional body?

An organisation claimed to be the principal support organisation for firms in the UK printing industry and related trades. It claimed exemption under art.132(1)(l) PVD on the basis that its activities and aims were to defend its members' interests and represent them to appropriate third parties. It was therefore an organisation of a trade union nature. The context was a *Fleming* claim for £6m in relation to the 23 years up to March 1996, as well as two claims for three years' worth of VAT paid up to 2007 and two years' worth up to 2009, totalling another £2.3m.

The Tribunal examined the history and activities of the organisation and concluded that it provided a number of services to its members. Some of these were commercial in nature, including training and consultancy, and these went beyond the representational activities that might qualify for exemption. Exempting the subscriptions might create a distortion of competition, because other providers of similar services would have to charge VAT.

The Tribunal concluded that there was "insufficient evidence which would enable the Tribunal to find that the principal objective of the appellant was restricted to that of an organisation whose main aim was to defend the collective interests of its members and represent them vis-a-vis third parties". It therefore did not qualify for exemption, and its appeal was dismissed.

First Tier Tribunal (TC03288): *British Printing Industries Federation*

2.3.12 Trade association

An unincorporated association was founded in 1989 to be a representative body for tour operators. It accounted for VAT on its members' subscriptions, but submitted a claim for repayment in 2008 on the basis that the subscriptions should have been exempt under Item 1(d) Group 9 Sch.9 VATA 1994.

The First-Tier Tribunal considered that it was the "primary purpose" of the Association that would bring it within the exemption or would fail to do so. The chairman was satisfied that the primary purpose of the Association was the representation of the views of its members to government, which might naturally include the EU government as matters which affected tour operators would cross country boundaries. The test in Item 1(d) was therefore satisfied.

Note 5 excludes exemption unless an association's membership is restricted wholly or mainly to persons whose business interests are directly connected with its purposes. The chairman noted that this did not use the expression "primary purpose", and therefore it was not essential that the members were all interested in the representational activities.

Accordingly, the First-Tier Tribunal concluded that exemption was available and was not excluded by Note 5. The appeal was allowed.

HMRC appealed to the Upper Tribunal. The judge considered the questions of law arising in relation to both the arguments, and decided that the FTT had erred in respect of one but not the other:

- the "primary purpose" test was not subjective, as the FTT had decided (what the directors and constitution of the organisation said it was for) but objective (what actually happened in practice). HMRC argued that the FTT had found as a fact that most members joined the association for networking and business development opportunities, but the judge did not agree that this would have necessarily led them to the conclusion that the objective test was not satisfied. He remitted the case to the FTT for further consideration of the evidence on this issue.
- the interpretation of Note 5 was approved by the judge, respectfully disagreeing with Sir Stephen Oliver's comments in *The British Association of Leisure Parks, Piers and Attractions* (TC01504). On its plain wording, it did not require the interest of the members to be in the primary purpose, but rather in the purposes in general.

HMRC's appeal was allowed to the extent of remitting the case to the FTT for further findings of fact.

The original panel of FTT judges heard the remittal. They did not start again from the beginning, but refreshed their memories of the evidence and considered new representations from both parties. They concluded that the lobbying activity was the predominant aim of the organisation; it had other aims and activities, but none of them were as significant as making representations to government on behalf of tour operators in Europe. Accordingly, it satisfied the conditions for exemption, and its appeal was allowed again.

First Tier Tribunal (TC03353): *European Tour Operators Association*

2.3.13 New manual

HMRC have published their new *Cost Sharing Exemption Manual*, providing guidance on the VAT exemption for services of cost-sharing groups. Legislation for the exemption was introduced in the UK with effect from Royal Assent to FA 2012.

www.hmrc.gov.uk/manuals/csemanual/index.htm

2.4 Zero-rating

2.4.1 Printed matter and service

A company franchised an educational method to self-employed instructors. Until 1 November 2005 it supplied them with study materials to use in their teaching and charged an inclusive fee, all of which was treated as standard rated. From November 2005 onwards, separate supplies were made of the franchise agreement for a standard rated royalty, and worksheets provided by a subsidiary company for zero-rated consideration. The total amount payable by the tutors was materially the same as it had been before. HMRC ruled that the division of the teaching programme was artificial, and there was no free-standing supply of study material. Alternative assessments (totalling nearly £7m) were raised to collect the VAT from the holding company and from the subsidiary.

The company relied on the decision of the Court of Appeal in *Telewest* that supplies by two different companies could not be treated as a single supply, even though it was accepted by the appellant that the change to the arrangements was made mainly to achieve a VAT saving.

HMRC's arguments were summarised as follows:

(1) there was no supply of the worksheets by KBS to the instructors because the instructors never acquired any right to dispose of the worksheets as owner;

(2) there was a single supply of services, namely the right to use the Kumon Method, under the Licence Agreement between KE and the instructors and the Worksheet Sales Agreement between KBS and the instructors and no separate supply of the worksheets;

(3) the creation of two separate agreements under the new arrangements was a sham and they could be ignored; and/or

(4) the new arrangements were an abusive practice which resulted in the accrual of a tax advantage that was contrary to the purpose of the VAT Directives and the legislation transposing them into UK law so that the arrangements must be redefined so as to re-establish the situation that prevailed under the old arrangements.

The Tribunal noted that it was clear from precedents such as *Hitch v Stone* and *Lower Mill Estate Ltd v HMRC* that the burden of proof lay on HMRC in respect of an arrangement being a sham or an abuse.

The Tribunal was able to review the way in which the change was introduced in some detail. The company had made presentations to its self-employed instructors to explain the change, and answers to questions raised by them are included in the decision. It is clear that the company was careful to make it plain that the arrangement was both real and effective in reducing the VAT liability, and should be entered into on the basis of full disclosure to the authorities.

HMRC's first ground was dismissed: it made no difference whether the instructors obtained ownership of the worksheets as goods. They were certainly supplied with the possession of the worksheets; whether that was goods or services, it was capable of being zero-rated.

In respect of the second ground, the Tribunal considered itself bound by the view of the Upper Tribunal in *Lower Mill Estate* that *Telewest* remains good law, even after the CJEU decision in *Part Service*. It is for the national court to decide whether such an arrangement – splitting a single supply between two connected companies – constitutes an abuse. If it is not abusive, then the supplies remain distinct.

HMRC attempted to distinguish *Telewest* by arguing that the worksheets were so integrated with the teaching method used by the company and its franchisees that they could not be regarded as a separate supply. Although it might be essential for the franchise supply that the instructors should also be supplied with worksheets, there was nothing that required those worksheets to be supplied by the same person.

The evidence suggested that the two companies and the instructors considered the new arrangements in some detail when they were introduced, and it appeared that they all intended them to be implemented in the way in which they were described. They were not a sham.

In relation to abuse, the Tribunal considered the judgments of the CJEU in *RBS Deutschland*, *Weald Leasing* and *Paul Newey t/a Ocean Finance*. These supported the proposition that a taxpayer is entitled to choose between different courses of action, one of which will have a lower tax liability attaching to it. What is 'artificial' was considered in some detail in the *Newey* case: the contracts must not reflect commercial and economic reality. HMRC tried to make something of the fact that the contracts were not at arm's length and were intended only to produce a VAT advantage, but the Tribunal held that this was not enough: they were not artificial, and were therefore not abusive.

The appeals against both of the alternative assessments were upheld.

It is interesting to note in the comments of the FTT that the judge appears to regard the CJEU's judgment in *Newey* as indicating that the

arrangements in that case were abusive. The Upper Tribunal, which referred *Newey* to the CJEU, has not yet come to that decision.

First Tier Tribunal (TC03249): *Kumon Educational UK Co Ltd and related appeal*

2.4.2 Vehicles for the disabled

A small company specialised in adapting VW motor vans for use by disabled people. HMRC did not dispute that the customers were wheelchair users, but did not agree that the legislative requirements for zero-rating were met: some of the adaptations were options put in by the manufacturer which were available to able bodied persons as well; other features such as an ambulance ramp kit and grab handles were not put in for the specific needs of the particular disabled person. HMRC also argued that the adaptations were not permanent or substantial for the purposes of the legislation, and that even if the adaptations enabled a disabled person to enter the vehicle, they were not adaptations which enabled the disabled person "to drive, or otherwise be carried" in the vehicle.

The company complained that it had followed HMRC's published guidance and industry practice, only to find that HMRC were now retrospectively imposing further conditions. The Tribunal commented that the reasonableness of HMRC's conduct was not within its jurisdiction; it would consider only the law.

The Tribunal examined the law and the precedents, and concluded that it was not necessary for the adaptation to be made with the particular disabled customer in mind. Whether an adaptation was "substantial" had to be assessed in the context of what it enabled the disabled person to do, and it was a question of degree.

The swivel seats were a standard option that the manufacturer offered, and they were chosen by some able-bodied customers as well. However, the Tribunal was satisfied that they were essential for a wheelchair user; if they were chosen by such a customer, they would constitute an adaptation which enabled the disabled person to enter and drive the vehicle.

The Tribunal concluded that the vehicles were all qualifying motor vehicles for the purposes of the legislation, and discharged the assessments for about £43,000.

First Tier Tribunal (TC03250): *Concept Multi Car Ltd*

2.4.3 Updated Notices

HMRC have issued an updated version of their Notice *Caravans and Houseboats*. The main change is to incorporate the changes to the VAT liability of caravans with effect from 6 April 2012 as a result of changes in the 2012 Budget.

Notice 701/20

HMRC have also updated their Notice *Food*. The main change is to incorporate information about the liability of sports nutrition drinks.

Notice 701/14

2.5 Lower rate

2.5.1 Infringement

The Commission has instituted infringement proceedings against Poland for applying a lower rate of VAT to goods which are intended to protect premises against fires. The Commission argues that these are not mentioned in Annex III of the PVD, and Poland's reasons for the lower rate do not justify a breach of the Directive.

CJEU (Application) (Case C-639/13): *Commission v Poland*

2.5.2 Energy saving?

In a divergence from the stream of recent cases about supplies which appear partially to qualify for the reduced rate, the FTT has found that a supply of box-sash windows with draught-stripping was a mixed supply, and the installation of the draught-stripping qualified for the lower rate. HMRC argued that there was a single supply of "draught-proof windows". The VAT at issue was over £400,000 in assessments covering two different companies over several periods.

The Tribunal noted that the Commission has commenced infraction proceedings against the UK on the basis that the installation of energy-saving materials in private houses does not satisfy the conditions of art.98 and Annex III PVD. However, the company could rely on the UK legislation alone.

The two supplies were offered to customers separately. They might be installed in a single operation, but the judge was satisfied that they were not "so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split." The draught-stripping was not attached to the box-sashes but to the window frames. Each could be bought without the other, and there were customers who did that. The judge considered that, according to the principles of *CPP*, they should each be given their independent VAT liabilities.

In case he was wrong on that, he had to consider whether a single supply could have two liabilities, as contended by the appellant (based on *Talacre*). In line with the decisions in *Morrisons* and *AN Checker*, he rejected that argument. If there was a single supply, it would have a single standard rated liability.

First Tier Tribunal (TC03361): *Envoygate (Installations) Ltd and related appeal*

2.6 Computational matters

2.6.1 Prompt payment discounts

The Budget included the unexpected announcement that the UK law on prompt payment discounts (PPDs) is to be amended. The explanation is twofold:

- HMRC have started to detect increasing use of PPDs in transactions with consumers, which gives rise to a VAT loss if the PPD is not taken up;
- it has been suggested that the UK law is not in accordance with the VAT Directive.

In the UK, Sch.6 para.4 VATA 1994 provides that "Where goods or services are supplied for a consideration in money and on terms allowing a discount for prompt payment, the consideration shall be taken for the purposes of section 19 as reduced by the discount, whether or not payment is made in accordance with those terms." This makes it easier to issue a VAT invoice with a certain amount of VAT on it. As PPDs have traditionally mainly been used in business-to-business transactions, any VAT loss would be small – it would only arise where a trader who could not fully deduct input tax bought something with a PPD and failed to take up the discount.

HMRC have now identified some offers of PPDs to consumers, particularly in the telecommunications and broadcasting sectors. It is also considered that the PVD requires VAT to be calculated on the actual consideration received, rather than on the discounted consideration if the discount is not in fact given.

The change will apply to all supplies from April 2015, but it will apply to supplies of telecommunications and broadcasting services where there is no obligation to provide a tax invoice (i.e. supplies to consumers) from 1 May 2014. There will also be anti-forestalling measures in case they are needed for other supplies before April 2015.

There will be a consultation on the detailed implementation of these rules, but it appears likely that the paperwork for transactions involving PPDs will have to change.

www.gov.uk/government/uploads/system/uploads/attachment_data/file/293887/OOTLAR_19_March_2014.pdf – section A72

2.7 Discounts, rebates and gifts

2.7.1 Reduction of taxable amount

The full court has gone against the Advocate-General's opinion in the case about travel agents' discounts. Following unsuccessful attempts by UK businesses – *First Choice Holidays plc* (Case C-149/01) and *TUI Travel plc and others* (First-Tier Tribunal TC02493) – a German travel agent received a favourable opinion from Advocate-General Wathelet. However, the full court has confirmed that the UK Tribunal in TUI was correct.

The referring court provided the following example of the transactions at issue (the situation being very similar to that argued in *TUI)*:

- A package tour was priced by a tour operator at €2,000 (€1,724.14 plus €275.86 VAT at 16%).
- The operator paid a commission of €232, including €32 VAT, to a travel agent for its service as intermediary.
- To promote the package tour, the travel agent granted a 3% discount to the customer, that represents €60. Therefore the customer paid only €1,940 (€1,672.41 plus VAT of €267.59 EUR) for the package tour.
- However, the travel agency then paid €1,768 (€1,524.14 plus VAT of €243.86) to the tour operator, i.e. the initial price of the package tour at €2,000 minus the commission of €232. That also equals the discounted price of €1,940 minus the commission of €232 plus the discount of €60.
- In accordance with art.26 6th Directive (and the decision in *First Choice Holidays*), the tour operator paid VAT on the full price of the package tour – in this example, €275.86 on a taxable amount of €2,000.
- The travel agent paid VAT on the commission received, i.e. €32 on a taxable base of €232.

The travel agent then submitted a claim for a reduction in its taxable amount and output tax liability, on the basis that it should have been reduced by the discount allowed.

The Advocate-General's opinion has not been made available in English, even though the UK government made representations, and it was available in 20 other languages. According to the French version, the Advocate-General considered that the application of the *Elida Gibbs* principle requires a reduction in the intermediary's taxable amount: contrary to the decision in *TUI*, it made no difference that the travel agent stands in a different place in the supply chain to the manufacturer in *Elida Gibbs*, nor that the principal transaction falls under TOMS.

If the principal transaction is not chargeable to VAT, the Member State would be entitled to refuse a repayment of the "VAT" element of the discount without enacting specific provisions to produce that effect.

The full court viewed the situation as being fundamentally different from that in *Elida Gibbs*. Instead of a chain of similar transactions in goods

moving from a manufacturer to a consumer, there was a triangular transaction: the tour operator made a supply directly to the consumer, while the agent intervened as an intermediary, supplying a completely different service to the tour operator. In that context, the discount given by the intermediary ('on the agent's own initiative and at his own expense') could not be a refund of any of its taxable income: the tour operator was the recipient of the agent's supply, and the discount was given to the consumer. The tour operator still received the full amount expected for its supply (gross income less commission as calculated); the discount was (as found by the Tribunal in *TUI*) third party consideration from the agent for the consumer's supply, not something that could reduce either taxable supply.

CJEU (Case C-300/12): *Finanzamt Düsseldorf-Mitte v Ibero Tours GmbH*

2.7.2 Promotional scheme

The publishers of the Daily Mail and Mail on Sunday entered into a promotional scheme in which they wrote to potential customers and offered half-price newspapers for a period, at the end of which the customer would qualify for a retailer voucher (e.g. issued by Marks & Spencer) for between £10 and £100. Participating newsagents were also issued with a similar voucher (typically £5 per customer).

M&S charged a reduced rate of VAT on the supply of the vouchers. The Tribunal noted that no explanation of this was given to it; it assumed that this was a composite rate based on the average liability of sales made on redemption. The Tribunal also raised questions about whether VAT should have been charged at all on the issue of retailer vouchers: this was not answered at the hearing, so written submissions were invited to follow up the point.

In 2007, the company notified HMRC that it intended to claim back the input tax on the purchase of the vouchers. HMRC responded in November 2007 stating that they were satisfied that the input tax was deductible and that no output tax was due under SI 1993/1507 (the Supply of Services Order). However, the letter made it clear that the area was under review, and this was only a temporary ruling.

In July 2009 HMRC wrote again saying that the review was complete and the policy had changed. From that date, they regarded as the 'gift' of the vouchers as falling within the Supply of Services Order, and output tax would be due equal to the input tax deducted. Correspondence followed, leading to a formal decision in October 2011, and an appeal to the Tribunal.

HMRC's decision was based on the assertion that the customers paid nothing extra for the supply of the vouchers, so they were bought-in services that were supplied on for no consideration. They were therefore within the terms of SI 1993/1507.

The company responded that the output tax charge only applies where such services are made available to a third party 'for a purpose other than a purpose of the business'. It argued that the use for a highly successful promotional scheme was a purpose of the business, and therefore the SI did not apply.

The Tribunal examined the CJEU precedents on 'purposes other than those of his business' – *Julius Fillibeck Söhne GmbH & Co KG v Finanzamt Neustadt* (Case C-258/95) and *Danfoss A/S and another v Skatteministeriet* (Case C-371/07). It also noted that the rules for gifts of goods and services were differently phrased in the Directive, a distinction noted by the Advocate-General in his analysis of the *Kuwait Petroleum* case – a gift of goods is chargeable simply on the basis of a disposal free of charge, whereas services must be used 'privately' or 'for purposes other than those of the business'.

HMRC argued that the *Fillibeck* and *Danfoss* decisions emphasised the business necessity of the services supplied for no consideration in those cases. It was not simply a question of there being a commercial reason for the gift: it had to be a commercial requirement.

The decision then turns to the written submissions about the propriety of Marks & Spencer charging VAT on the issue of retailer vouchers, and the question of compliance of Sch.10 VATA 1994 with the Directive. HMRC suggested that the Tribunal should disregard the implications and give a decision on the question put to it, which the judge said 'raised a metaphorical eyebrow'. However, the position appeared to be that:

- HMRC regarded the end result as the same – the company should not have deducted improperly charged input tax, and would then not have to account for output tax under SI 1993/1507;
- the amount specified by M&S on its invoices may have been the 'notional VAT' that is used by intermediaries when making onward sales of retailer vouchers – in which case there is a question (not apparently considered by the Tribunal) about whether the company actually had to pay that amount to M&S;
- the questions in the case were still wholly relevant to situations in which the company bought vouchers from intermediaries, because VAT was properly paid in relation to those vouchers;
- there were arguments that the UK's approach to vouchers in Sch.10A was not in accordance with the Directive, but HMRC argued that it was a reasonable approach in an area where the Directive was not prescriptive.

The Tribunal decided not to delay a decision on the point at issue while the issue of the correctness of the VAT charge was debated. As a preliminary point, the judge observed that para.3 SI 1993/1507 was not consistent with art.26 PVD:

- The wording of SI 1993/1507 is 'where a person carrying on a business puts services which have been supplied to him to any private use or uses them, or makes them available to any person for use, for a purpose other than a purpose of the business...' This implies that it is the use by the recipient that is relevant in determining whether there should be a charge.
- By contrast, art.26 uses 'the supply of services carried out free of charge by a taxable person for his private use or for that of his staff or, more generally, for purposes other than those of his business'. This relates 'purpose' to 'the supply of services' – it is the trader's

purpose in making the services available that determines the treatment.

The Tribunal distinguished the circumstances in *Fillibeck* and *Danfoss*, which were concerned with supplies (home-to-work transport and food) which could very easily be outside the scope of the business. The judge decided that the strictness of the wording of those judgments was due to that context. In *Danfoss*, the judge noted an assumption that food for business contacts would have a business purpose, whereas the trader would have to demonstrate a business necessity in relation to food provided to employees; this suggested that the context was important, and the approach was not as strict as HMRC suggested.

The Tribunal concluded that:

The SPICE campaign was a highly effective business promotion campaign and the vouchers were distributed as a result of binding legal commitments to do so which the Appellant undertook on a fully commercial and arms' length basis as part of that campaign in the normal course of its business. It could not, in our view, properly be said that by distributing the vouchers the Appellant has made them available to its customers for purposes other than a purpose of the business of the Appellant.

The appeal was allowed in respect of what has now become a preliminary issue, subject to other potential arguments about whether the VAT should have been charged in the first place.

First Tier Tribunal (TC03256): *Associated Newspapers Ltd*

2.7.3 Manufacturers' refunds

The Value Added Tax (Amendment) Regulations 2014 have introduced a new reg.38ZA into SI 1995/2518 with effect from 1 April 2014. It requires an adjustment to a manufacturer's output tax where a refund is given to someone further down the supply chain than the immediate customer. This has been the subject of consultation over the last year, following suggestions that the UK had not properly implemented the *Elida Gibbs* decision in this circumstance. The background to the change is explained in a note issued with the amending instrument, and also in a Tax Impact and Information Note.

SI 2014/548; www.gov.uk/government/consultations/vat-treatment-of-refunds-made-by-manufacturers

2.8 Compound and multiple

2.8.1 Pitch hire and administration

HMRC have issued a Brief to announce a change in their policy following the *Goals Soccer Centres* case. The company operated football leagues, providing pitch hire and administration to teams. HMRC ruled that this was a single taxable supply on the grounds that the pitch hire was incidental to the administration; the Tribunal ruled that the pitch hire was undoubtedly an "aim in itself" for the purchaser. HMRC have now accepted that organisations that make similar supplies can treat them as partly exempt and partly taxable. This includes traders who hire pitches from third parties such as local authorities, schools and clubs. However, exemption will only apply where there is a series of lets in accordance with the conditions set out in Note 16 Group 1 Sch.9 VATA 1994. More details are provided in Chapter 5 of VAT Notice 742 *Land and Property*.

Where a single price is charged to the customer, HMRC accept that it will be possible – and necessary – to apportion this into standard rated and exempt elements. Documentary evidence should be kept to show that a fair and reasonable apportionment has been used. The business will also need to consider its partial exemption input tax recovery position.

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2.9 Agency

2.9.1 SecretHotels win in the end

The Supreme Court has continued (and ended) the legal ping-pong match in the case of *Secret Hotels2 Ltd*:

- the FTT found for HMRC;
- the Upper Tribunal overturned that decision and found for the taxpayer;
- the Court of Appeal unanimously overturned that decision and restored the ruling of the FTT;
- the Supreme Court has unanimously overturned that decision and restored the ruling of the UT.

The Supreme Court also decided that there was no need for a reference to the CJEU, in spite of the apparent uncertainty indicated by such contradictory decisions among different levels of the judicial system.

Background and FTT

A company operated a website which marketed hotel accommodation in countries around the Mediterranean. HMRC formed the view that it was buying and selling hotel accommodation as principal or undisclosed agent, and should therefore account for VAT in the UK under TOMS. The company argued that it was not liable for the VAT, because either:

- it was selling the hotels as disclosed agent, so the supplies were made where the accommodation was located and was therefore outside the scope of UK VAT; or
- it was selling as principal but on a wholesale, business to business basis, which would take the supplies outside the scope of TOMS. 94% of its supplies were to tour operators and travel agents.

The First-Tier Tribunal's decision examined the EU and UK legal background to TOMS, and also the contractual arrangements between the company, the hotels and the customers. HMRC's counsel put forward 8 pointers which suggested that the company was not acting as an agent:

- The hotels looked to it for payment, not to the customer. The invoices were paid by it unless it decided to withhold payment in circumstances where a customer complained. If the Appellant became insolvent, the hotel could not look to the customer for payment.
- It had the ability to determine its own undisclosed level of profit.
- The absence of any requirement upon it to account for its profit or commissions to the hotels.
- The fact that it retained any under-invoicing. This was said by Mr McLintock [a director] to be consistent with the contract, but it was not consistent with a fiduciary relationship between it and the hotel.
- The paying of the hotel in advance before a customer booked laid it open to a significant foreign exchange risk.
- The absence of any requirement for a separate account which was to be compared with the Travel Agent contract in which the travel agent was bound to provide a separate account.
- The fact that the hotels owed money to it was inconsistent with it being the hotel's agent.
- The fact that it set the terms and conditions with the customer was not what was to be expected in an agency situation where the principal is expected to tell the agent what its terms were with its customer which it was for the agent to procure. In the present case, for the most part the hotels did not produce terms and conditions.

After a small change to the terms and conditions, the company accepted that for a period (June 2007 to July 2008) it was acting as a principal. It argued that the change had been significant and had arisen for reasons unconnected with VAT (commercial pressure from travel agents for the supplier to take responsibility as principal following the deaths of some UK tourists from carbon monoxide poisoning in a Corfu hotel). After July 2008, the company changed its terms again and believed that its status returned to that of agent. HMRC said that the change was small and insignificant, so the fact that in the later period the company accepted principal status meant that it had been a principal throughout.

The First-Tier Tribunal examined the agreements in detail and how they were operated in practice. It dismissed the appellant's arguments that certain aspects that appeared inconsistent with agency were merely breaches of its fiduciary duties: even though the agreements stated that

they were agency contracts, the substance of them was inconsistent with that. The appeal was dismissed.

Upper Tribunal

The company appealed to the Upper Tribunal. The judge slightly rephrased the fundamental question at issue: "*in relation to the supplies of hotel accommodation, who is the supplier? Is it the hotel operator (as Med contends) or is it Med (as the Commissioners contend)?*" The FTT had concentrated on the contracts between the hoteliers and Med. The UT judge considered that the importance of the supply of accommodation meant that it was better to start with the contract entered into by the holidaymaker. He examined all the contracts in detail, and also rehearsed the place of supply rules, before summarising the question as follows:

"*If the hotel accommodation is supplied by the hotel operator, and not by Med, to the holidaymaker, then Med is not liable to account for VAT on that supply. In such a case, Med will have supplied agency services to the hotel operator and will be liable to account for VAT on that supply or to arrange for that VAT to be paid by its principal, the hotel operator. The parties are agreed that such liability will be in the Member State where the relevant hotel is situated and not in the UK.*

If the hotel accommodation is supplied by Med to the holidaymaker, then Med is liable to account for VAT on that supply to the Commissioners in accordance with TOMS."

The judge then considered the way in which a court should construe a contract, by reference to all the terms of that contract and all relevant background facts. The principles of contractual construction had been examined carefully by the High Court in *A1 Lofts* in a passage which the judge quotes with approval:

I would summarise my conclusions as follows:

i) Where two or more persons (call them A and B) are involved in the supply of goods or services to an ultimate consumer (call him C) different contractual structures may entail different VAT consequences ... ;

ii) Those consequences will follow whether C knows about the contractual arrangements between A and B or not ... ;

iii) The starting point for determining the true relationship between A, B and C is an analysis of the contractual arrangements between them ... ;

iv) Where the contractual arrangements are contained wholly in written agreements, this will be a question of construction of the agreements. But a contract may be partly written and partly oral, in which case what the parties said and did may throw light on the extent of their contractual obligations ... ;

v) The apparent contractual arrangements will not represent the true relationship between A, B and C if the contractual arrangements are a sham; or if the parties have failed to operate the contractual arrangements; or if the evidence is wholly inconsistent with the apparent contract ... ;

vi) The identification of the true rights and obligations of the parties will be the same, whether the question arises in the context of VAT or in the

context of an action for breach of contract; and is the same whether the question arises in a domestic or a European context ... ;

vii) Having identified the true rights and obligations of the parties, it will then be necessary to decide how those rights and obligations should be classified for the purposes of VAT ... ;

viii) Sometimes this will be concluded by the terms of the contract themselves; but it may not be ... . If it is not then the classification of the parties' rights and obligations for the purposes of VAT may involve the application of particular deeming provisions of the VATA ... ; or deciding whether the nature of the supply falls within a particular description ... ; whether there is one contract or more than one ... ; or in some cases deciding whether on the true construction of a single contract there is one supply or more than one ... ;

ix) Depending on the true relationship between A, B and C the conclusion might be that A makes a supply to B, who makes an overall supply to C; or A and B may make separate and concurrent supplies to C ... .

HMRC's counsel argued that the supplier under UK contract law would not necessarily be the supplier under VAT law, because UK contract law was not followed throughout the EU. The judge dismissed this as irrelevant. The contracts were governed by English law; it was necessary to construe them in accordance with that law; once they had been so construed, it was necessary to apply the principles of VAT law to the supply. The fact that a similar contract might have been construed differently if it had been made under Portuguese or Greek law was not in any way relevant.

Because the judge concentrated on the contracts which the holidaymaker entered into, he considered the contracts between the hotels and the appellant to be inadmissible. The First-Tier Tribunal had found a number of indications in those contracts that the appellant was acting as a principal; the UT judge's emphasis on the receipt of the supply was particularly helpful to the appellant's case.

The judge considered that the clear and unambiguous terms of the contract between the appellant and the holidaymakers were that the hotel supplied them with accommodation. Similarly, the clear and unambiguous terms of the contract between the hotels and the appellant were that the appellant had authority to act as agent in booking contracts between holidaymakers and the hotels. There was nothing in the background to suggest that these were not the actual supplies that were being made. Accordingly, the appeal was allowed, but HMRC appealed further to the Court of Appeal.

Court of Appeal

The Court of Appeal considered that there were two matters to be determined:

- whether the FTT had erred in law in construing the contracts not only on the basis of the written documents themselves but also by considering the "behaviour of the taxpayer";
- whether it was entitled to reach the conclusions it had reached, if that was the correct approach.

The Court of Appeal held that the FTT had adopted the correct approach. According to precedent cases such as *C&E v Reed Personnel Services Ltd* (1995), it was necessary to have regard to the whole facts of the case, not just the written contracts.

In applying that to the facts, the FTT had also been entitled to take everything into account rather than concentrating on particular elements. In the leading judgment, Sir John Chadwick emphasises the following points as indicative that the correct conclusion had been drawn:

(1) Medhotels dealt with holidaymakers in its own name in respect of the use of its website and in the services of its local handling agents.

(2) Medhotels dealt with holidaymakers in its own name (and not as intermediary) in those cases where the hotel operator was unable to provide accommodation as booked and the holidaymaker rejected the alternative accommodation offered.

(3) Medhotels dealt with matters of complaint and compensation in its own name and without reference to the hotel operator.

(4) Medhotels used the services of other taxable persons (the hotel operators) in the provision of the travel facilities marketed through its website.

(5) In relation to value added tax, Medhotels dealt with hotel operators in other Member States in a manner inconsistent with the relationship of principal and agent. In particular, Medhotels did not provide the hotel operators with invoices in respect of its commission (nor even notify the hotel operators of the amount of that commission); so making it impossible for the hotel operators to comply with their obligations to account to the tax authorities of that member State in accordance with the Sixth Directive.

(6) Medhotels treated deposits and other monies which it received from holidaymakers and their agents as its own monies. It did not account to the hotel operators for those monies. It did not enter those monies in a suspense account so as to take advantage of Article 11A(3)(c); and so cannot rely on the exclusion from the scope of Article 26 of the Sixth Directive which is contained in the second sentence of that Article.

HMRC's appeal was allowed, and the decision of the FTT restored. The assessments were for some £7m.

Supreme Court

Only Lord Neuberger gave a detailed judgment in the Supreme Court: Lords Sumption, Reed, Hughes and Hodge all simply agreed.

Lord Neuberger identified the key distinction made by the PVD:

- art.306(1)(a) imposes the TOMS on supplies carried out by "travel agents who deal with customers in their own name and use supplies of goods and services provided by other taxable persons, in the provision of travel facilities";
- art.306(1)(b) excludes from TOMS "travel agents where they act solely as intermediaries and to whom point (c) of art.79(1) applies for the purpose of calculating the taxable amount".

Art.79(1)(c) excludes "amounts received by a taxable person from the customer, as repayment of expenditure incurred in the name and on behalf of the customer, and entered in his books in a suspense account" from the taxable amount.

The parties had agreed between themselves that the essential issue was "whether the FTT was entitled to find (as a matter of law and fact) that Med was supplying accommodation services as principal, in which case it was required to account for VAT in the UK, or whether it should have found that Med was acting as agent for a disclosed principal, in which case the supplies of accommodation services fell to be treated as made in the jurisdiction in which the hotel was situated and so do not give rise to any liability to VAT in the UK."

Lord Neuberger went on to set out the issue as he saw it, and to comment on each of the decisions below. In his view, it was necessary to consider whether, as a matter of domestic law, Med was acting as an agent or as a principal. The starting point for that was the documentation, which included the agreements made both between Med and the customers and between Med and the hotels. It had never been suggested that these contracts were a sham or in need of rectification; however, the CJEU decision in *Newey* required the court to consider whether they reflected commercial and economic reality.

In the judge's view, the agreements clearly identified Med as an agent, and the supply as the arrangement of a principal transaction between the customer and the hotelier. The factors which, for the Court of Appeal and FTT, counted against that being "the reality" were considered and dismissed; they all stemmed from the dominant position of Med in the commercial relationship. For example, it was able to set its own commission because it was in a much stronger bargaining position than an individual hotelier.

The judge commented on the fact that the "economic reality" included the ownership of the accommodation by the hotelier and the use of the accommodation by the customer; it was more in line with that reality to treat Med as an agent arranging a transaction, than a principal taking part in a chain of supply. Following the CJEU in *RBS Deutschland*, it was proper for parties to a transaction to structure their relationships as they chose: choosing a structure that created a favourable tax result was acceptable, as long as the result was in accordance with commercial reality.

Given that he was satisfied that Med was acting as an agent, and that this reflected economic reality, it followed that it was also acting as an intermediary within art.306(1)(b) rather than as a principal within art.306(1)(a). The appeal was allowed, and the decision of the Upper Tribunal restored.

Supreme Court: *Secret Hotels2 Ltd v HMRC*

2.9.2 Tour Operators Margin Scheme

HMRC have issued a Brief to comment on the judgments of the CJEU in the recent infringement proceedings brought by the Commission against 8 member states (Spain, Poland, Italy, Czech Republic, Greece, France, Finland and Portugal). HMRC note that the effect of the decision is that:

- travel services supplied to another business for onward sale ('wholesale' supplies) should be covered by TOMS;
- the TOMS calculation should be carried out on an individual transaction basis.

In the UK, we only apply TOMS to supplies to final consumers or to businesses for their own consumption (for example, business travel for employees). Wholesale supplies are subject to normal VAT rules.

Nevertheless, HMRC have decided not to take any action to amend the UK's rules at this time. The Commission has announced an intention to review the operation of TOMS, and making changes only to reverse them shortly afterwards would be unnecessarily costly. The decision to take no action will be reviewed after a year.

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2.9.3 More TOMS

Belgium treated the supply of holidays outside the EU as subject to TOMS, even though the Directive exempts such supplies. The Belgian law was in force when the 6th Directive was implemented, and Belgium claimed that it was therefore protected by a "standstill clause". However, the law had been amended to give that effect between the adoption of the Directive and its implementation (with effect from 1 December 1977, before which such services were exempt in Belgium); two taxpayers argued that this was not permitted.

The CJEU ruled that Member States were not permitted to change their legislation in ways that would seriously compromise the attainment of the result prescribed by the Directive. However, the taxation of some supplies by travel agents was not something that would make a great deal of difference; Belgium was therefore allowed to make such an amendment. The Directive provided for an exception for supplies covered by a standstill clause; such supplies therefore could not be fundamental to its objectives.

Belgium also draws a distinction between these services when made by travel agents (taxable) and by travel intermediaries (exempt). The CJEU ruled that this did not breach the principles of equal treatment or fiscal neutrality, because the two suppliers were not in a comparable situation. Belgian law may provide that only the services of travel agents, but not those of intermediaries, are taxable with regard to journeys outside the EU.

CJEU (Case C-599/12): *Jetair and BTW-eenheid BTWE Travel4you*

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

2.11.1 Donation of land to charity

The FTT heard an appeal which concerned Isle of Man VAT legislation which equates to Sch.8 Group 15 Item 2 – zero-rating of a gift of goods to charity. The appellant company had donated some land to charity, and claimed that this qualified as a gift of "goods" because the law regarded interests in land such as this one as "goods". However, the Isle of Man legislation had a similar provision to Group 15 Note 1F, which states that:

"*In items 1, 1A and 2, and any Notes relating to any of those items, 'goods' means goods (and, in particular, does not include anything that is not goods even though provision made by or under an enactment provides for a supply of that thing to be, or be treated as, a supply of goods).*"

The taxpayer tried to make something of a small difference between the wording of the Manx 1996 Act and the UK 1994 Act – the Manx Act zero-rated a supply "which is treated as a supply of goods", while the UK Act zero-rated "a supply of goods". However, the Tribunal concluded that the exclusion of deeming provisions applied in the Manx legislation as well; in this context the word "goods" had to be given its ordinary meaning, which did not include interests in land. The appeal was dismissed. As the land had been opted, presumably output tax would be due.

The case report includes some information about the agreement between the governments of the UK and the Isle of Man on treating their territories as an effective customs union (the "Common Purse Agreement"). This is rarely examined in cases, and did not help the appellant here. It seems that the effect was to apply the Isle of Man legislation to the transactions, even though the land was situated in Lancashire. That would put the place of supply in the UK, so the UK VAT Act would be expected to apply.

First Tier Tribunal (TC03295): *Rondini Ltd*

2.12 Other supply problems

2.12.1 Vouchers

A company provides hot air balloon rides. It also sells some goods: binoculars, T-shirts, children's T-shirts, mugs and other souvenirs; and it offers the service of providing photographs during the flight. It offers vouchers which can be redeemed for a balloon ride, but can also be used to buy merchandise. Because these vouchers are often given as presents, they do not show the face value in print on their face, but they have a code which can be read by the company. When the voucher was used to buy something, the company noted the remaining balance in its records; the customer could find out what this balance was by asking.

The letter accompanying a voucher would explain that it was enough to buy a particular intended ride – for example, a standard evening trip, or a 'VIP ride' which was only for two people. The face of the voucher explained that it could also be used to buy merchandise. It was common for vouchers to be sold with a little extra value to cover souvenirs after the ride.

The taxpayer initially accounted for VAT on the issue of vouchers. After considering the law and HMRC statements on the matter, she decided that this was incorrect, and made an application for repayment of VAT in relation to earlier periods. When HMRC refused, she appealed, stating that she would be happy to recalculate the VAT due on the 'redemption' basis if the Tribunal determined the point of principle. She was aware that the company would probably end up paying more VAT, because in several cases the vouchers would have been issued when the rate was 15% or 17.5% and redeemed when it had risen to 17.5% or 20%.

HMRC argued on two points:

- first, that the vouchers were in reality a prepayment for a balloon ride, rather than a voucher as normally understood;
- second, that they were not face-value vouchers, because their value was not disclosed on their face.

The Tribunal judge disagreed. The system of recording codes on the voucher and the value in the company's records meant that the value of the voucher was 'printed or recorded on it' in much the same way that a B&Q gift voucher, readable by a terminal, might 'record' the value. They were therefore face value vouchers. They were clearly redeemable for different possible supplies, even if there might be an intention that they would be used for a particular ride – so they were 'multi-purpose retailer vouchers', chargeable to VAT on the redemption basis rather than the issue basis.

First-Tier Tribunal (TC03173): *Skyview Ballooning Ltd*

2.12.2 More vouchers

A partnership traded in face value retailer vouchers. It bought them on issue by retailers, and sold them on at a profit, but still below face value. The partnership also supplied 'accountancy and taxation advice'; however, it appears to have accepted the following misleading advice from HMRC without question:

Mr Nagle ... said that before commencing this trade he had telephoned HMRC to ascertain whether the Partnership should be registered for VAT and says he was told that the sale of vouchers was zero-rated but that fees for accountancy and taxation advice were standard-rated and that only if these standard-rated supplies exceeded the VAT registration threshold would registration for VAT be required.

HMRC raised an enquiry in December 2010 pointing out that it had received a self-assessment tax return disclosing turnover of £323,000, and wanting to know why there was no record of a VAT registration. The partner replied on 9 January 2011 to explain that the majority of the turnover related to 'discounted food vouchers' and that the firm had been advised that these could be disregarded. HMRC responded in a letter stating that '*it would be unusual for the sale of vouchers to be treated as zero rated other than vouchers sold by retailers for redemption in their own stores.*'

The partnership then registered with effect from 1 April 2011, accounting for output tax on the sale of vouchers where the partner was certain they were used for standard rated supplies (e.g. fuel vouchers). The first return, for the six months to 30 September 2011, claimed a repayment of £5,400 – input tax of £8,500 less output tax of £3,100.

Following investigation, HMRC amended the EDR to 6 December 2008, refused the claim to input tax, and ruled that all sales of vouchers were liable to output tax. The partnership appealed.

The Tribunal examined the underlying law in Sch.10A VATA 1994, and concluded that the intermediary sales of vouchers were chargeable to VAT. It was necessary to come to a just and reasonable apportionment where vouchers were used to obtain supplies chargeable at different rates (para.6(5) Sch.10A); the Tribunal invited the parties to negotiate the rate that would be appropriate and return to the Tribunal if they could not agree.

However, the input tax claim could not be allowed at all, because the issue of retailer vouchers is not chargeable to VAT.

The Tribunal noted that the firm claimed the letter which referred to the possible zero-rating of '*vouchers sold by retailers for redemption in their own stores*' created a legitimate expectation that it should not have to account for VAT on most of its sales. HMRC did not accept that this was a ruling of any sort, and the Tribunal confirmed that it did not have jurisdiction to consider the point – following *Noor*, that was a public law matter that was reserved to the Upper Tribunal or the High Court.

First-Tier Tribunal (TC03271): *S J Nagle & J Kemsley t/a Simon Templar Business Center*

No mention is made of the practice of allowing 'notional VAT' to the first intermediary in the chain so that it is only effectively charged on the margin earned on its sales – in effect, it is given credit for the output tax that the retailer expects to account for when the vouchers are redeemed. If no credit is allowed at all, there is a double charge to VAT on what the customer pays. This concept is not mentioned anywhere in the decision. It is hinted at, but not explicitly described, in para.8.9 of Notice 700/7/12.

Example

A retailer issues a £100 face value voucher for £55 to an intermediary. The retailer expects to make sales which are 60% standard rated, 40% zero rated (based on gross selling prices) for its vouchers. It informs the intermediary of this split.

The intermediary (X) sells the vouchers on to another intermediary (Y) for £70 gross. Intermediary Y sells them to a member of the public for £95, VAT-inclusive.

Who should account for what VAT?

The 'just and reasonable proportion' approach suggests a VAT fraction of 10% should be applied to the gross price (1/6 x 60%).

The retailer accounts for VAT under the *Argos* principle – it treats the redemption of vouchers as chargeable to output tax according to the actual liability of products supplied, and using the £55 consideration received on issue instead of the £100 face value/selling price.

If the split is the expected 60/40 split, the retailer will account for output tax of 1/6 x 60% x £55 – £5.50.

Intermediary X accounts for output tax of 10% of £70 – £7. According to the decision, there is no deduction for input tax.

Intermediary Y accounts for output tax of 10% of £95 – £9.50. The £7 charged by X is deductible, so £2.50 is paid to HMRC.

HMRC have therefore collected VAT of £15.00. The retailer has supplied standard rated goods for which the consumer has paid 60% x £95 = £57. The 'proper' VAT charge should therefore be £9.50 (1/6 x £57).

The 'right answer' would be achieved if Intermediary X (in the position of the appellant in this case) is allowed to deduct the £5.50 to be accounted for by the retailer on redemption. It would then pay £1.50 to HMRC, and HMRC would collect in total £9.50.

2.12.3 Bitcoin

HMRC have issued a Brief to set out their policy on the tax treatment of Bitcoin and similar "cryptocurrencies". The legal and fiscal status of such instruments is an evolving area; HMRC note that whatever the EU decides to do with them must be consistently applied across the territory, so this is only a provisional statement of HMRC's current view. In addition, the VAT treatment does not impact in any way on other regulatory aspects of dealings in these currencies.

HMRC's provisional view is:

1. Income received from Bitcoin mining activities will generally be outside the scope of VAT on the basis that the activity does not constitute an economic activity for VAT purposes because there is an insufficient link between any services provided and any consideration received.

2. Income received by miners for other activities, such as for the provision of services in connection with the verification of specific transactions for which specific charges are made, will be exempt from VAT under Article 135(1)(d) of the EU VAT Directive as falling within the definition of 'transactions, including negotiation, concerning deposit and current

accounts, payments, transfers, debts, cheques and other negotiable instruments.'

3. When Bitcoin is exchanged for Sterling or for foreign currencies, such as Euros or Dollars, no VAT will be due on the value of the Bitcoins themselves.

4. Charges (in whatever form) made over and above the value of the Bitcoin for arranging or carrying out any transactions in Bitcoin will be exempt from VAT under Article 135(1)(d) as outlined at 2 above.

However, in all instances, VAT will be due in the normal way from suppliers of any goods or services sold in exchange for Bitcoin or other similar cryptocurrency. The value of the supply of goods or services on which VAT is due will be the sterling value of the cryptocurrency at the point the transaction takes place.

The Brief also sets out HMRC's views on the income tax, corporation tax and capital gains tax consequences of transactions in Bitcoin.

Revenue & Customs Brief 9/2014

2.12.4 Reverse charge for gas and electricity

The Budget included the announcement of a new measure to introduce a reverse charge for wholesale supplies of gas and electricity, making the customer rather than the supplier liable for VAT. It is also intended as an anti-fraud measure removing the opportunity for fraudsters to charge VAT before disappearing without paying. Further consultation is needed – taking into account the amount of time needed for businesses to make the necessary IT changes and other preparations – before an operative date can be announced. The government estimates that about 1,000 companies would be affected.

The power for member states to introduce a reverse charge for this kind of supply is given by art.199a PVD.

www.gov.uk/government/publications/vat-reverse-charge-for-gas-and-electricity

2.12.5 Fuel scale charges

The VAT scale charges are amended for returns commencing on or after 1 May 2014. Although the legislative procedure for amending the rates has changed this year, the new rates were released as part of the Budget day procedure in the same way as they have been in the past.

www.hmrc.gov.uk/vat/forms-rates/rates/rfsc-2014.pdf

3. LAND AND PROPERTY

3.1 Exemption

Nothing to report.

3.2 Option to tax

Nothing to report.

3.3 Developers and builders

3.3.1 RRP and dwellings

HMRC have issued a Brief and an Information Sheet to provide updated guidance on the application of the zero-rate to buildings designed as dwellings and those intended to be used for a relevant residential purpose. HMRC recognise that there are some buildings that could qualify under either heading; if that is the case, the trader can choose which to claim. This will have an effect, for example on the liability of supplies made by sub-contractors – sub-contractors can zero-rate supplies relating to the construction of dwellings, but only the main contractor can zero-rate supplies of the RRP building to the person who issues a certificate of intended RRP use.

The Information Sheet sets out some useful indications of what is the minimum requirement for living accommodation to be regarded as 'self-contained'. The following interesting comment is included about the requirement that separate use or disposal is not prohibited by the terms of any planning consent or similar provision:

In the example of a development like student accommodation where the dwellings take the form of studio or cluster flats, we would expect that there are no conditions or prohibitions under the terms of the planning consent that prevents individual flats from being sold or leased. However, this condition is still met if any prohibition on the sale of individual flats arises as a result of a financial agreement (for example, terms of mortgage or finance of the property) or from agreements to let the accommodation to students of a particular university or other educational body.

Revenue and Customs Brief 4/2014; VAT Information Sheet 2/2014

3.3.2 Students

HMRC have issued a Brief to clarify the meaning of 'student' for the purpose of determining whether a building is intended to be used for a relevant residential purpose. It states that:

The term 'student' in this context refers to a person undertaking a course of educational study or instruction. It covers any person who is receiving education or vocational training from a university (or a centrally funded higher education institution or a further education institution) or from any other supplier who is providing similar, or the same type of, education or vocational training to a similar, or the same, academic standard.

Examples include (but are not necessarily limited to) individuals who have left school and are undertaking higher or further education or training with a view to:

1. obtaining a generally recognised academic or professional qualification

2. maintaining an existing professional qualification for which accreditation is received

3. undertaking a course of study which, whilst not leading to a recognised qualification, has a high level of academic content and is intended to improve the knowledge and understanding of the student in an area of academic interest

The maintenance of existing professional qualifications would include Continuing Professional Development (CPD) applicable in cases where either:

- *a professional body requires from its members the continuing recognition of a qualification;*
- *an employer requires employees to maintain or improve relevant technical skills.*

Examples are given of borderline cases. For example, persons engaging in theological studies in order to become a minister of faith (such as a priest, rabbi or imam) will qualify as 'students'; those attending seminaries or religious retreats which do not serve this purpose but are intended primarily to foster or reinforce faith, are not considered to be receiving educational or vocational training to an academic standard and will not qualify as 'students'.

Revenue and Customs Brief 3/2014

3.3.3 Building work

An individual owned a Grade II listed building. He applied for and was granted planning consent to construct a large garage adjoining the house in order to contain his classic car collection. He claimed that the work qualified for zero-rating as an approved alteration to a protected building.

HMRC allow zero-rating for the construction of a garage only if it takes place at the same time as a substantial reconstruction of the building. They cited earlier cases as supporting their view that this project did not qualify: *Sherlock & Neal Ltd* (VTD 18,793) concerned a very similar project, and *Zielinski Baker & Partners Ltd* (HL 2004) concerned the conversion of an outbuilding into a swimming pool.

The FTT distinguished *Zielinski Baker* (which would be a binding precedent) and disagreed with *Sherlock & Neal* (which would not). The point in *Zielinski Baker* had been that the works were carried out on an outbuilding which was not itself a protected building; in this case, the protected building was altered. It was irrelevant that the alteration happened to create a garage – it was the whole structure that was being considered, not a separate garage, and the whole structure qualified within the words of Group 6 Note 1. The extra conditions for garages in Group 6 Note 2 would only apply if the garage was not part of the house.

First Tier Tribunal (TC03384): *Mr Ian Owen*

3.4 Input tax claims on land

3.4.1 DIY

An individual arranged for the construction of what was described in the planning application as a "replacement garage/guest annex" adjacent to his Grade 2 listed home. This involved razing an old garage to the ground and building a new structure on its footprint. It was not physically connected to the main building, and contained a workshop, store room, studio, bathroom and utility room.

Surprisingly, the planning consent did not impose any restrictions on separate use or disposal of the new building, and both parties agreed that it was "self-contained living accommodation". The FTT rejected an argument by HMRC that restrictions should be read into the planning consent: if they were not there, they could not be assumed to apply.

However, the FTT agreed with HMRC that the new building was an "annexe" within the meaning of Sch.8 Group 5 Note 16(c), and the builder should not have zero-rated the construction work. This was in accordance with the decisions of the High Court in the two appeals by Mr and Mrs Cantrell in respect of their construction of an additional building adjacent to a care home. The applicable principle required consideration of the two buildings together: it was not enough just to look at the new building and consider whether it could be used independently, but whether it was "*a supplementary structure, an adjunct or accessory to the main house. There is, in our view, a functional connection between the new building and the main house sufficient to render it an annexe. The new building is designed to meet the deficiencies of the main house and to operate in conjunction with it.*"

The individual appealed to the Upper Tribunal, arguing that the FTT had been wrong in law to take into account his intentions when submitting his planning application in considering whether the building was an annexe, and also that it failed to apply the correct objective tests in deciding whether it was an annexe. The appellant argued that the FTT, having concluded that it was a building "designed as a dwelling", should necessarily have concluded that it was not an annexe. He based his contentions on a detailed analysis of the decisions in the *Cantrell* cases.

The UT rejected his appeal, while acknowledging that HMRC's guidance in Notice 708 confused the issue. That notice appeared to say that a physically separate building cannot be an annexe; however, it was clear from the precedent cases that it can. It was entirely proper for the FTT to consider the purpose and intended use of a building in deciding whether it was an adjunct to an existing building. The FTT had made a decision of fact which it was entitled to reach on the basis of the evidence; indeed, the UT considered that it would inevitably have come to the same decision.

Upper Tribunal: *Stephen Colchester v HMRC*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

HMRC have issued an Information Sheet to inform those registered under the special scheme for e-traders that the VAT rate in Cyprus increased from 18% to 19% with effect from 1 January 2014.

VAT Information Sheet 1/2014

4.2 Where is a supply of services?

4.2.1 POSMOSS

The Commission has published new guidance on the new place of supply rules which will apply from 1 January 2015. It is very brief, but contains some useful tables comparing the present and future treatments.

ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/telecom/index_en.htm

The government has published a Tax Impact and Information Note on the POSMOSS changes.

www.gov.uk/government/uploads/system/uploads/attachment_data/file/264626/7._VAT_-_place_of_supply_and_the_introduction_of_the_Mini_One-Stop_Shop.pdf

The Financial Times commented that the UK Treasury can expect to receive more revenue from e-traders after the changes, because the competitive advantage of registering in low tax jurisdictions such as Luxembourg will disappear. UK businesses may also benefit from the removal of unfair competition. However, businesses will have to suffer greater compliance costs.

Financial Times, 14 February 2014

Indeed, the press appears to have concluded that POSMOSS is an anti-avoidance measure introduced by George Osborne to close down loopholes which are being exploited by international businesses.

4.2.2 Advertising or organising?

It has been some time since the Tribunal has had to consider the nature, and therefore the place, of supply of someone who organises an exhibition. The context for the latest case was a claim for refund under the 8th Directive and under Directive 2008/9.

An Italian company arranged an enclosure at the Farnborough Air Show to be made available to fellow Italian subsidiary companies. The subsidiaries invited customers, potential customers and the press to the enclosure. The arranging company incurred VAT on related costs and claimed it back from HMRC.

HMRC argued that the claimant company was making a supply in the UK – it was the service of organising an exhibition or a fair, which until 1 January 2011 was supplied where the exhibition took place. The company argued that it was supplying a marketing or advertising service, which would have been supplied in Italy where the supplier was established (up to 31 December 2009) or in Italy where the customers were established under the normal B2B rule (from 1 January 2010).

The FTT considered precedent cases including *Gillan Beach* and *Inter-Mark*. It concluded from the reasoning of the CJEU in those cases that the categories of art.9(2) 6th Directive were intended to be mutually exclusive: a supply could not fall under more than one heading. If something was "advertising", it could not also be regarded as "event organising". The judge went on to state that:

I have no doubt that the services which FGS supplied to its sister companies were: (1) designed and used for the purposes of the dissemination of messages intended to inform potential buyers of the existence or quality of the products offered by those companies with a view to increasing the sales of such products, and (2) formed an inseparable part of the centrally coordinated advertising campaigns of the group companies by contributing to and conveying their marketing messages: the presence at the enclosure of employees of the group companies indicated that integration. As a result, because of the mutual exclusivity of the nature of the services described in the Article 9(2) provisions, the supply cannot fall within Art 9(2)(c) 'events'. Therefore the place of supply falls to be determined under the applicable general rule, and is Italy.

In case he was wrong about the mutual exclusivity of the art.9(2) categories, he went on to consider whether the supply could also fall within art.9(2)(c). He set out what he regarded as the main features of an art.9(2)(c) supply, which included a complex service organising an event which would be attended by a number of people, including many final consumers. He concluded that this was not a correct description of what this appellant did – it made a more limited supply to businesses within the context of an event organised by someone else.

The appellant failed to overturn a separate HMRC decision to disallow two claims for VAT on specific expenses. One was held to be an advertising service on which no UK VAT should have been charged to an Italian customer; the second was not supported by a VAT invoice, and the Tribunal declined to exercise a supervisory jurisdiction to override HMRC's decision to disallow. It could not be said to be an unreasonable decision.

First Tier Tribunal (TC03364): *Finmeccanica Group Services SPA*

4.3 International supplies of goods

4.3.1 Diversion

The Tribunal heard an appeal by a Dutch company against assessments for excise duty, customs duty and VAT in respect of a consignment of 2 million cigarettes that had been diverted from a customs procedure. HMRC had called on a bank guarantee and demanded further amounts from the company, which was now in liquidation. A number of individuals had been successfully prosecuted in respect of the diversion fraud.

The Tribunal examined various arguments put forward by the company's representatives, but could find no reason to displace the assessments. The appeal was dismissed.

First Tier Tribunal (TC03296): *TXT International BV (in bankruptcy)*

4.3.2 Temporary movements

A French company sold gas compressors to a customer established in Spain. The compressors were imported from China by an Italian subsidiary; the French company transferred components from France to Italy for incorporation into the imported compressors, and contracted with an Italian subcontractor for the assembly and installation of the compressors at the customer's premises in Spain.

A dispute arose about the treatment of the transfer of goods from France to Italy, and about the place and liability of the subcontractor's supply. The taxpayer argued that the subcontractor made a supply of goods – in effect, the French company supplied components to the subcontractor, which then made a supply of goods to the end customer. The Italian authorities ruled that the supply of goods from France to Italy could not be treated as a temporary movement, excluded from being treated as a transfer by art.17(2)(f) PVD, because those goods were not returned to the member state from which they had come.

The circumstances and the relevant law are hard to follow in the decision. The judgment itself notes that the order for reference appears to be confused: it refers to "intra-Community acquisitions in connection with art.17", when acquisitions are dealt with by art.21. The court has therefore considered the rules on "transfers of goods", which are in art.17.

Art.17(2)(f) provides that the dispatch of goods to another member state for the purpose of providing a service there is not regarded as a transfer of goods for the purposes of VAT, provided that the goods are returned to their state of origin after the services are supplied. The exceptions in art.17(2) are exhaustive, and must be strictly applied; for art.17(2)(f) to apply, the goods would have to be returned to France.

That answered the referring court's second question. The first question was incapable of applying, because it depended on the possibility that art.17(2)(f) applied. The CJEU therefore declined to answer it.

CJEU (Case C-606/12): *Dresser Rand SA v Agenzia delle Entrate – Direzione Provinciale Ufficio Controlli*

4.3.3 Confiscation

An individual was stopped by Customs in the Green Channel at Gatwick Airport and found to be carrying gold jewellery which was later valued at £9,979. It was confiscated, and the Director of Border Revenue decided not to return it. The individual appealed against that decision, which had been confirmed on review. The FTT considered the law and the facts, and concluded that the appellant's account of her "honest mistake" was unsatisfactory. There were also procedural problems: she should have challenged the legality of the seizure at an earlier stage, rather than apparently accepting that it was lawful and then asking for the goods back. The decision was confirmed.

First Tier Tribunal (TC03359): *Khalida Hosseini*

4.3.4 Small consignments

HMRC is consulting until 14 April 2014 on a draft amending order which ensures that the exclusion of VAT low-value consignment relief applying to goods imported from the Channel Islands is limited to mail order goods. The current order refers to goods sent under a 'distance selling arrangement', which is wider than 'mail order'. The change is required to comply with the specific wording of the exclusion permitted by EU Council Directive 2009/132/EC. A draft amending instrument has been issued.

SI 2014/Draft; www.hmrc.gov.uk/drafts/vat-relief-mar14.pdf

4.3.5 Change to EU territory

The Value Added Tax (Amendment) (No 3) Regulations 2013, which came into effect on 1 January 2014, have inserted a new reg.137(b) in the General VAT Regulations. This regulation adds the territories of Mayotte and Saint-Martin to, and removes the territory of St Pierre and Miquelon from, those treated as excluded from the territory of the member states and the EU for the purpose of the VATA 1994. This reflects amendments made to art 6(1) PVD by European legislation. The Notice on Imports has also been amended to reflect these changes.

SI 2013/3211; Notice 702

4.3.6 Updated Notices

HMRC have updated their Notice *The Single Market*, replacing the June 2013 version. The only highlighted change relates to the introduction of Croatia and alterations to Irish VAT number formats.

Notice 725

HMRC have updated the *Intrastat General Guide*, replacing the January 2013 version. The only highlighted changes are the increases in the arrivals threshold from £600,000 to £1.2m and the delivery terms threshold from £16m to £24m.

Notice 60

HMRC have issued a new Notice *VAT Personal Export Scheme*, replacing the October 2011 versions of Notices 705 and 705A. The new notices have combined the earlier notices to reduce duplication and make it easier for buyers and sellers to find all the information they need.

Notice 707

4.3.7 Consultation: simplification of Intrastat

HMRC have invited businesses to submit comments on EU proposals to simplify the Intrastat system. Views are requested by 8 April 2014. The key part of the Eurostat proposal is known as SIMSTAT (Single Market Statistics). This will be a mandatory data exchange between member states so that one country can use another's dispatch (EU exports) data to compile its own arrival (EU import) figures.

HMRC's consultation document explains what it thinks the impact of this proposal will mean in practice, and asks for views on alternative proposals.

www.gov.uk/government/uploads/system/uploads/attachment_data/file/273862/Intrastat_consultation_.pdf

4.3.8 Notification of Vehicle Arrivals (NOVA)

HMRC have issued a Brief to explain changes to the rules regarding the notification of vehicles arriving in the UK where the intention of the ultimate use of a vehicle changes after the vehicle has entered the UK. The rule changes are to prevent penalties for late notification being generated where there is such change of intention.

These new rules were introduced from 1 April 2014. Changes of intention can be notified online rather than using the more cumbersome paper form. The Brief should be read by:

- VAT registered businesses authorised to register vehicles through the DVLA secure registration scheme (SRS) using form V55/1 or V55/2 or the web-based equivalent Automatic First Registration and Licensing (AFRL) system;
- anyone who brings a vehicle into the UK with the intention that the vehicle will not remain in the UK for longer than 6 months.

Revenue & Customs Brief 12/2014

4.4 European rules

4.4.1 Exemptions in the public interest

The Commission has extended until 25 April 2014 its consultation on a review of VAT legislation on public bodies and tax exemptions in the public interest (art.132 – 134 PVD). The consultation document sets out some of the problems with the current arrangements (inconsistency between member states, distortion of competition, complexity) and a number of possible new approaches.

ec.europa.eu/taxation_customs/common/consultations/tax/2013_vat_public_bodies_en.htm

4.4.2 Cross-border rulings pilot extended

The pilot scheme for cross-border EU VAT rulings has been extended to the end of 2014, and Finland has joined the list of countries involved. It was originally set to run for just 7 months from 1 June 2013 to 31 December 2013. The other states are the UK, Belgium, Estonia, Spain, France, Cyprus, Lithuania, Latvia, Malta, Hungary, Netherlands, Portugal, and Slovenia.

Taxable persons planning cross-border transactions to one or more of these participating Member States may ask for such a ruling with regard to the transactions they envisage. They may make their request for a cross-border ruling in the participating Member State where they are registered for VAT purposes, in line with the conditions governing national VAT rulings in that Member State. If two or more companies are involved, the request should only be introduced by one of them, acting on behalf of the others.

Such requests should generally be accompanied by a translation into the official language of the other Member State(s) concerned (although English is accepted in all 14 states).

Taxpayers are invited to submit their comments on their experience of the procedure to Taxud-EU-VAT-Forum@ec.europa.eu.

ec.europa.eu/taxation_customs/resources/documents/taxation/vat/vat-forum-note-information_en.pdf

4.4.3 Co-operation against fraud

The Commission has announced a proposal to negotiate with Russia and Norway for stronger cooperation on administrative arrangements to prevent VAT fraud. Fraud involving third country operators is considered to be a particularly high risk in the telecoms and e-services sectors.

http://europa.eu/rapid/press-release_IP-14-121_en.htm

Amendments have been made to a draft EU anti-fraud law in order to define the offences and set the penalties. T he Budgetary Control and Civil Liberties committees voted on the rules to prosecute and punish fraud against the EU budget on 20 March 2014. Currently, fraud is estimated to cost the EU budget €600m every year.

New EU penalties including jail terms of 5 to 10 years would apply for offences involving €100,000 or more, or only €5,000 for individuals rather

than companies. For smaller amounts, the penalties would be left to the member state concerned. The rules will extend to cover not only VAT fraud but also passive and active corruption, misappropriation of funds, money laundering and obstruction of public procurement procedures.

www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fTEXT%2bIM-PRESS%2b20140317IPR39133%2b0%2bDOC%2bXML%2bV0%2f%2fEN&language=EN

4.4.4 Quick Reaction Mechanism

The Commission has issued a regulation to lay down the standard form for Member States to notify a special measure introduced under the rules for the Quick Reaction Mechanism against VAT fraud.

Commission Implementing Regulation (EU) No 17/2014; eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:008:0013:0015:EN:PDF

4.4.5 Taxing the digital economy

The OECD has published the comments received in response to its request for input on the tax challenges of the digital economy, as part of a project examining 'Base Erosion and Profit Shifting' (BEPS). A discussion draft on the digital economy was published on 25 March 2014, inviting comments by 14 April. An online public consultation meeting was due to take place on 23 April.

www.oecd.org/ctp/comments-received-tax-challenges-digital-economy.pdf; http://www.oecd.org/tax/discussion-draft-action-1-tax-challenges-digital-economy.htm

The Commission set up the 'Expert Group on Taxation of the Digital Economy' to examine the risks and benefits of various alternative ways of taxing digital transactions in the EU. It met for the first time on 12 December 2013, and a summary of the proceedings has been published on the internet.

ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/good_governance_matters/digital/2013-12-13_summary-record.pdf

4.4.6 Correction of errors

A Romanian trader paid VAT to a supplier in circumstances in which it should not have been charged, because the transaction was subject to the reverse charge. The supplier then became insolvent. The overcharge could therefore not be recovered from the supplier; the trader claimed it back from the authorities, but the claim was refused on the basis that it was not for valid input tax.

The CJEU distinguished this situation from the *Ecotrade* case, in which a matching deduction of input tax had to be allowed when enforcing a reverse charge liability. Here, the reverse charge had to be paid and the matching deduction followed; what was being disallowed was a further deduction for an amount that should not have been charged and should not have been paid, because it was not VAT. The fact that the error could not be corrected because of the insolvency did not assist the trader.

It also made no difference that the authorities had initially allowed the claim and then reversed their decision. '*The principle of legal certainty does not preclude an administrative practice of the national tax authorities whereby, within a limitation period, they revoke a decision by which they granted the taxable person the right to deduct value added tax and then, following a fresh investigation, order him to pay that tax together with default interest.*'

CJEU (Case C-424/12): *SC Fatorie SRL v Direcția Generală a Finanțelor Publice Bihor*

4.4.7 Matching liability and deduction

The Italian court has referred questions to the CJEU to clarify the scope of the decision in *Ecotrade* (cases C-95/07 and 96/07). In that case, a company had wrongly failed to account for reverse charges on the purchase of services on the grounds that it believed the transactions were exempt; the court ruled that it could not be denied the matching deduction for the input tax which would necessarily arise from enforcing the reverse charge, even though the time limit for correcting an input tax error had expired. The new question refers to a situation in which the trader has failed to comply with billing and registration obligations for intra-community transactions – presumably it relates to the liability for acquisition tax and the matching deduction that would be available for the same amount as input tax.

CJEU (Reference) (Case C-590/13): *Idexx Laboratoires Italia srl v Agenzia delle Entrate*

4.4.8 Different rates for similar supplies

Germany applies a reduced rate to taxi fares, but the standard rate to minicab fares. Two minicab companies disputed this on the grounds that the services were indistinguishable, and the difference in rates contravened the principle of fiscal neutrality.

The CJEU considered that taxis are not the same as minicabs: they are subject to different regulations which make the service, objectively and in the eyes of the customer, distinguishable. They are therefore a "concrete and specific aspect" of the category "transport of passengers and their accompanying luggage" in Annex III of the PVD. For example, a taxi licence obliges taxi operators to be on call in order to provide a transport service, and prohibits the holder from refusing to provide transport in the expectation of a more profitable journey or from taking advantage of situations in which they could request a different fare from the official fare. In such circumstances, providing for differential VAT rates was not contrary to the principle of fiscal neutrality.

However, one of the appellants argued further that it had entered into a special agreement with an insurance company to transport patients. This agreement was effectively identical with that governing taxi companies providing the same service. The CJEU ruled that this changed the outcome: it was for the national court to determine whether the service would then be similar from the point of view of the average customer, but if it was, the lower rate had to be allowed to the minicab firm as well as to the taxi.

CJEU (Case C-454/12): *Pro Med Logistik and Oertel*

4.4.9 False invoices

The CJEU has ruled that a trader cannot deduct input tax based on invoices which show that the supply was made by someone who could not possibly have done so, because it did not have the personnel, equipment or assets required for such an activity. The normal conditions of the *Kittel* decision were attached: that there must be a fraud involved, and the taxable person seeking to make the deduction knew or should have known that the invoices were connected with a fraud. That decision must be based on objective evidence which must be of a standard to justify a departure from the normal rule that a taxable person is entitled to deduct input tax on expenses.

The company argued that it held invoices in the correct form, that it had paid its suppliers, and that it had undoubtedly received the supplies, as evidenced by the fact that it had made onward supplies in respect of some of them. The CJEU, consistent with other decisions, ruled that this was not enough if the national court determined that it had the means of knowing that it was participating in a fraud.

The court also ruled on a question about accounting rules: it seems that Bulgaria implemented the tax point rules to require VAT to be charged for when revenue from a transaction is recognised for accounting purposes. The court considered this to be incompatible with the Directive – member states were permitted to require taxable persons to observe national accounting rules consistent with international accounting standards, but could not go beyond what is necessary to attain the objectives of ensuring the correct levying and collection of the tax and preventing tax evasion. The modified tax point rule went beyond this limit.

CJEU (Case C-18/13): *Maks Pen EOOD v Direktor na Direktsia Obzhalvane i danachno-osiguritelna praktika Sofia*

4.4.10 Competing taxes

Spanish law charged the acquisition of the majority of the share capital of a property investment company to an indirect tax other than VAT. A taxpayer company applied for repayment of the 6% capital transfer tax on the acquisition of a controlling holding in another company whose value essentially represented property, arguing that such a tax was incompatible with the VAT Directive – it charged a different tax on a transaction that ought to be exempt from VAT.

The CJEU had already ruled on the compatibility of the tax concerned with the VAT Directive in *N.N. Renta SA v Tribunal Económico-Administrativo Regional de Cataluña (TEARC), Generalidad de Cataluña* (Case C-151/08). The tax could not be classified as a turnover tax, and was therefore not ruled out by the Directive; the possibly discriminatory treatment of direct and indirect acquisitions of immovable property (i.e. as real estate or share transactions) was within the scope permitted to the member states.

CJEU (Case C-139/12): *Caixa d'Estalvis i Pensions de Barcelona v Generalidad de Cataluna*

4.4.11 Procedure for challenging rulings

A Bulgarian company disputed two rulings by the tax authorities on the classification of imports, leading to increased import VAT. It appealed directly to the national courts, where the authorities argued that Bulgarian law required the company to go through an administrative review procedure first. Questions were referred to the CJEU to determine whether Bulgaria was allowed to impose such restrictions on the right of appeal.

The CJEU ruled that it was permissible for a member state's national law to provide for two separate routes to dispute a ruling, as long as that did not contravene the principles of equivalence and effectiveness. However, an appellant should not be required to exhaust the administrative review procedure first – the court hearing the appeal should decide whether it should determine the matter itself or whether it should refer it back to the competent administrative authority.

CJEU (Case C-29/13): *Global Trans Lodzhistik OOD v Nachalnik na Mitnitsa Stolichna*

4.4.12 Reduced rate

The Commission has applied to the CJEU for a declaration that Poland's application of the reduced rate to various products is in breach of the Directive. The items objected to are:

- medical equipment, aids and other appliances which are not intended for the exclusive personal use of disabled persons and/or which are not normally intended to alleviate or treat disability;
- products such as, inter alia, disinfectants, products and preparations for pharmaceutical use, as well as spa products, which are not pharmaceutical products of a kind normally used for health care, prevention of illnesses or as treatment for medical and veterinary purposes, or products used for contraception and sanitary protection.

CJEU (Reference) (Case C-678/13): *Commission v Republic of Poland*

4.4.13 Abuse question

The Portuguese court has referred a question about the country's rules for dealing with abusive tax avoidance. The context appears to be a transfer of land between connected companies for use in an exempt business (healthcare); Portuguese law "provides for a mandatory preliminary procedure applicable to abusive practices in taxation matters", which will presumably be clarified when the decision is made. The question referred is:

When the tax authorities suspect the existence of an abusive practice designed to obtain a VAT refund and Portuguese law provides for a mandatory preliminary procedure applicable to abusive practices in taxation matters, is that procedure to be regarded as inapplicable to VAT, given the Community origin of that tax?

CJEU (Reference) (Case C-662/13): *Surgicare – Unidades de Saúde SA v Fazenda Pública*

4.4.14 Letting a football stadium

The Belgian court has referred questions to the CJEU about whether an agreement to let a football stadium for up to 18 days in a year could be exempt from VAT, where the lessee did not have exclusive use for the season, the lessor had control over access, and ancillary services (such as changing rooms, bar and caretaking) made up 80% of the value of the supply. The owner of the stadium can enter other agreements to rent the stadium to other users on other days during the season.

CJEU (Reference) (Case C-55/14): *Régie communale autonome du stade Luc Varenne v État Belge*

4.4.15 VATable cost?

The Belgian court has referred a question about the determination of "cost" where that may be relevant for the calculation of the VAT base for a transaction (e.g. on a deemed supply). The question is whether interest on borrowed capital should be included in the "cost price" where it may be included in construction costs according to EU Directives on accounting treatments.

CJEU (Reference) (Case C-16/14): *Property Development Company NV v Belgische Staat*

4.4.16 Social well-being

The German court has referred questions to the CJEU about the extent to which a member state can draw distinctions between different types of welfare supply. It appears that Germany exempts supplies by persons who provide their services to social security funds and care funds, but does not also recognise State-examined care workers who provide their services directly to persons in need of care. Further questions relate to an agency hiring out such State-examined care workers, and whether the supply of such staff is "closely linked to welfare" because a care home cannot operate without staff.

CJEU (Reference) (Case C-594/13) *"go fair" Zeitarbeit OHG v Finanzamt Hamburg-Altona*

4.5 Eighth Directive reclaims

4.5.1 Eligibility for claim

A German company was active in the Romanian energy market before Romania joined the EU in 2007. It appointed a local tax representative to handle its VAT obligations, and had a local VAT number. When Romania joined the EU, all its supplies became subject to the reverse charge (supplies of electricity to taxable dealers), and the obligation to use a tax representative was no longer applicable. Nevertheless, the representative filed tax returns claiming repayment of local input VAT. The Romanian authorities refused these claims, and appear to have decided that the company had placed itself in a legal vacuum – the existence of a representative meant that it could not claim under the 8th Directive (which was then still in force), but the VAT returns were not proper claims.

The CJEU observed that the principles of effectiveness and equal treatment meant that a claim to input tax must be met where the substantive conditions exist, even if some of the formal requirements are not satisfied. The proper answer here was to allow the 8th Directive claim; the existence of a tax representative on its own, without the ability to make or receive supplies, did not constitute an 'establishment' that ruled out the operation of the Directive.

CJEU (Case C-323/12): *E ON Global Commodities SE v Agentia Nationala de Administrare Fiscala*

5. INPUTS

5.1 Economic activity

5.1.1 No evidence of business

An individual applied to register for VAT in November 2010. After some discussion, his EDR was set as 1 February 2007; a late registration penalty was raised, and then cancelled when he explained that most of his sales were of consultancy services to businesses belonging outside the UK, so there was no output tax to pay. When he submitted a claim for repayment of £25,000 of input tax for the long period from 1 February 2007 to 30 September 2011, HMRC decided that he was not carrying on a business and was not entitled to the tax. He appealed to the FTT.

The Tribunal heard evidence from the appellant and examined the documents that he produced. These did not substantiate the nature of the supplies that he made to clients, nor did they establish a link between supplies made and consideration received. It appeared that he had the trappings of a business (accounts, website, bank account), but there was insufficient evidence to show that he charged for the services that he provided.

As the onus of proof was on him to satisfy the Tribunal of this precise point, his appeal was dismissed.

First Tier Tribunal (TC03242): *Andrew Adelekun*

5.2 Who receives the supply?

5.2.1 Connected companies

A property dealing company appealed against four assessments disallowing input tax, and one imposing a penalty. HMRC ruled that the invoices from solicitors and a valuer were proper to a connected property development company, not the company that had made the claim.

Two of the solicitors' bills were in respect of costs awarded against the appellant after a legal dispute. These did not represent supplies made to the appellant, so the appeals against those assessments were dismissed.

A further bill was argued to relate to work done for the appellant but was incorrectly addressed to the development company. This appeal was also dismissed on the grounds that the property company had recharged it to the development company.

A proportion of the valuer's bill appeared to relate to the company's properties, so 7/8 of the input tax on that invoice was deductible. Another claim related to the correction of the Land Registry entries in respect of a trading asset, and that too was deductible, although there were some difficulties in identifying the amount claimed with specific invoices – it appeared to be common for suppliers of professional services to ask for stage payments and not to provide clear invoices or statements of account.

The penalty was discharged. Although the claims included amounts that were not properly deductible, the decision to impose a penalty on the "deliberate conduct" scale was based on the view that the company had been specifically warned not to claim input tax on awards of costs. The Tribunal decided that the circumstances were not so similar to the earlier occasion that it was obvious that the same principles applied; the claim was made not in defiance of the previous instruction, but on the basis of an honest if mistaken belief that relief was due. The appeal against the penalty was allowed.

First Tier Tribunal (TC03298): *Grimshaw Properties Ltd*

5.2.2 Partner and firm

A partnership of tax advisors was dissolved at the end of 1994, and the partners made payments – treated as VATable after a dispute that went to court in 2003 – for taking over a portion of the client base. One of the partners started a new firm and introduced the client base to it as a capital contribution. He claimed to deduct the VAT paid to the old partnership as input tax. The German authorities ruled that the input tax was paid by him as an individual, while the new business was carried on by the firm, so neither acquired a right to deduct. Questions were referred to the CJEU.

The CJEU considered a number of precedents, including Case C-280/10 *Polski Trawertyn*. In that case, the CJEU had ruled unlawful Polish legislation which did not allow a deduction either by a partnership or by the partners for expenditure that was incurred before the partnership was registered, but which was undoubtedly used for the purposes of the partnership's economic activity.

The court distinguished the earlier case on the grounds that the current appellant had done something that was outside the scope of VAT – he had contributed the client base to the new partnership without charge, and the client base did not become part of the capital assets of the partnership in the same way as the quarry contributed by the partners in *Polski Trawertyn*. He had had a choice (to make that supply for consideration) which would have entitled him to a deduction. Accordingly, the precedent did not apply; because he had exercised a choice that the German law allowed him, the principle of fiscal neutrality also did not require that he should enjoy a deduction.

CJEU (Case C-204/13): *Finanzamt Saarlouis v Heinz Malburg*

5.3 Partial exemption

5.3.1 Housing associations

HMRC have updated their *Framework for Housing Association Partial Exemption Special Methods*, which was first published in June 2010.

www.hmrc.gov.uk/menus/pe-frame-ha.pdf

5.3.2 Article

An article in *Taxation* examines the FTT decision in *University of Cambridge* (TC02836) and its possible impact on the VAT recovery calculations for other universities and charities. The writer compares the principles of the case with the earlier decisions from 2006 in *Church of England Children's Society* (which was about fund-raising activities) and *University of Southampton* (which was about publicly funded research activities).

Taxation, 30 January 2014

5.4 Cars

5.4.1 Updated Notice

HMRC have issued an updated version of the Notice *Motoring expenses*, replacing the July 2012 version. There is no "what's changed" section to highlight the reasons for the update. Recent changes to the scale rate and partial exemption are not explained in detail in this notice.

Notice 700/64

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Pension fund management costs

HMRC have issued a Brief commenting on the CJEU judgment regarding deduction of VAT on pension fund management costs (*PPG Holdings BV* Case C-26/12). The Brief sets out HMRC's previous policy in this regard, which has been to distinguish between costs incurred in relation to:

- the setting up and day to day administration of occupational pension funds; and
- the management of the investment activities of the fund.

HMRC previously allowed employers to deduct VAT incurred in relation to the general management (that is, administration) of an occupational pension scheme on the basis that these costs are overheads of the employer and thus have a direct and immediate link to their business activities.

In respect of investment management costs, HMRC considered these costs to be of the pension fund itself and to relate solely to the activities of the pension fund. To the extent that these inputs were deductible, they were only deductible by the fund and/or trustees of the fund.

Where a single invoice was received covering both the administration of the pension fund and the management of the investments in the fund, HMRC allowed the employer to claim 30% of the VAT as relating to the general management of the scheme and the pension fund to claim 70% as relating to the investment management. However, often the pension fund would not be entitled to full or any recovery of the VAT on its share of the fees.

HMRC consider that the judgment confirms the principle that costs must first be examined for a direct link to an output in order to determine their deductibility. If there is such a direct link, it is not permissible to regard them as general costs of the business. For example, costs of managing a rental property will be directly connected to the rental income. However, it is possible that investment management costs will be general costs rather than being directly linked to transactions in the investments. In that case, provided the supply is received by the employer rather than by the pension fund, the VAT incurred will potentially be deductible by the employer.

However HMRC will not accept that the VAT incurred in relation to pension fund management/administration is deductible by an employer where:

- the supplies were not made to the employer (this includes, but is not limited to, consideration of whether the employer has commissioned and paid for the services); or
- the supply is limited to investment management services only (that is, it is not a combined supply of both investment management and pension administration services).

Additionally, where the employer receives the supply but the pension fund bears the cost of the services (whether by way of reimbursement or by a set-off against pension contributions), HMRC will require an equivalent

amount of output VAT in respect of the amounts reimbursed to be accounted for. This amount is potentially deductible by the pension fund to the extent that it is engaged in taxable business activities.

Where an employer is engaged in non-business activities or makes exempt supplies, it will need to take these into account when deducting any VAT incurred and restrict its deduction accordingly, in accordance with the general principles of business/non-business apportionment and partial exemption.

The new policy applies from 3 February 2014. HMRC do not propose to take any action to amend previous claims to input tax that were made in accordance with the old policy. In order to allow employers and pension funds to respond to the change, they may agree that the 70/30 split continues in respect of single invoices issued for charges in the six months following the change of policy.

HMRC acknowledge that it is open to employers, who believe that they have claimed too little input tax in the past, to make retrospective claims. They also note that further guidance will be available soon in the CJEU judgment in *ATP Pension Service A/S* (Case C-464/12). This may decide that fees for managing defined contribution schemes should be exempt as they are comparable to special investment funds. HMRC state that they will take appropriate action to protect their position in relation to input tax claims if that is the decision.

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5.6.2 Business use

In TC01320, decided in 2011, the FTT allowed an appeal by a trader against a notice of deregistration. A builder had been VAT registered since 1973, but had not traded since being made bankrupt in 2004 (for the second time). He submitted nil returns until 2009, when he claimed £10,000 in input tax. HMRC ruled that he was not carrying on a business and directed that he should be deregistered. The builder argued that he intended to revive the business and had a contract to build a house.

The FTT considered that the direction to cancel the registration was not valid. Sch.1 para.13 VATA 1994 requires a cancellation to be from the time when the trader ceased to be registrable, or such later time as is agreed between HMRC and the trader. As no later date had been agreed, the direction to cancel could only be backdated to the time that HMRC concluded the trade had ceased. If a current date was used, it had to be shown that the trader was not currently entitled or required to be registered; the Tribunal was satisfied that the current building project amounted to economic activity, and the direction to cancel the registration was therefore invalid.

The remaining problem was the deductibility of the VAT. Much of this appeared to relate to the trader's continuing disputes arising out of his bankruptcy, rather than to the building project. This would not be deductible because it did not relate to the business; the Tribunal explicitly rejected the trader's argument that he needed to sue his insolvency practitioners in order to be able to trade. Other VAT appeared to be private or unrelated to building, and some had not been claimed within the relevant time limits. The Tribunal adjourned the hearing for the parties to

attempt to agree how much of the VAT was referable to the taxable activity.

Subsequently HMRC accepted that the trader could claim £3,996. He continued to appeal, arguing that a larger amount was referable to his business. In the light of his evidence at the hearing (which included some documentation which he had not previously produced), HMRC agreed to allow a further £1,250, whereupon he agreed to withdraw the appeal in relation to the remainder.

First Tier Tribunal (TC03222): *Michael Edward Gardner*

5.6.3 Power boat

A company purchased a power boat and claimed input tax of £31,219, plus £1,050 on associated transport equipment. HMRC initially raised a penalty assessment as well as disallowing the VAT, but withdrew this before the hearing.

The company had originally run Chinese restaurants. This had been very successful: the owner had a strategy of developing a new restaurant and then selling it. He had later become interested in powerboat racing, and had purchased at least one boat personally. A second boat had been purchased by a subsidiary company and used for the owner to enter the world championships.

He saw a new business opportunity in providing catering for powerboat racing events. In his view, he needed to be involved in those events to be taken seriously as a potential supplier. That was the connection between the purchase of the new boat and the company's business. Unfortunately, the main business to which he hoped to supply catering had withdrawn from powerboat racing, so the use and related income of the boat had been minimal; however, in his view he was still entitled to the input tax on the basis of his subjective intention to use it for a taxable business.

The Tribunal noted that the owner was clearly an astute and successful businessman. He would have recognised that obtaining the catering contracts was a speculative venture at best, and the purchase of an expensive powerboat was hardly bound to secure a profitable outcome. There must therefore have been other benefits in his mind when he purchased it. On the balance of probabilities, the Tribunal concluded that the purchase was not made in order to make taxable supplies; the possibility of obtaining the catering contracts was too remote to satisfy the *Lord Fisher* tests of what was a business. The appeal was dismissed.

First Tier Tribunal (TC03352): *Lai's Ltd*

5.7 Bad debt relief

Nothing to report.

5.8 Other input tax problems

5.8.1 Payments on account

The CJEU has confirmed the Advocate-General's opinion in a case about the right to deduct input tax on payments on account. The dispute concerned a payment in advance for a delivery of wheat. The supplier was not in fact authorised to trade in wheat, and immediately after receiving the payment transferred the money in a circular transaction through another company. It never accounted for the output tax, and no wheat was delivered. The authorities formed the view that the transaction was fraudulent, in that the claimant knew that VAT would not be paid over. They therefore refused the deduction of input tax. The company appealed, and questions were referred to the CJEU.

Advocate-General Kokott gave an opinion that input tax is deductible at the time a payment on account is paid, where the taxable supply is expected to be carried out in the ordinary course of business. That follows from art.167, which provides that the right to deduct arises when the VAT becomes chargeable, and art.63, which makes the VAT chargeable when a payment on account is received by the supplier. However, that is subject to the principles of *BUPA* (Case C-419/02) and *Bonik* (Case C-285/11): VAT will only be chargeable if the subject of the supply is specifically identified, and it will not be deductible if the customer is aware that the transaction is connected with an intended fraud. It is for the national court to determine whether these factors exist.

If the supply is then not carried out, an adjustment of deduction is required, regardless of the return of the payment on account to the claimant or whether the supplier should have accounted for output tax; if there is no supply, there can be no deduction. The full court agreed with this reasoning: non-delivery was a change in the factors used to determine the appropriate amount of the deduction, and it therefore required adjustment under art.185 PVD.

That is the established position in the UK, confirmed in a number of cases.

CJEU (Case C-107/13): *'FIRIN' OOD v Direktsia 'Obzhalvane i danachno-osiguritelna praktika' – Veliko Tarnovo*

5.8.2 Missing traders

A company appealed against the First-Tier Tribunal's decision to refuse £234,442 in input tax on five purchases of CPUs, mobile phones and iPods in the periods to 07/2006 and 08/2006. The FTT decided that the company did not know at the time of the transactions that they would be connected with a VAT fraud, but that it should have known, and therefore could not deduct the VAT. The company appealed to the Upper Tribunal, arguing two points: first, that the Tribunal applied the wrong legal test; and second, that the Tribunal's decision was one that no person acting judicially and properly instructed as to the relevant law could have come, in other words, one that was not open to it on the evidence.

The trader identified a 'misstatement' of the *Mobilx* test: the FTT had referred to it as '*if HMRC prove that the only reasonable explanation for the circumstances in which the trader's purchase takes place is that the*

purchase has been or will be connected to fraud'. The appellant argued that this is an objective test, whereas the *Mobilx* test is subjective: '*if a trader should have known that the only reasonable explanation for the transaction in which he was involved was that the transaction was connected with fraud*'. The Upper Tribunal judge concluded that the FTT applied the correct test. There were points within the decision that could have been more accurately worded, but the '*challenge is based upon a textual analysis of isolated parts of the decision that is unfair to its author*.'

On the second ground of appeal, the FTT had noted 8 different factors which, cumulatively, persuaded it that the trader should have been more suspicious. The UT judge examined each of them in turn, and although some conclusions could be criticised, he was satisfied that the overall result was one that the Tribunal was entitled to come to on the evidence before it. None of the individual factors, which the appellant attempted to pick apart individually, was on its own crucial to the decision: it was the cumulative effect of all the factors that persuaded the FTT that the trader should have known, and that was not disturbed by undermining individual elements of the 8 factors.

The judge noted that HMRC also put forward an argument that there was other evidence before the Tribunal, but which was not referred to in its decision, which supported its conclusion. That would be a disturbing assertion, as decisions usually state that they contain the full grounds for making them; but it was not necessary for the judge to consider this point, because he decided that the grounds that were stated were adequate to support the conclusion.

Upper Tribunal: *Else Refining and Recycling Ltd v HMRC*

A company claimed £2m in respect of transactions in April, May and June 2006. The Tribunal concluded (in late 2011) that the director should have asked more questions, and if he had done so, he would inevitably have realised that there were significant doubts about the transactions. The FTT decision (TC01579) was said to have been reached 'with some hesitation', but the result was the usual one.

The company appealed to the Upper Tribunal, arguing only in relation to one of the disputed deals. It claimed that two key conclusions concerning sales volumes and the extending of credit by suppliers were not open to the Tribunal on the evidence before it. Without those conclusions, the Tribunal would not have decided that the company should have known that this first deal was connected with fraud.

The judge considered that the complaint about the finding on sales volumes was well-founded, but not the complaint about the finding on credit. The judge decided that the Tribunal would then still have reached the same overall conclusion, that the director should have known that the transaction was connected with fraud, even with one part of the basis of that conclusion taken away. The company's appeal was dismissed.

Upper Tribunal: *Annova Ltd v HMRC*

TC01248, decided in the second half of 2011, concerned HMRC's disallowance of input tax in relation to mobile phone transactions in 03/06, 04/06 and 06/06 amounting to £15.25m. After 463 paragraphs of exhaustive examination of the transactions, due diligence procedures,

customers and legal arguments about the way HMRC had presented their case, the chairman stated that the Tribunal's task was "simply" to determine in respect of the disputed transactions:

(1) Was there a VAT loss?

(2) If so was it occasioned by fraud?

(3) If so were the Appellant's transactions connected with such a fraudulent VAT loss?

(4) If so did the Appellant know or should it have known of such a connection?

In another 194 paragraphs the chairman applied these questions to the earlier background and concludes that the trader knew when it entered into the transactions that the counterparties were engaged in VAT fraud, so it was not entitled to input tax credit. The case was interesting because of the involvement of contra-traders: this appellant was not able to use the 'clean chain/dirty chain' distinction to insulate it from the fraud.

The company appealed to the Upper Tribunal, where the judge summarised the legal basis of the appeal (which also disputed some of the FTT's findings of fact) as:

(1) the authority of cases decided in the CJEU trumped any English authority;

(2) properly analysed, the European cases only sanctioned the denial of input tax claimed in respect of transactions within the scope of VAT in the case of a trader who claims in respect of a purchase from a fraudster and with knowledge of the fraud, and

(3) do not in any event sanction such denial where the fraudulent evasion of VAT is perpetrated by traders in another chain of supply in which the person claiming deduction is not involved.

The UT judge dismissed the appeal, holding that the UK and CJEU authorities are consistent. In particular:

(1) contrary to the (legal) submissions of the Appellant, it is irrelevant whether the fraudulent evasion of VAT preceded or followed the purchase;

(2) the Appellant's further legal submission that a transaction may only be treated as sufficiently 'connected with' a VAT fraud to permit denial of a claim to input tax if that VAT fraud occurs in the same chain of supply of goods and services, so that such denial is not permitted where the VAT fraud occurs in another chain of supply, is inconsistent with Mobilx.

The judge examined the FTT decision in detail, and also the relationship between the CJEU precedents (*Kittel*, as developed in *Mahageben*, *Gabor Toth* and *Peter David*) and the UK's leading case (*Mobilx*). This was consistent with another recent decision of the UT in *Fonecomp Ltd*. The judge also reviewed alleged procedural irregularities in the way in which the FTT appeal was carried on. He could find no basis for overturning the FTT decision in any respect.

Upper Tribunal: *Edgeskill Ltd v HMRC*

A company appealed against the refusal by HMRC of a claim to £6.23m of input tax in the periods 03/06 to 05/06. The Tribunal examined the facts in detail and concluded that the company had acted in a manner consistent with knowledge of fraud and inconsistent with being an innocent dupe. For completeness, the decision also records that the director 'should have known', even if he did not. The company's representative argued that this was not a reasonable finding because it was not put to him in cross-examination; the judge responded that this test is an objective one, and not an allegation of fraud, so it does not have to be put to the person concerned.

First Tier Tribunal (TC03269): *Electrical Environmental Services Ltd*

Judge Bishopp had to consider an application by HMRC to have 6 MTIC appeals by traders struck out. All had lost before the FTT, and had permission to appeal to the UT. HMRC argued that all their appeals were based on the claim that *Mobilx* had been wrongly decided and the FTT decisions relying on it were therefore unsound; as the UT has recently and repeatedly confirmed that it regards *Mobilx* as good law, at the very least the appellants should be required to amend their grounds of appeal to strike out these particular arguments. HMRC should not be forced to litigate the same points over and over again.

The judge declined to grant HMRC's application. In his view, where leave to appeal had been granted, it would require exceptional circumstances for the Tribunal to refuse to allow such an appeal to proceed. The powers that HMRC urged him to use to order an amendment to the grounds of appeal had to be considered in their context: it would also be exceptional to force an appellant to strike out part of the case, rather than hearing it.

On the other hand, the judge refused an application by the appellants to make a reference to the CJEU in these cases. In his view, the recent consideration and confirmation of *Mobilx* by the Upper Tribunal showed that there was no uncertainty in the mind of the court that warranted referring questions to the CJEU.

Upper Tribunal: *Universal Enterprises (EU) Ltd and others v HMRC*

A trader was denied input tax credit of £1.9m claimed in May 2006. Part of the appeal related to the inability of the company to obtain a fair hearing because it could not afford proper representation. The Tribunal considered this question and decided that the company did receive a fair hearing, which does not seem to have been helped by the director not offering himself as a witness. The Tribunal concluded that at the very least he ought to have known that the transactions were connected with fraud.

First Tier Tribunal (TC03294): *Outkey Trading Ltd*

A trader was denied £1m of input tax in relation to purchase of mobile phones in the period to June 2006. The director was also responsible for another company, *Blue Sphere Global*, which is one of the few traders to win a MTIC appeal (in the Court of Appeal, having lost before the VAT Tribunal). He formed the opinion that the Tribunal would not give him a fair hearing – there were various procedural matters in the history of this dispute and the earlier one which caused him to lose confidence in the

impartiality of the FTT. He therefore did not attend the hearing and withdrew instructions from his solicitors.

The Tribunal judge asserted that he would consider the facts independently of any findings in relation to the earlier case. One of the differences between them was that HMRC were not permitted to amend their statement of case in *BSG* to cover actual knowledge of fraud as well as means of knowledge; in this case, the Tribunal could consider both grounds. The Tribunal decided that there was ample evidence that the director must have known of the connection to fraud:

(1) The release of goods before payment when they were transported on a "ship and hold" basis – the only reasonable explanation as to why goods transported on such a basis were being released before payment is that it was known that payment was to be received in any event;

(2) Minimal commercial risk – DDR did not make any payment to its supplier until it had been paid by its customer;

(3) The consistent mark-ups in all of the transaction of approximately around 6% irrespective of the type of mobile telephone involved or the quantities traded;

(4) DDR continued to purchase goods from Infinity seemingly without raising any questions despite concerns being raised about the company by HMRC Officers Lisa Orr and Doug Armstrong during their visit to BSG on 19 June 2006 when they met with Mr Peters shortly before transactions with which this appeal is concerned took place

(5) The failure by DDR to react when told by HMRC that transactions in its 12/05 repayment claim had been traced to fraud; and

(6) The anomalies in the inspection reports mentioned ... above.

The due diligence carried out was also inadequate. The appeal was dismissed, with costs awarded to HMRC.

First Tier Tribunal (TC03356): *D D R Distributions Ltd*

An unusual variation on the normal MTIC appeals has arisen in a civil claim by the liquidators of a company against counterparties for dishonest assistance of breaches of fiduciary duty – they had helped the directors of the claimant company to carry out transactions which resulted in the company suffering losses (the refusal of HMRC to repay input tax). The High Court found that some of the claims were well founded, while others were not made out on the evidence. Judgment would be given against the defendants where the evidence supported it.

High Court: *Alpha Sim Communications Ltd (In Compulsory Liquidation) and others v Caz Distribution Services Ltd and others*

Another variation on the normal "*Kittel/Mobilx*" MTIC 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 FTT dismissed the appeal with costs awarded to HMRC.

The company appealed to the Upper Tribunal, where it was permitted to advance just two grounds – that the FTT had erred in reaching its decision in that it had given insufficient weight to the witness evidence, and that it should not have granted the order for costs. The UT considered that the FTT had considered and explicitly rejected the witness evidence that formed the ground of appeal; although it had not expressly addressed one particular statement of corroboration, that did not add a great deal to the appellant's case, which had been fairly dismissed. In the circumstances, it was not unreasonable for the FTT to award costs – it had decided that the transactions had not taken place; it was therefore naturally unreasonable of the director to bring an action to support a claim for input tax on them.

Upper Tribunal :*Reddrock Ltd v HMRC*

A company appealed against decisions to refuse repayments totalling £1.8m in relation to (unusually) 3 quarterly return periods (12/05, 03/06 and 06/06). The appeal proceedings had been particularly tortuous, including an application by the appellant to have the judge "recused". This was turned down, and in the end the original judge concluded that the company's witnesses were not credible: "*The discrepancies and anomalies within the individual deals were significant, and the failures of Mr Andrews and Mr Case to act on those discrepancies undermined their assertions that they were involved in the bona fide trading of mobile phones.*" The Tribunal was satisfied that they knew that their transactions were connected with fraud; it was therefore not necessary to consider the alternative test, but for completeness the Tribunal also concluded that they should have known.

First Tier Tribunal (TC03380): *Tricor Plc (formerly PNC Telecom plc)*

A company was denied claims for £22m in relation to periods 02/06, 03/06 and 06/06. The usual exhaustive examination of the deals convinced the Tribunal that the directors knew of the connection with an orchestrated fraud.

First Tier Tribunal (TC03388): *Advent Worldwide Distribution Ltd (in Administration)*

A company claimed that it was an "innocent dupe" and therefore the victim of a MTIC fraud, rather than a participant. Its claim was for £2m in relation to 04/06 and 05/06. The FTT concluded that there was no credible explanation for the transactions other than a connection with fraud, the risk of which was known to the directors. Their appeal was dismissed, and costs were awarded to HMRC.

First Tier Tribunal (TC03387): *MFT Communications Ltd*

5.8.3 Reclaim bodies

The government has published a Tax Impact and Information Note about the effect of the Care Bill (currently going through Parliament) which will introduce two new health service bodies, Health Education England and the Health Research Authority. Finance Bill legislation will be introduced to add these organisations, once established, to the named bodies entitled to recover the VAT paid in relation to certain non-business activities.

www.gov.uk/government/uploads/system/uploads/attachment_data/file/264475/8._VAT_refunds_to_health_service_bodies.pdf

The Treasury will also make an order which adds five combined authorities (e.g. the Barnsley, Doncaster, Rotherham and Sheffield Combined Authority) to the list of bodies entitled to claim under s.33 VATA 1994. Up to now, they have not been included in the definition of "local authority".

www.gov.uk/government/uploads/system/uploads/attachment_data/file/294387/VAT_refunds_to_combined_authorities.pdf; SI/Draft The Value Added Tax (Refund of Tax) Order 2014

5.8.4 Corporate purchasing cards

HMRC have replaced their Notice *Corporate purchasing cards* to reflect changes in the marketplace since March 2002. It explains how VAT must be accounted for by suppliers accepting purchase cards and businesses buying goods and services using them. The tax point rules for supplies are explained along with the invoicing requirements.

Note that references made in the notice to acceptability for VAT reporting and input tax recovery apply only to purchasing cards which have an associated VAT invoicing capability. Ordinary purchasing, charge and credit cards do not have this capability, and statements/reports from such cards are not acceptable for VAT purposes.

Notice 701/48

5.8.5 Advisory fuel rates

The fuel-only advisory mileage rates now change quarterly, although only by very small amounts. For the month following a change (i.e. the month of March) employers may use either the old or the new rate.

The rates from 1 March 2014 (1 December 2013 in brackets) are:

Engine size	Petrol	LPG
1400cc or less	14p (14p)	9p (9p)
1401cc – 2000cc	16p (16p)	11p (11p)
Over 2000cc	24p (24p)	17p (16p)

Engine size	Diesel
1600cc or less	12p (12p)
1601cc – 2000cc	14p (14p)
Over 2000cc	17p (17p)

Although the rates change quarterly, the actual adjustments are very small – in this case, a 1p adjustment to one of the figures for LPG.

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

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

6.2.1 Exception from registration

A trader exceeded the registration threshold in the 12 months to 31 October 2011. HMRC ruled that he should be registered with effect from 1 December. He appealed, arguing that they should accept that his turnover would be below the deregistration threshold for the following 12 months, so he should be excepted from registration.

The trader only realised that he had exceeded the threshold when preparing his 2011/12 income tax accounts. His accountants wrote to HMRC in January 2013 to explain the situation. His turnover had not exceeded £55,000 in the five years to 31 March 2011; it had risen during 2011 because of three large jobs, but would reduce again afterwards. However, the accountants' schedule of turnover showed that the historical turnover threshold was breached in every month from October 2011 to December 2012, apart from November 2011. The turnover had fallen sharply after May 2012 to "more normal levels".

The refusal of exception was phrased as follows:

The Commissioners can only consider this request in the light of the facts which were available at the time your liability to be registered first arose.

On the basis of those facts they are unable to accept that at the appropriate time they could have been satisfied that the value of your taxable supplies in the period of one year then beginning would not exceed £71,000.

The Commissioners therefore consider that you should be registered with effect from 1/12/11.

The decision was confirmed on review. The conclusion of the review stated:

When considering the exception retrospectively, the most important aspect is that only information that would have been available at the time the liability to register first arose that can be considered.

In his letter of 8 January 2013 your accountant confirms that you exceeded the relevant VAT threshold in October 2011 and as of that date you were not aware of "the level for the VAT threshold".

The commissioners consider that it is a reasonable expectation that a prudent business would monitor turnover and be aware of all potential tax liabilities.

Therefore on the basis that you were unaware of the VAT threshold as of the date of turnover breach and there is no evidence that would have been available as of the critical date that you were reviewing your work levels

and giving consideration to either reducing or refusing work, I must conclude that you were not in a position to satisfy the commissioners that as of October 2011 your turnover would fall below the relevant VAT deregistration threshold in the subsequent 12 months.

Exception from registration has been correctly refused.

The FTT considered that the decisions should have been explained by at least one of the officers appearing as a witness. It was unsatisfactory that their lawfulness should have to be considered only on the basis of the written decisions, the first of which gave no reasons. The second appeared to consider the information that would have been available in October 2011, not on 1 December 2011, as required by the court's decision in the case of *Gray*. Accordingly, the FTT could not be satisfied that these decisions were reasonably arrived at.

However, when considering the facts that would have been available on 1 December 2011, it concluded that HMRC would inevitably have come to the same decision. Even if the appellant had told HMRC at the time that his turnover had risen because of an "exceptional contract", further enquiry would have shown that there had been more than one such contract, and it would therefore have been difficult to be satisfied that the turnover would probably fall in the next 12 months.

As a properly arrived at decision would have inevitably been the same as the unreasonably arrived at decisions that were actually made, the appeal could not succeed.

First Tier Tribunal (TC03306): *Jonathan Savagar*

6.2.2 Registration limits

The VAT registration and deregistration thresholds in respect of taxable supplies and acquisitions from other EU member states have all increased by £2,000 in line with inflation. The registration limit for both taxable supplies and acquisitions is £81,000. The deregistration limit for taxable supplies is £79,000, and for acquisitions is £81,000. The new limits apply from 1 April 2014.

SI 2014/703

6.3 Payments and returns

6.3.1 Flat rate scheme: classification

A company started to trade in 2006 as a souvenir shop which also sold refreshments. It joined the Flat Rate Scheme in May 2008, deciding that the appropriate trade classification was 'retailing that is not listed elsewhere' with a rate of 7.5%. HMRC later visited the shop and concluded that it sold more refreshments than other items. It should therefore have been classified as 'catering services including restaurants and takeaways' with a rate of 12.5%. Assessments were raised for all the periods from 08/08 to 05/12; by the time of the hearing, the first two and the last one had been withdrawn.

The Tribunal had to consider whether the company had reasonable grounds for choosing its classification. HMRC's Notice states that a choice will not be overturned retrospectively provided that it was made on reasonable grounds.

In May 2008, the company's lease provided that it was supposed to be a shop, and any catering activity was required to be ancillary. However, HMRC observed that between 66% and 87% of turnover came from catering.

The appellant argued that 'catering' as commonly understood meant cooking hot food from raw ingredients; all she did was heat up pre-prepared meals, and serve cold food and hot drinks. HMRC responded that the proper definition of catering for VAT purposes was wider than that, and covered her activities.

In the alternative, the taxpayer argued that HMRC ought to draw a trader's attention to the criteria in the regulations (i.e. the definition of catering) to avoid a crippling assessment for back tax some years later. HMRC argued that the business was well established by 2008; a reasonable trader would have read Notice 733 and would have concluded that the correct classification was 'catering'.

The Tribunal noted that the trader offered no evidence for any alternative definition or understanding of the word 'catering'. It therefore concluded that the definition in Sch.8 Group 1 VATA 1994 was appropriate for interpreting the FRS regulations. On that basis, the trader should certainly have taken account of the relative amounts of turnover from the end of the first year in the FRS.

There was also no evidence of the composition of the turnover before 2008. The Tribunal held that the terms of the lease were a relevant factor which the trader was entitled to take into account in deciding on the category to choose. Accordingly, the initial choice was defensible, but it should have been changed after a year. The criticism of raising back duty assessments in the circumstances of the case was not something that the Tribunal considered to be within its jurisdiction.

The appeal was upheld for the periods 02/09 and 05/09, the last two quarters of the first year. It was dismissed for all subsequent quarters.

First-Tier Tribunal (TC03160): *The Vintage Tea House Ltd*

A company joined the FRS and chose the category "agricultural services" (currently charged at 11%). It later changed this to "general building or

construction services" (currently 9.5%), and asked HMRC to backdate the effect of this to its entry to the FRS. HMRC refused, and the company appealed.

It argued that there was no specific category in the list that applied to its business of landscape gardening, and "agricultural services" was an inappropriate description of what it did (which mainly related to building driveways and walls and laying foundations for buildings). The trader appears to have been confused by the existence of the separate flat rate scheme for farmers, which plainly did not apply to its trade; it seemed to believe that this meant the FRS categorisation of "agricultural services" had to be wrong.

HMRC responded that it was up to the trader to choose the most appropriate category; as long as that was a reasonable choice, HMRC would not seek to backdate any change, and nor could the taxpayer. The FTT agreed that this was not an unreasonable decision; that was the extent of the Tribunal's jurisdiction in this type of dispute. HMRC were under no obligation to advise the trader on how to save tax, and the trader had professional representatives who might have done so instead. The appeal was dismissed.

First Tier Tribunal (TC03374): *A K Bray for Gardens Ltd*

6.3.2 Backdating the FRS

A trader registered for VAT from September 2004. Its business was acting as archaeological consultants advising on historic sites and buildings. On 31 March 2011 it wrote to HMRC to ask for retrospective admission to the Flat Rate Scheme. HMRC agreed that it could join with effect from 1 January 2011 if it submitted an application promptly, but it could not go further back than that.

The company asked for a review, claiming that there were "exceptional circumstances" which justified retrospection. The FTT examined the facts and could find nothing exceptional. The fact that the company would have paid less tax under the FRS was not in itself an exceptional circumstance; VAT is a self-assessed tax, and the onus is on the taxpayer to make returns. HMRC are under no obligation to bring tax-saving schemes to a taxpayer's attention. The decision to refuse retrospection was reasonably made.

First Tier Tribunal (TC03343): *C & N Hollinrake Ltd*

6.3.3 Article

In an article in *Taxation*, Neil Warren considers the rules, pitfalls and opportunities which affect leaving the Flat Rate Scheme.

Taxation, 27 February 2014

6.4 Repayment claims

6.4.1 *Fleming* claims allowed

A NHS Trust made *Fleming* claims for nearly £180,000 in input tax not claimed on zero-rated supplies of prescription drugs made to outpatients from April 1973 to 31 March 1997. Such input tax was not claimed at the time because it was not realised that this was possible until the Court of Appeal's decision in *Wellington Private Hospital* in 1997. By 2009, it was not possible to produce detailed evidence of the amounts paid, so the Trust proposed a method of estimation and extrapolation from other figures. The Tribunal was asked to rule on whether the Trust's proposal was a reasonable basis for making a claim.

The Tribunal made a number of recommendations for improving the logic of the method, but considered it a reasonable basis for making a claim. The parties were sent away to agree the amount that would be repayable after adjustment of the calculations; in the absence of agreement, they could return for a further hearing.

First Tier Tribunal (TC03308): *St George's Healthcare NHS Trust*

6.4.2 Unjust enrichment

Reed Employment made *Fleming* claims in March 2009. The Upper Tribunal held that these were new claims, rather than variations on a 2003 claim made during the first *Marks & Spencer*-led opportunity to claim for some capped VAT. This was critical, because the defence of "unjust enrichment" was discovered to be flawed after 2003; it was rectified with effect from 26 May 2005, with the intention that it would apply to all subsequent claims for repayment, whatever period they applied to. If the *Fleming* claims were variations of the existing 2003 claims, unjust enrichment could not apply; if they were new claims, it would.

The company appealed to the Court of Appeal, arguing that the introduction of the unjust enrichment defence in 2005 breached a number of EU legal principles:

- equal treatment and fiscal neutrality, in that claims made before May 2005 would not be subject to the rule whereas those made afterwards would be;
- legitimate expectations and effectiveness, in that it was introduced with retrospective effect without a transitional period, thereby denying the company an opportunity to exercise its rights.

The Court of Appeal did not accept that any EU principles were breached, or that a reference to the CJEU was needed. The case of *Weber's Wine World* (Case C-147/01) confirmed that it was acceptable to introduce an unjust enrichment defence in this way: it was not necessary to allow claims for earlier periods to remain unaffected, nor was it necessary to allow a transitional period. If there was unequal treatment, it had been approved by the CJEU.

Court of Appeal: *Reed Employment Ltd v HMRC*

6.4.3 *Fleming* and public authorities

An NHS health authority claimed a repayment of output tax wrongly accounted for between April 1974 and December 1996. The subject matter was catering supplies to staff, patients' families and friends, outpatients and medical and other students, which it claimed were properly zero-rated (as cold takeaways) or exempt (as incidental to exempt supplies of education to medical students). It had treated all its catering supplies as standard rated for the whole of that period.

The Tribunal had to consider whether its methodology in estimating the amount of overpaid VAT – extrapolating back from the proportions of zero-rated and exempt sales in October and November 2007, adjusted for changes in behaviour and the mix of cold and hot takeaway sales. The knock-on effect on input tax was also in dispute: the general activities of the authority were non-business, so reclassifying income as exempt or zero-rated could have an effect on its recovery calculations. The Tribunal made a decision in principle in favour of the authority, and directed the parties to go away and agree the detailed calculations.

The authority also sought to amend its original claim (made on 30 March 2009) to cover hot takeaways for the period before May 1984, when all takeaways were zero-rated. The Tribunal decided that the wording of the original claim was in effect a waiver of any claim in this regard, and a subsequent attempt to add this category was a new claim made after the deadline, rather than a variation of the existing timely claim. To this extent, its appeal was refused.

First Tier Tribunal (TC03381): *NHS Dumfries and Galloway Health Board*

By contrast, another Scottish NHS body failed to convince the Tribunal that any of its *Fleming* claim should be allowed. It had to produce sufficient evidence of the amount of VAT that had been incurred and had not been claimed under the contracted-out services provisions; and to provide a method that could be agreed as a fair and reasonable way of calculating the recoverable amount. The Tribunal was not satisfied that it had discharged the burden of proof laid on it by the law. The decision is detailed and probably only of direct interest to those involved in *Fleming* claims and/or NHS partial exemption methods.

First Tier Tribunal (TC03397): *NHS Lothian Health Board*

6.4.4 Direct tax

Early in 2012, the First Tier Tribunal rejected appeals by four companies which were each representative member of a group of retailers which had received large VAT repayments (£125m) together with statutory interest (£175m) 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; all the trades that had given rise to the overpayments had been discontinued, and the claimant company was now

dormant. The FTT 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 FTT 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 FTT 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 FTT examined the arguments of the counsel for each side in relation to each of these propositions. In respect of the first, the FTT 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 FTT 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 FTT 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 FTT 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 FTT 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 FTT 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.

The companies appealed to the Upper Tribunal, arguing that the FTT had erred in law in six respects:

i) in holding that the VAT repayments (VRPs) and, accordingly, the interest payments (IPs) arose from a trade carried on by the Appellants which recorded the relevant sums ("the Sums") in their accounts (the Source argument);

ii) in determining that the Appellants had a beneficial entitlement to the VRPs and IPs as if it were a question of fact instead of a question of law or a question of mixed fact and law and as a consequence erred in concluding that the VRPs and IPs were taxable (the Beneficial Entitlement argument);

iii) in holding that SDG was liable to tax under section 103 Income and Corporation Taxes Act 1988 (ICTA) in respect of those parts of VRP2 which related to the trades of GUS plc, Kay & Company and Abound Ltd in circumstances in which the FTT also held that the rights to those parts of VRP2 had been retained by those companies (the SDG Retention argument);

iv) in construing the asset sale agreement between SDG and SDHSL dated 28th October 2005 (the 2005 Agreement) as ineffective to transfer to the latter such rights as SDG had to VRP2 and IP2 (the SDG Construction argument);

v) in construing section 103 ICTA as imposing a charge to tax on any person receiving a particular sum regardless of whether that person formerly carried on the trade to which the sum related (the s103 argument);

and lastly,

vi) in holding that IP6 was taxable on LRL as interest under Case III Schedule D and in holding that the remainder of the IPs were payments of interest and in holding that such interest fell within the loan relationship rules, (the Interest arguments).

The Upper Tribunal summed this up with the concept that only the representative members of the VAT groups were entitled to the VAT repayments and interest; as the underlying trading transactions were not part of the trade of the representative members, the income was too remote from any trade.

The UT judge considered the facts, the precedents, and the decision of the FTT in great detail, and concluded that in all respects the FTT was entitled to come to the decisions it had made. There was no error of law, and the appeals were dismissed.

The companies appealed again to the Court of Appeal, arguing in particular that the rules on taxation of post-cessation receipts could only charge a company which had carried on the trade that had now ceased. The judges disagreed: any recipient of a post-cessation receipt was taxable on it. This was consistent with the wording of the legislation and the intention underlying the law.

Furthermore, HMRC's obligation to pay was a money debt, and the interest charged on it therefore fell within the scope of the rules on loan relationships.

The appeal was dismissed on both counts.

Court of Appeal: *Shop Direct Group and other companies v HMRC*

6.5 Timing issues

Nothing to report.

6.6 Records

Nothing to report.

6.7 Assessments

6.7.1 Investigation

An individual was assessed to income tax, VAT and penalties totalling about £500,000 following a back duty investigation covering a period going back to 1991. He appealed against some aspects of the assessments, which were based on analysis of a number of previously undisclosed foreign bank accounts. In particular, there was a dispute over whether a particular receipt of £535,000 was a business receipt or a loan; whether a

deduction should be made from some of the receipts in respect of business expenses; and whether proper allowance had been made for input tax that would have been deductible against output tax assessed.

The Tribunal held that the receipts in the bank account appeared to be pure profit. Any expenses must have been paid out before the receipts were banked. There was therefore no basis for making any deductions, either for expenses or for input tax.

On the other hand, the £535,000 did not appear to be a trading receipt. It also did not appear to be a loan; rather, it was some sort of transfer from the appellant's father. The FTT commented that it might be liable to inheritance tax or in some other way assessable, but it was not subject to income tax in the appellant's hands. To that limited extent, his appeal was allowed. The rates of penalty applied by HMRC were approved by the Tribunal.

First Tier Tribunal (TC03350): *James Ray Swanston*

6.7.2 Best judgement

A company provided training in first aid. It fell into financial difficulties and ceased trading during 2009. An enquiry was carried out by HMRC in August 2010, following which assessments were raised for £35,000 in VAT and £1,000 in penalties in respect of under-declared output tax and over-claimed input tax for the preceding 3 years. The company appealed.

It appeared that the company's computerised accounting system was faulty, or the operators did not know how to use it. Figures for VAT were included in more than one period, and input tax from one period might appear again as output tax the following period. The discrepancies were substantial – on the last return, VAT of £75,000 was declared on a turnover of £237,000, in the knowledge that this was incorrect, but in order to bring the filings up to date so that the company could be deregistered.

The Tribunal reviewed the schedules of adjustments produced by the assessing officer. It was hard to understand exactly how the errors had arisen, but some of the adjustments appeared to have a logical basis and were therefore made to best judgement. However, the Tribunal rejected others as not logical: the problems with the computer system appeared to have started from a particular date, and there was no reason to extrapolate the errors before that date.

The basis for the penalties was confirmed – they were levied under s.63 VATA 1994 at the rate of 15%, mitigated by 50% to reflect co-operation. The director was reassured that they carried no implication of dishonesty – only carelessness.

First Tier Tribunal (TC03344): *Medaid Training Services Ltd*

A fish and chip shop was assessed to £63,000 of undeclared output tax covering the period from 1 April 2006 to 31 March 2009. No penalties, surcharges or interest were levied. Original assessments amounting to £112,000 were reduced to this figure on review. The Tribunal considered the history of the investigation and the basis of the assessments in detail and rejected the appellants' assertion that their records were wholly accurate:

"*One of the most striking aspects of this appeal is the evidence that for the appellant's business years 2003, 2004 and 2005, the appellant voluntarily added a total of £149,800 to their recorded takings, while maintaining the view that their records were accurate for those years. It is extremely difficult to accept that any businessman who honestly and diligently kept proper and accurate records would do so, whether or upon the advice of an accountant, whatever apprehensions he might have about a tax enquiry because his GPR was substantially lower than the average for his type of business. These circumstances entitled HMRC to be suspicious of the record keeping of the appellant.*"

Given that the appellant's basis of appeal was that the returns were complete and accurate, and the FTT was not satisfied that this was the case, it followed that the assessments were in principle valid – they were made to best judgement. However, the FTT did accept some of the arguments raised at the hearing that suggested the amount of the assessments was excessive. The parties were instructed to go away and agree the revised figures on the basis of the Tribunal's findings.

First Tier Tribunal (TC03372): *Luigi Pia & Sons*

6.8 Penalties and appeals

Yet again, there has been an extraordinary volume of FTT decisions on default surcharge – in this quarter, 8 succeeding or partially succeeding, and 36 not succeeding at all. According to HMRC's statistics (6.8.8), fewer surcharges are now being issued, but more surcharges are cancelled on review than any other kind of HMRC decision. By the time they reach the Tribunal, HMRC must be relatively confident that their hardline stance is justified. Even so, the Tribunal still shows itself to be more sympathetic than the HMRC reviewers in some cases.

6.8.1 Default surcharge – successful appeals

A company appealed against a 10% surcharge issued for its quarter to March 2013. HMRC wrote a letter to the trader on 15 February 2013, stating that the direct debit mandate had been cancelled. The trader claimed that this letter had never arrived – it had moved premises and HMRC correspondence was still sent to the old address, and must have gone astray – so it was unaware that there was any reason to expect the payment at the beginning of April not to be made in the same way as the previous payments. A cheque was sent as soon as the surcharge notice arrived.

The Tribunal examined the evidence, such as it was. HMRC's records did not explain how, why or by whom the mandate had been cancelled: it appeared most likely that this was done by the bank, but there was no explanation for that action. The Tribunal accepted that the trader had not received the HMRC warning letter, and therefore had a reasonable excuse for late payment.

First-Tier Tribunal (TC03144): *Capital Coin Machine Co. Ltd*

A company was in the surcharge regime for several periods, but only appealed against the first two penalties charged at 15%. The self-represented taxpayer put forward 'cash flow difficulties' as the ground of appeal, which could not succeed; however, he also mentioned in the hearing that he had had open heart surgery during the preceding six months. HMRC did not object to this being added to the grounds of appeal, and the Tribunal decided that part of the cash flow difficulty could be attributed to his serious illness and absence from the business. The appeal was allowed in respect of one of the two return periods, but by the time of the second, the illness was considered too remote.

First Tier Tribunal (TC03257): *Purple Chameleon Ltd*

A group of companies had an understanding with its bankers that VAT payments would be honoured, even if the individual company did not have available funds, provided that the group as a whole could cover the amount. The group would then sort out the intra-group balances by the end of the day. This was in the form of a 'gentleman's agreement', rather than a written arrangement, and a new bank manager was unaware of it. As a result, he stopped a CHAPS payment that had been accepted by his staff. The company was unaware of this until too late to rectify the delay.

The Tribunal did not consider this a reasonable excuse, but accepted that the company had made the payment at such a time and in such a manner that it was reasonable to expect that it would be received by the

Commissioners within the appropriate time limit. That cancelled the surcharge under s.59(7)(a) VATA 1994. The appeal was allowed.

First Tier Tribunal (TC03230): *HR Transport Services Ltd*

A company pleaded the serious illness and subsequent death of its administrator, following which her responsibilities were passed to a director who had a disabled daughter which imposed extra pressures on him. The company was late several times, but HMRC accepted that a reasonable excuse for one of the periods. Two surcharges were levied, totalling £15,000.

The Tribunal accepted that the illness of the administrator was a reasonable excuse for the first period. Even though it was not an 'unforeseen event', and the directors had the primary responsibility to ensure that VAT was paid, even a conscientious trader might struggle in the circumstances. However, there was no such excuse in the later period. A disproportionality defence was as usual rejected; the Tribunal confirmed that the penalty did not seem out of order (as the penalties were both charged at 15%, striking out the first would not reduce the second).

First Tier Tribunal (TC03280): *Armkor Ltd*

A trader suffered a 10% penalty of £701 for the period to March 2013. The payment was made one day late. It was the trader's fourth default; Time To Pay arrangements had been asked for in the past but refused, once because another TTP arrangement was already in place, and once because the due date had passed.

The appellant ran a pub. The due date was the Tuesday after the May bank holiday. The takings for the weekend would normally be paid into the bank on the Monday, but because of the holiday they were paid in one day late; as a result, the funds were only available to settle the VAT one day after that, on 8 May. The trader said she tried to contact HMRC on the due date to explain the problem but could not get through to the helpline.

The Tribunal accepted that the banking practice of clearing funds one day late after a bank holiday was something that she could not know about and could not control. It was therefore a reasonable excuse for the late payment.

First Tier Tribunal (TC03287): *A S P Inns Limited (The Selborne Arms)*

A company specialised in removing graffiti from buildings. Although its activities were not covered by the Construction Industry Scheme for deducting income tax from payments to contractors, some customers nevertheless withheld income tax. This led to cash flow difficulties, made worse when HMRC delayed the repayment of the amounts suffered by the company. Even though the company should not have suffered the deduction at all, HMRC would only offset it against PAYE and corporation tax liabilities after the end of the accounting period, often a year after the deduction had been made.

When the company was late paying its VAT for January 2013, it claimed that the withholding of these payments represented a reasonable excuse. The Tribunal agreed that *Steptoe* applied, at least to the extent that the shortage of funds was due to HMRC holding on to these payments. The appeal was allowed in part.

First Tier Tribunal (TC3201): *Graffiti Busters Ltd*

A company appealed against a 5% surcharge of £2,445. It pleaded reasonable excuse, disproportionality, and a reduction in rate for an earlier period being covered by Time To Pay. The appellant had previously defaulted on VAT payments in period 07/11, when a VAT surcharge liability notice was issued, and again in periods 01/12, 04/12 and 07/12. The penalties for periods 01/12 and 07/12 were subsequently removed as HMRC agreed that a time to pay arrangement had been agreed with the Appellant. The default under appeal was therefore a third default.

The Tribunal could not accept disproportionality, and did not see any reasonable excuse. Although the company argued that it was in financial difficulties, it clearly had sufficient funds to pay the VAT, as it was only two days late in doing so. However, the Tribunal accepted that it had a reasonable belief that a TTP arrangement had been in place in 07/11, the period recorded by HMRC as the first default. No evidence other than the employee's word is given for this, but it succeeded in reducing the rate of surcharge from 5% to 2%.

First Tier Tribunal (TC03331): *S E George and another t/a Abraxas Cookshop LLP*

A 77-year old trader persuaded the Tribunal that his forgetfulness was, in the circumstances, a reasonable excuse. He was under a genuine misapprehension that the end of his return period was September when it was in fact August; as soon as he realised his mistake, he filed the return and made the payment immediately, both 3 days late. The Tribunal noted that he had taken steps to make sure that the mistake did not recur, and allowed his appeal.

First Tier Tribunal (TC03365): *Award Framers International Ltd*

6.8.2 Default surcharge – unsuccessful appeals

A company appealed against a 10% surcharge of £234. The grounds of appeal were insufficiency of funds due to late payment by a client; payment was 3 days late. Had more information been given about the late receipt, the Tribunal might have been able to consider it; however, in the absence of details, it could not be a reasonable excuse.

First-Tier Tribunal (TC03153): *Veronalder Holdings Ltd*

A company appealed against a surcharge of £873. The return was 3 days late and the payment 8 days late. The company pleaded that the person responsible for filing returns had been on holiday abroad and had had his flight home cancelled, so he arrived back in the UK later than expected. However, he arrived home on 2 April; his failure to file on time was rather more related to a misunderstanding that he had 12 days to file the return (hence the filing on 10 April). This misunderstanding could not be a reasonable excuse.

First-Tier Tribunal (TC03155): *Omni Jewellers Ltd*

A company appealed against a 15% surcharge of £1,246. The return was filed on time, but the payment arrived 3 days late, on 10 January 2013. The excuses offered were "administrative error" and "departure of a partner who used to do the book-keeping" (the Tribunal was not sure if this was a business partner or not). Neither of these were considered to be reasonable excuses: the company was in the surcharge regime, and ought to have been well aware of the due dates for payment.

First-Tier Tribunal (TC03156): *People With Passion Ltd*

A company incurred a 10% surcharge of £2,678 for paying a VAT liability one day late. It pleaded insufficiency of funds and disproportionality. The Tribunal had to reject the second; it considered the *Steptoe* argument, but concluded that the fact the company paid its liability one day late suggested that it could have paid on time, if the company had exercised better foresight and management of resources. The appeal was dismissed.

First-Tier Tribunal (TC03162): *Taylors Mortgage Services Ltd t/a Taylors Property Services*

A company appealed against a surcharge of £586. It entered the surcharge regime when it settled the VAT for three successive quarters very late, but the first only incurred a liability notice, and the others failed to reach the £400 level at which 2% and 5% surcharges are collected. It was then liable for a surcharge at 10% and two at 15%, before submitting two returns and making the related payments on time; then it was late again; then on time; then late again, which incurred the surcharge that was the subject of the appeal.

The grounds for appeal appeared to constitute no more than insufficiency of funds, with no particular special circumstances. The appeal was dismissed.

First-Tier Tribunal (TC03178): *Wilmslow Audio Ltd*

A company had been in the surcharge regime since June 2006 and had never paid any of the surcharges, which by the time of its appeal amounted to £18,869. The director claimed that she had never been informed of the amount outstanding, and if HMRC had given her better information she could have managed the debt better. The Tribunal examined the history of her payments, Time To Pay arrangements and various defaults, and concluded that she had no reasonable excuse. Some of her cash flow difficulties arose from accepting partial payments from her clients if they could not afford to pay; unfortunately for her, it was not possible for the tax collection system to be run on the same altruistic basis.

First Tier Tribunal (TC03224): *Access Employment Law Ltd*

A company argued that it had cash flow difficulties at least partly because HMRC had failed to repay a Construction Industry Scheme income tax refund. It should be entitled to offset the CIS credit against the VAT liability, which it had paid as soon as HMRC made the repayment.

The Tribunal accepted that the cash flow problem was partly due to the CIS repayment not being made, but did not regard this as a reasonable excuse. There was no evidence that it had applied for the repayment promptly; a prudent taxpayer would have contacted HMRC to explain the

problem before the due date for the VAT, which ought to have led to a quicker repayment or to an agreement of Time To Pay. The appeal against the surcharge was dismissed.

First Tier Tribunal (TC03231): *French Polish Ltd*

A company appealed against surcharges for 6 successive periods totalling over £28,000. The appeal was based on disproportionality and an assertion that some of the liability notices had not been received. The first had to be rejected following *Total Technology*; in respect of the second, there was no evidence put before the Tribunal on which the Tribunal could find that the notices had not been received. There was only a witness statement from a director which said that the company 'had no record of receiving' notices for some (but not all) of the periods in question. The judge commented that this was a different point, and did not support the assertion that the company needed to make.

First Tier Tribunal (TC03241): *Frontier Environmental Ltd*

A company pleaded insufficiency of funds arising from a client not paying on time. The Tribunal does not give details of this argument, but comments that it accepted HMRC's argument that '*a prudent tax payer would have had contingencies in place to deal with a client in distress and potentially going into receivership*.' There was no Time To Pay agreement in place, and no reasonable excuse to cancel the penalty.

First Tier Tribunal (TC03261): *Munro Ventures Ltd*

A company experienced some difficulties with online filing, apparently having to ask for recovery of its password in three successive quarters. It had also suffered some bad debts, although no specific evidence of these was presented to the Tribunal. There was nothing that amounted to a reasonable excuse for late payment.

First Tier Tribunal (TC03262): *Mile End Joinery Ltd*

A trader claimed not to have received any of nine letters notifying surcharge liability and surcharges. It had not moved, and HMRC had not received any returned mail. A transcript of a conversation which took place between a director and HMRC after the date of the third of the disputed letters was consistent with the director being aware that the company was in the surcharge regime. The directors stated that there were no other problems with post being lost or misdirected. The Tribunal concluded that the letters had been received, and the defence was 'misconceived'.

First Tier Tribunal (TC03265): *Skipton Windows Ltd*

A trader suffered a surcharge of £303 at 10% after paying electronically on the due date at 7pm. He protested that this was what he always did, and he could not understand why he had been charged a penalty. It seems likely that he had failed to notice SLNs arriving, and this was the first late payment that had triggered a payable penalty (as amounts below £400 at 2% and 5% would not be collected). He did not have a reasonable excuse.

First Tier Tribunal (TC03266): *Tinsley Electrical Ltd*

A trader claimed that HMRC had the wrong address on file, and the surcharge liability notice had never been received. As it was a Non-Established Taxable Person, notices were sent to the NETPU in Aberdeen and forwarded to the principal place of business in Vienna.

The company had received and acknowledged a SLN in respect of the period for which the surcharge had been raised. The Tribunal saw no reason to suppose that the SLN for the earlier period had not been delivered in the same way, as there had never been a change of address. The appeal was dismissed.

First Tier Tribunal (TC03278): *Klampfl Kreativ*

A company within the payments on account regime made all its payments for the quarter to June 2011 on 18 July. This was due to internal miscommunications within the company. The surcharge based on the late payments on account was £38,000.

The company pleaded 'disproportionality' and 'innocent employee error', which could not succeed. It also argued that HMRC should have sent a surcharge notice following the first late payment on account, which would have prevented it missing the second payment.

The Tribunal agreed with HMRC that the requirement to send a surcharge liability notice relates to the period as a whole, not to individual payments on account. The company had been sent a SLN in respect of the December 2010 period which made it clear that it would be within the regime until December 2011.

The company complained that the UK's rules are much harsher than those in force in the Netherlands. The Tribunal commented that the surcharge regime is one which the Upper Tribunal considered was within a wide range of possible arrangements for member states, so this was not relevant.

First Tier Tribunal (TC03281): *Tom Tom Sales BV (UK Branch)*

A company pleaded cash flow difficulties and the absence of a staff member on maternity leave. The Tribunal considered that the first was ruled out by statute, and the second could not be an unexpected or unforeseeable event to which the taxpayer could not respond.

First Tier Tribunal (TC03282): *Orange Blossom Beauty Ltd (in liquidation)*

Another trader failed to convince the Tribunal that general cash flow difficulties could be an excuse. A previous Time To Pay agreement had been cancelled because the trader had failed to meet the conditions. A penalty of £226 at 15% was confirmed.

First Tier Tribunal (TC03283): *D E Cooke t/a Unique Paint & Powder*

A trader appealed against three surcharges, but did not give any details of the reasons for the 'unexpected shortage of funds' in correspondence and did not attend the hearing. The appeal was dismissed.

First Tier Tribunal (TC03284): *Michael Alexander and Company*

A company missed the CHAPS deadline by 70 minutes on 5 April 2012, and as a result was a day late in paying its liability (because of the Easter holiday). Nothing in the written submissions could count as a reasonable

excuse, and the director failed to attend the hearing. The appeal was dismissed. The director asked in correspondence 'is the charge the same whether the delay is 1 day or 100?' – to which the Tribunal gave the answer 'yes'.

First Tier Tribunal (TC03286): *Hair Development Ltd*

A company was two days late paying for a period for which the return had been filed on time. The Financial Controller was on holiday and the company was in the middle of migrating its Sage accounting system onto a new version. The Tribunal did not accept that any of these circumstances constituted a reasonable excuse.

First Tier Tribunal (TC03292): *Rhinowash Ltd*

A company claimed that it had "no knowledge of the previous default" when it was issued with a surcharge at 2% for a period when it admitted it was late paying. The Tribunal only considered (and dismissed) the defence of reasonable excuse, without examining whether a surcharge liability notice had been issued to the appellant.

First Tier Tribunal (TC03293): *Inveroak Ltd*

A trader argued that a 10% surcharge was incurred due to an "oversight" by a member of staff, and that extra charges could put the company out of business. The Tribunal accepted HMRC's argument that a trader on a 10% surcharge rate should be well aware of the consequences of defaults. As the surcharge was £650, it is possible that the previous 5% surcharge was below the £400 threshold and this was the first occasion that the company became properly aware of the consequences.

First Tier Tribunal (TC03330): *Promotional Paper Works UK Ltd*

A company had long-standing cash-flow problems. HMRC had agreed TTP for every return for a 2-year period, but then started to refuse: such arrangements were designed only to be a short term remedy and could not be relied upon as an alternative to the company making adequate payment arrangements. The company was therefore late for the next two quarters, and appealed, mainly arguing unfairness and financial hardship, including bad debts. The only possible relevant factor was the bad debts, but the Tribunal noted that the losses were no more than 1% of the company's turnover, so they could not be material to the ability to pay its VAT liability. The appeal was dismissed.

First Tier Tribunal (TC03335): *Euro Architectural Hardware Ltd*

A trader claimed that the penalty was unfair when it had always initiated BACS payments on the due dates. The Tribunal concluded that there was plenty of information available to traders to warn them that BACS transfers take several days. The appeal was dismissed.

First Tier Tribunal (TC03367): *Cygnet Electronics Ltd*

A trader claimed that he had agreed TTP before the due date for a period in which he was subjected to a 15% surcharge. HMRC's records showed that TTP had in fact been refused because of failure to comply with earlier agreements. The trader had been explicitly warned that a surcharge would probably follow. The trader had also alluded to medical problems, but had produced no evidence of these, so they could not be taken into account. The appeal was dismissed.

First Tier Tribunal (TC03368): *Michael Sheridan t/a Longs*

A trader claimed trading difficulties and a slow paying main customer as reasonable excuses for late payment. As the company had fallen behind with an earlier TTP agreement, the book-keeper had not thought it worthwhile asking for a new one. The Tribunal considered the facts and decided that the difficulties were not so out of the ordinary that *Steptoe* applied. The appeal was dismissed.

First Tier Tribunal (TC03371): *Blue Whale Logistics Ltd*

A trader claimed that her online payment of VAT had been rejected by her bank because other debits had been processed before the online transfer, leaving insufficient funds, and her bank manager was on annual leave on the day in question and was therefore unable to authorise the payment – as he would have done had he been present. If the payment had been made by cheque, the bank would have cleared it, as the excess was within acceptable limits, but these did not apply to online payments; also the trader had a linked account with sufficient money to cover the payment.

The Tribunal held that this constituted "insufficiency of funds", and could not be a reasonable excuse. A prudent trader would have realised that the payment would take the account close to the overdraft limit, and would have made arrangements to transfer funds in order to cover it.

First Tier Tribunal (TC03373): *Key Systems EC2 Ltd*

A trader pleaded "trading difficulties", but the Tribunal could find nothing unusual about the circumstances that would make *Steptoe* apply. The appeal against a 5% surcharge of £600 was dismissed.

First Tier Tribunal (TC03377): *Malcolm Abram Brandwood*

A company was in default for periods 09/10, 03/11 and 03/12. It appears to have accepted a 2% surcharge for 03/11, but appealed against a 5% surcharge for 03/12 amounting to £5,320. The payment was initiated on Thursday 3 May, but Monday 7 May was a bank holiday, and the BACS transfer did not arrive until the following day. The Tribunal found that the company was given sufficient notice that the payment should arrive before the weekend, and therefore did not have a reasonable excuse.

First Tier Tribunal (TC03383): *Intramed Ltd t/a Fortuna Healthcare*

A trader did not attend the hearing, but set out full grounds of appeal in writing: her parents had been ill, and she had tried to contact HMRC several times but the line had been engaged. The Tribunal accepted HMRC's arguments that the parents' illness had clearly not prevented the timely filing of the return, so it did not appear to constitute a valid reason for not paying the liability; HMRC's phone records showed that the trader had rung about bad debts and reductions in trade, but no TTP agreement had been put in place; and the date given for the unsuccessful attempts at

contact was after the due date for the tax. The appeal was dismissed, with sympathy expressed about the circumstances.

First Tier Tribunal (TC03389): *Distinct Flooring Ltd*

A trader paid a liability of nearly £90,000 in a series of bank transfers on successive days, all of which arrived after the deadline. The reason was that its bank imposed a daily limit on BACS payments of £20,000. Had the company realised that a surcharge would ensue, it would have made a single payment by CHAPS; the director claimed that he had phoned HMRC and explained the proposed course of action, and had not been told that there would be a penalty. HMRC had no record of this call, but did have a record of a call after the due date in which the director explained what was happening and made no reference to having made an earlier call.

The Tribunal held that even if the call had been made before the due date, it did not constitute a reasonable excuse. A diligent taxpayer would not have inferred from silence that late payment was acceptable. The appeal was dismissed.

First Tier Tribunal (TC03391): *Mobile Cellular Solutions Ltd*

A trader appeared to be confused by a balance on its VAT account that arose because HMRC had imposed a surcharge for the previous period. Following a conversation with someone in debt management, the trader believed that this was a credit balance, and deducted it from the amount paid for the next return. As a result, it suffered a further surcharge. HMRC agreed to halve the rate for this surcharge (it is not clear under what legal provision this was done, as it appears to be mitigation of an unmitigable penalty), but the FTT was satisfied that there was nothing that could constitute a reasonable excuse. The test of "shortage of funds" imposed by *Steptoe* was a strict one, and did not apply here.

First Tier Tribunal (TC03401): *Temps Ltd*

A trader asked for a statement of case in preparation for making an appeal to the Upper Tribunal after failing to persuade the FTT that it had a reasonable belief that the VAT return had been submitted on time. The written decision states that no evidence was presented by the company to support its assertion that the belief was reasonable; it had been submitting online returns long enough to know that an acknowledgement of successful submission should be received, and had been in the surcharge regime long enough to know that it needed to take extra care. The FTT could not find any form of excuse.

First Tier Tribunal (TC03402): *George Gallagher Metals Ltd*

A trader claimed that "IT problems" had contributed to its defaults, but did not offer any further explanations. Correspondence with HMRC referred to "trading difficulties", which could not be a reasonable excuse without far more detail. Its appeal against a penalty of £9,437 was dismissed.

First Tier Tribunal (TC03405): *Complete Cladding Systems Ltd*

A company was one day late submitting its return, with the result that HMRC applied for the direct debit one day late and imposed a surcharge. At a preliminary hearing, a FTT judge asked for more information about

the operation of the DD system – was it possible for HMRC to accelerate the application so that the payment would have been received on time? In *The Staircase Company Ltd* (TC02867), the FTT decided (in the absence of any further information about the DD system) that HMRC had the information in time to collect the tax on the due date, so the failure was within their control rather than the taxpayer's.

In the current case, HMRC presented evidence that a DD could only follow 3 days after submission of the return. The trader could have made an accelerated payment, but HMRC could not have initiated this – it had to be done by the trader. The FTT was satisfied that the trader should have known of the consequences of late payment, and ought to have taken steps to prevent it. The appeal was dismissed.

First Tier Tribunal (TC03406): *Gillens Ltd*

A trader defaulted 11 times, including two occasions when Time To Pay was requested after the due date had already been missed. Its grounds of appeal only amounted to general trading difficulties; there was no reasonable excuse.

First Tier Tribunal (TC03407): *Spatial Design & Architecture Ltd*

A trader pleaded financial difficulties, software problems, issues with the bank refusing direct debits, and the maternity leave of its finance director. HMRC gave a long list of reasons for rejecting each of these excuses, and the Tribunal agreed – the appeal was dismissed.

First Tier Tribunal (TC03415): *M.A.T. Electrics Ltd*

6.8.3 Late registration

In November 2012, a computer consultant notified HMRC that he had exceeded the registration threshold in the 12 months to 31 May 2012. It subsequently came to light that he had exceeded the threshold in the 12 months to 31 May 2011, and should have been registered from 1 July 2011. The turnover disclosed in the first long period of 19 months was £247,000: as HMRC said, it was not a case where the threshold had been marginally exceeded.

The taxpayer's appeal against a late notification penalty of £3,050 (at 10%, the minimum where the delay is over 12 months) was mainly based on the complexity of the rules and the fact that he had made no deliberate attempt to conceal anything. As disproportionality could not be a defence, and these grounds did not constitute a reasonable excuse, the penalty was confirmed.

First Tier Tribunal (TC03225): *Simon Steward*

6.8.4 Sales list penalty

HMRC wrote to a trader on 13 January 2012, requiring submission of an EC Sales List for the period to September 2011. If it was not received by 31 January, a penalty would be levied at £5 per day until it was received. On 26 February 2013, HMRC wrote and notified the trader of the issue of penalties for the failure to submit ECSLs by the due dates for the periods 06/12 and 09/12. The penalty notice for 12/12 was issued on 6 November 2013. The penalties were for 100 days at £5, 86 at £10 and 44 at £15.

The Tribunal had some sympathy for a small trader whose profits were only £10,000 – the total penalty was 14% of this. However, the grounds of appeal were essentially based on the harshness of the penalty and the fact that HMRC had not lost any revenue from the late submission. These could not be reasonable excuses, and the appeal was dismissed.

First Tier Tribunal (TC03404): *Samantha Holmes*

A trader failed to submit an EC Sales List for the period to 30 September 2012. A penalty liability notice had been issued after the trader was late submitting the ECSL for November 2011. A notice levying a £500 penalty was issued for September 2012 on 22 May 2013: that is, £5 x 100 days (the maximum) for lateness running from 22 October 2012 to 29 January 2013. The trader submitted the missing ECSL shortly afterwards, but the penalty was not withdrawn.

The trader protested that HMRC should have acted more quickly, rather than waiting for the full 100 days to maximise the penalty. The value of the exports on the return (two items) was less than the fine. The FTT could not accept either of these as a reasonable excuse; it noted that the trader had been filing ECSLs for many years, and the warning about penalties on the PLN (that they would be issued without further warning) was clear enough.

However, the fact that HMRC had not issued the penalty until well after the due date for any ECSL that might be due for the next return period (January 2013) struck the FTT as potentially unfair. The purpose of the penalty regime was to deter lateness, not to raise money; as the issue of the penalty had prompted the trader to file the late ECSL very quickly, it clearly worked, but could not operate unless the trader was told that a penalty was due. Although no such penalty for the next period was under appeal, the judge suggested that if one was levied, the trader might complain to the Parliamentary Ombudsman or the Adjudicator.

First Tier Tribunal (TC03417): *Rayknight Enterprises Ltd*

6.8.5 Costs

A trader lost a MTIC appeal in the FTT, and applied for leave to appeal. This was refused, so it applied directly to the UT for leave. This was refused once on paper, and then again at an oral hearing. HMRC applied for their costs of attending the oral hearing. Judge Bishopp refused this application, holding that HMRC had not demonstrated that it was reasonable for them to have incurred the costs of attending the hearing. Costs would be awarded if leave was given and the appeal was unsuccessful – that was a risk that the appellant took. To impose the risk of an award of costs in relation to applying for leave seemed to impose too severe a potential penalty. An award would only be appropriate in cases of deceit or a partial account of the evidence, which the judge was satisfied had not occurred here.

Upper Tribunal: *Softhouse Consulting Ltd v HMRC*

An individual appealed against some assessments in May 2012. In December 2012 he supplied a Statement of Case in support of his appeal. On 15 February 2013, HMRC agreed to withdraw their assessments and settle the appeal by agreement. He applied for costs.

The judge concluded that HMRC had not acted unreasonably overall in conducting the case, because they did not have the information that led to their withdrawal before December, and they needed time to consider it; however, they should have considered it more quickly, and therefore there was unreasonableness from 1 February to 15 February. Costs of £150 were awarded.

The judge also gave the following warning:

If it could be shown that an appellant was in possession of information or evidence that would have persuaded HMRC to withdraw its defence of an appeal, but for whatever reason that appellant withheld that information or evidence and as a result put HMRC to the unnecessary effort and expense of continuing with the appeal until a much later date, HMRC may well have a claim for their own costs in respect of the appellant's unreasonable conduct in doing so, even though the appeal itself is successful as a result of their withdrawal upon the eventual production of that information or evidence. In such circumstances, a wasted costs order might also be made against an adviser personally.'

First Tier Tribunal (TC03219): *PK Lam*

A golf club was in dispute with HMRC over the attribution of input tax incurred on expenditure on the clubhouse. When the dispute came to a hearing before the FTT, the judge observed that he had no jurisdiction to hear the appeal: it was in effect a dispute about hypothetical issues – future supplies – rather than real issues, and it did not fall within s.83 VATA 1994. The principle of the 1992 case of *Odhams Leisure Group Ltd* meant that the appeal had to be struck out. This precedent was raised by the FTT judge at the hearing; he had had it cited to him in another recent case in which he was sitting.

The club applied for costs, arguing that HMRC had stated repeatedly that its decisions were subject to appeal, and had proceeded to a hearing knowing that the club's case was hopeless. The FTT judge rejected this argument, and the Upper Tribunal has now confirmed the decision. Both judges accepted that HMRC were not unreasonable in pursuing and defending the action; their legal representatives were not aware of the *Odhams* decision before the hearing in August 2012, and had certainly not deliberately withheld that judgment from the appellant. The club had been professionally represented, and should have been informed of the FTT's jurisdiction by its own advisers.

Upper Tribunal: *Bedale Golf Club Ltd v HMRC*

6.8.6 Appeals and time limits

In December 2010, an import agent received a Post Clearance Demand Note in respect of some goods imported for a customer. The goods had been imported between 2007 and 2010; on investigation, HMRC had concluded that the wrong commodity code had been used, and the volumes were understated. Extra VAT of £22,866 was due.

The agent argued that the VAT should be collected from its customer. This argument continued until February 2013, when the company requested a formal review. HMRC ruled that this related to a decision that had been made in December 2010, and it was out of time. The company applied to the Tribunal for leave to appeal against the earlier

decision out of time, arguing that it had not been clear that HMRC had made a decision until early 2013.

The Tribunal agreed with the company: the letter from HMRC dated 18 April 2013, stating that no review would be carried out, gave the company 30 days to appeal against the refusal of a review, and the company had appealed to the Tribunal within 30 days of that letter. It was anomalous that the company appeared to be able to obtain another 30 days to appeal, without time limit, by making an out-of-time application for a review; but that appeared to be the effect of s.15E and s.16(1D) FA 1994.

If the Tribunal was wrong about that, it would exercise its discretion to allow the appeal to proceed outside the normal time limit, because the company had an arguable case based on material matters of fact which it should be given the opportunity to prove. The HMRC officer's correspondence during the period of the dispute could be interpreted as regarding the matter as not yet finalised, which was a possible excuse for making the appeal out of time. Although HMRC argued that the appeal had no real prospect of success and should therefore be struck out, the Tribunal considered that it should be allowed to proceed.

First Tier Tribunal (TC03246): *Scanwell Freight Services Ltd*

In TC03104, the FTT decided that a capital contribution received by a developer in respect of the use of communal fixtures in retirement homes was zero-rated rather than exempt, and therefore gave rise to entitlement to input tax recovery. The context was a *Fleming* claim going back to 1980, amounting to £2.8m.

HMRC asked for leave to appeal to the Upper Tribunal in respect of periods after 1 April 1989, when certain amendments to the legislation made by FA 1989 came into force. The FTT gave permission for the appeal on 4 April, but HMRC did not provide a notice to the Upper Tribunal until 1 July 2013, 56 days after the 30 day time limit (which started on 6 April because 4 April was a Saturday).

HMRC therefore had to apply to the UT for permission to make the appeal out of time. The company opposed that application. It had regularly checked with the UT whether an appeal had been lodged, and by 19 June it had concluded that it could adjust its accounts and notify key shareholders and lenders that the repayment would be paid. The repayment was a material asset in the accounts of the company.

The reason for the delay appeared to be that the two officers who were dealing with the case were not available: one had left the HMRC solicitors' office, and the other was on long-term sick leave. The covering officers had to work through a backlog of 1,500 e-mails and did not notice the permission to appeal. The case was revived when a manager noted that no response appeared to have been received to the request for permission to appeal; on checking with the FTT on 28 June, HMRC obtained a copy of the permission sent earlier. On 1 July, the company contacted HMRC to ask for repayment as soon as possible; this appears to have crossed with HMRC sending notice of the appeal to the UT.

The UT considered the Civil Procedure Rules rule 3.9, which changed on 1 April 2013, and the recent case of *Andrew Mitchell MP v News Group Newspapers Ltd*. The Court of Appeal's judgment is quoted at length, with the following extract appearing particularly relevant:

If the non-compliance cannot be characterised as trivial, then the burden is on the defaulting party to persuade the court to grant relief. The court will want to consider why the default occurred. If there is a good reason for it, the court will be likely to decide that relief should be granted. For example, if the reason why a document was not filed with the court was that the party or his solicitor suffered from a debilitating illness or was involved in an accident, then, depending on the circumstances, that may constitute a good reason. Later developments in the course of the litigation process are likely to be a good reason if they show that the period for compliance originally imposed was unreasonable, although the period seemed to be reasonable at the time and could not realistically have been the subject of an appeal. But mere overlooking a deadline, whether on account of overwork or otherwise, is unlikely to be a good reason.

Of the various factors which should be taken into account in deciding whether to grant relief, the two which appeared most relevant were 'Whether there is a good explanation for the failure' and 'The effect which the failure to comply had on each party'. HMRC had no good reason for failing to manage the appeals process efficiently; the effect on the company of reopening the case, when it had been reasonable to suppose that it was closed, would be significant.

HMRC's application was refused.

Upper Tribunal: *HMRC v McCarthy & Stone (Developments) Ltd and related appeal*

A farmer was registered under the Agricultural Flat Rate Scheme. HMRC ruled that it had to leave the scheme on 6 July 2011, after enquiries (to determine whether its savings under the scheme exceeded the statutory limit) went unanswered. The company appealed against this decision on 2 December 2011. The Tribunal issued directions in July 2012 and set a hearing date for February 2013. The appellant, which had not sought any legal or accountancy advice, failed to respond. The Tribunal struck the appeal out on 10 June 2013.

The appeal had been combined with a similar case in which agents had been appointed (by another company with the same director). It appeared that correspondence was sent to the agents, but they had not been appointed by the first company. The director sent a letter to HMRC dated 29 May 2013 saying that he had only just received an 'unless order' from the Tribunal dated 10 May, and he could therefore not comply with its terms.

The Tribunal were not convinced by this assertion, but it was the only evidence available concerning the serving of the unless order. HMRC did not produce any evidence on that question at all. The Tribunal therefore decided that the previous strike-out should be set aside, and the appeal should be allowed to proceed; however, a number of directions were issued to establish a strict timetable. If the appellant did not comply, the appeal would be struck out again, or the evidence on which the appellant sought to rely might not be admissible.

First Tier Tribunal (TC03187): *Blackburn Bros Cattle Company Ltd*

A golf club appealed against a ruling that it made taxable supplies. An initial hearing in February 2013 held that the club was not a non-profit making body, and was therefore not eligible for exemption. The club had applied in November 2012 to amend its grounds of appeal to add an argument that the 1999 Sports Order was inconsistent with the European legal principle of legal treatment, in that it imposed extra conditions on sporting bodies over and above the basic requirement to be non-profit. This additional ground was not considered at the first hearing, and HMRC now opposed its addition to the matters to be considered by the Tribunal.

The judge considered representations about the delay in adding the ground of appeal, and also about the likelihood of it making any difference. On both grounds, the application to add it should be refused. There was no good reason for the delay; and the *Bridport* decision, now available, confirmed that the principle of equal treatment was overridden by the clear words of the Directive. As the first Tribunal had decided that the club was not a non-profit body, it did not qualify for exemption.

First Tier Tribunal (TC03270): *North Weald Golf Club*

A complex series of *Rank*-based claims was considered in a case about appeals out of time. The Tribunal decided that the mixed messages coming from HMRC, particularly in the spring of 2009 following the *Fleming* deadline, gave the appellants and their representatives reasonable grounds to believe that HMRC were approaching the matter on a pragmatic rather than a legalistic basis – it was not necessary to make a formal appeal, because a request had been made to stand the cases over behind *Rank*. The appellant and the representatives had been diligent in making and pursuing their claims, only missing out the detail of the requirement to make a formal appeal each time HMRC sent a decision refusing the claim. In the circumstances, it was fair to allow these appeals to be made out of time.

First Tier Tribunal (TC03349): *Peter Arnett Leisure*

An individual's appeal against a VAT ruling was struck out on the grounds that the Tribunal saw no prospect of the appeal succeeding. He asked for leave to appeal against that decision; but when he came to do so, he realised that before doing so, he should have applied for a full statement of written findings and reasons in respect of the decision to be appealed against. An appellant has 56 days to appeal, but only 28 days to ask for the detailed findings against which to appeal.

He applied for leave to apply late for the written findings. The Tribunal dismissed this, holding that his reasons for failing to notice the shorter time limit were not acceptable. In addition, there was no prospect that his application would be allowed: *The grounds for his application for permission to appeal ... are that "compliance with tax regulations involves a considerable amount of work" and amounts to unpaid labour which breaches the Appellant's rights under Article 4 of the European Convention of Human Rights. The Appellant also takes exception to the word "mere" in paragraph 6 of the decision (the sentence in question reads "The mere fact that an activity may be beneficial to its participants (or more generally), is not sufficient for it to be exempt from VAT"). The Appellant objects to the implication that exemption from VAT has no relation to the worthiness of the cause or the value of an activity.*

The judge suggested that he should write to his MP if he did not like the law; he would not succeed in appealing against its clear operation in a Tribunal which had to uphold it.

First Tier Tribunal (TC03334): *Michael Basman t/a UK Chess Challenge*

Four related appellants had *Rank* claims refused for being appealed out of time, and appealed further to the Upper Tribunal against the FTT's refusal to allow the substantive hearings to proceed. The UT considered all the complaints made against the FTT's decision, and concluded that "*it has not been shown that, in the exercise of its discretion, the FTT took into account the irrelevant, failed to take into account the relevant, acted irrationally, perversely or unreasonably or in a disproportionate manner. It applied the correct test and there was no procedural impropriety. No question of infringing the appellants' legitimate expectations arises. Accordingly, we have not been persuaded the FTT erred on a point of law, and the appeal must be dismissed.*"

Upper Tribunal: *Graham (J&E) t/a Xs and Os Amusements and related appeals v HMRC*

6.8.7 Procedure

HMRC opened an enquiry into a trader's affairs. The issued estimated assessments for income tax, Class 4 NIC and VAT, and imposed penalties. In the course of correspondence, HMRC offered to settle appeals against the assessments on the basis of an estimated gross profit rate of 63%. The accountants accepted this, but asked for a further reduction of penalties.

Later the accountants wrote again to HMRC, asking for the appeals to be reinstated. HMRC refused, saying that the appeals had been settled by agreement. This decision was reviewed by the Tribunal, which held that the substantive assessments had indeed been settled and could not be reopened; however, there had been no agreement of the amount of the penalties, so the trader was still entitled to continue an appeal against them. However, he would only be able to argue about the overall validity of the penalties and the rate applicable – he could not reopen any dispute about the base figure of tax shortfall on which the penalties would be based.

First Tier Tribunal (TC03309): *Filit Tuncel*

A company had two separate appeals to the FTT pending against 36 MTIC assessments for more than £35m. HMRC applied for a winding-up order on the basis that the company had failed to pay the second batch of these assessments; it subsequently appealed out of time against them, and the FTT accepted that the appeal should proceed, not being one within SI 2009/273 rule 8(3)(c) ("the Tribunal considers there is no reasonable prospect of the appellant's case, or part of it, succeeding").

The High Court refused HMRC's petition for winding-up, noting that the winding-up jurisdiction was not to be used to resolve genuine and real disputes as to the existence of a debt. Accordingly, a petition should be dismissed as an abuse of process and its advertisement restrained by injunction if the debt relied upon by the petitioner was bona fide disputed on substantial grounds. Given that the FTT had not exercised its power to strike out the appeal as hopeless, the court should be cautious and treat the

assessments as "disputed on substantial grounds" until the FTT gave its decision.

High Court: *Enta Technologies Ltd v HMRC*

An appellant in a MTIC case applied for an extension of time to serve witness statements, and a direction that the cost of preparing bundles should be shared between it and HMRC instead of falling entirely on the appellant. The Tribunal granted the application to admit the witness statements but declined to make an order about costs.

First Tier Tribunal (TC03411): *London Cellular Communications Ltd*

6.8.8 Review statistics

HMRC have published a report containing information about internal reviews of tax decisions and appeals against decisions for the period 1 April 2012 to 31 March 2013.

Taxpayers asked for reviews of 38,975 decisions in 2012/13. HMRC completed 39,156 reviews, which includes the clearance of some cases from previous years. The number of review requests fell from 55,764 in 2011/12.

There were fewer requests for reviews of VAT default surcharges, down from 30,345 in 2011/12 to 20,046 in 2012/13. Fewer VAT default surcharges were issued in 2012/13: apparently compliance has improved.

Default surcharge cases made up the majority of cases which HMRC reviewed: just over half of completed reviews related to default surcharges, and a third to other types of penalties. Reviews of other types of HMRC decisions, such as assessments, made up the remaining 15%. Most of the reviews of penalties covered late filing and late payment. Many of those penalties were issued automatically when a return or payment was not received on time.

In reviews of non-penalty decisions, and of penalties in regimes other than VAT, HMRC upheld about two thirds of the original decisions (68% and 64% respectively). In 2011/12, the comparable figures were 68% and 74%. Four out of ten (43%) of VAT penalty decisions were upheld when HMRC reviewed them. In 2012/13 HMRC cancelled around 9,650 Default Surcharges, 48% of the total disputed, after conducting a review. The number of decisions cancelled on review represented a small proportion, less than 2%, of the total number of surcharges issued.

Fewer HMRC VAT penalty decisions were being upheld compared with other penalty decisions. This is because taxpayers can ask for reconsideration of other penalty decisions, such as self-assessment late filing and late payment, before a formal review. However, for VAT penalty decisions, taxpayers have to ask HMRC for a formal review as a first step.

Taxpayers made 7,560 appeals to the Tribunal in 2012/13. 4,564 cases were closed, either by a formal hearing, or by settlement before the hearing.

Just under a third (31%) of appeals was decided at a hearing, the rest being settled by agreement beforehand. In 2012/13, three quarters (76%)

of FTT decisions were in HMRC's favour, compared with 61% in 2011/12.

The majority of taxpayers were not represented by a tax agent at either the review stage or on appeal. As in 2011/12, only 15% employed an agent to help with a review, and 32% for an appeal. HMRC considers that it is an important feature of the review and appeal system that it should be accessible to unrepresented taxpayers. This helps to ensure that resolving a dispute with HMRC, and appealing to the Tribunal, need not be an expensive process for taxpayers.

www.gov.uk/government/uploads/system/uploads/attachment_data/file/267713/131202_Reviews_and_Appeals_Statistics_2012-13.pdf

6.9 Other administration issues

6.9.1 Withdrawal of extra-statutory concessions

HMRC have issued a technical note and call for evidence in respect of the potential impact of withdrawing 13 ESCs as part of the general review of concessions following the House of Lords decision in the *Wilkinson* case. The latest list includes five relating to VAT:

Construction of New Student Residential Accommodation – the current concessionary arrangement which allows Higher Education Institutions (HEIs) to ignore vacation use when determining whether new student accommodation is intended to be used solely for a relevant residential purpose will be withdrawn with effect from 1 April 2015.

New Student Dining Halls – the current concessionary arrangement which allows dining rooms and kitchens to be zero-rated as residential accommodation for students and school pupils if they are used 'predominantly' by the living in students will be withdrawn with effect from 1 April 2015.

Reduced Value Rule for Long Stay Accommodation – breaks in stay – the current concessionary arrangement whereby hotels, inns, boarding houses and similar establishments can continue to apply the reduced value rule where a long term resident vacates the accommodation with no continuing right to the accommodation during their absence, will be withdrawn with effect from 1 April 2015.

Tour Operators Margin Scheme: Use of a fixed rate margin (10%) for shore excursions sold by cruise operators – the current concessionary treatment which allows cruise operators to use a fixed rate 10% margin to determine the VAT due on sales to cruise passengers of bought-in shore excursions will be withdrawn from 1 April 2015.

Tour Operators Margin Scheme: The Airline Charter Option – the current concessionary treatment which allows tour operators to treat certain supplies of a charter flight, which they have bought-in and sold on to a traveller, as an in-house supply of zero-rated passenger transport, will be withdrawn from 1 April 2015.

Comments are invited by 25 April 2014.

www.hmrc.gov.uk/specialist/esc-withdrawal-tech-note.pdf

6.9.2 Disclosure of Tax Avoidance Schemes

HMRC have issued updated guidance on the DOTAS scheme, which was revised from 4 November 2013 by new regulations which introduced new prescribed information, a new employment hallmark and revised confidentiality hallmark, and extended the regime to include the new Annual Tax on Enveloped Dwellings. Apart from the revised confidentiality hallmark, it seems that the changes are mainly relevant to direct taxes and to the ATED, not to VAT.

Guidance on the rules for disclosing arrangements relating to VAT can be found in VAT Notice 700/8 *Disclosure of VAT avoidance schemes*.

www.hmrc.gov.uk/aiu/guidance.htm

6.9.3 High-risk promoters

HMRC have published draft Finance Bill legislation, for comment by 24 February 2014, on the high-risk promoters regime. The purposes of the regime are stated to be:

- forcing high-risk promoters of avoidance schemes to provide details of their products to HMRC using suitable information powers and penalties;
- ensuring that users of high-risk promoters' schemes appreciate the risks they are running and understand the consequences;
- raising the standard of reasonable excuse and reasonable care for high-risk promoters and the users of their avoidance schemes;
- encouraging users of avoidance schemes to settle their tax affairs after similar cases have lost in court; and
- amending the Disclosure of Tax Avoidance Schemes (DOTAS) regime to make sure the right information gets to HMRC at the right time.

An HMRC document sets out responses to an earlier consultation on the proposals, and the government's comments on those responses.

www.gov.uk/government/consultations/raising-the-stakes-on-tax-avoidance

6.9.4 Serious Error Office

It has been reported that HMRC have fined the Serious Fraud Office for incorrectly claiming VAT on fees paid to counsel between 2009 and 2012. In February, the SFP asked the Treasury for emergency funding of £19m, partly to pay this penalty, the amount of which has not been disclosed.

Financial Times, 1 March 2014

6.9.5 Information notice

Although it is in the context of income tax rather than VAT, a recent FTT case provides an interesting discussion of HMRC's powers to require the production of documents. A doctor was subject to an enquiry into her self-assessment return. With the help of a friend who had accounting experience, she identified and disclosed an error in the return before the

meeting with HMRC; the inspector then issued a notice requiring the production of further information and documents, including the doctor's appointments diary.

The doctor protested that this contained confidential patient information. HMRC continued to require production, so the doctor appealed to the FTT. The judge decided that the diary was not "reasonably required in order to check the taxpayer's position". It contained no financial information, and could not be used to identify consideration receivable for supplies made, nor could it be reconciled to the financial accounts. The question of the confidentiality of the information, and whether this overrode any need for HMRC to see the information, did not therefore need to be considered.

First Tier Tribunal (TC03339): *Dr Kathleen Long*

6.9.6 Security requirement

On 8 November 2011, a trader in computers was issued with a notice requiring deposit of security amounting to £638,000. The notice was issued under Sch.11 para.4(2)(a) VATA 1994 – the provisions relating to MTIC fraud, rather than risk to the revenue arising from insolvency.

The company is involved in a separate appeal about £445,000 of input tax denied for the period to July 2006, and considered it unreasonable for HMRC to insist on further financial protection while this amount was withheld from the trader. It was apparent to the Tribunal that various non-payments of VAT were undertaken by the trader in a deliberate manner to maintain the underpayment at approximately £445,000 – in effect, "if they won't pay me that input tax, I won't pay them that output tax". The trader claimed that he had been given assurances that no enforcement would be taken in respect of this amount until the hearing of the appeal against the input tax denial, but HMRC denied this.

After examining the background to the issue of the notice of requirement, the Tribunal decided that the process was flawed. The officer should have appreciated that the risk was limited to £445,000; the mechanical calculation of £638,000 took into account matters that should not have been taken into account, and the appeal was therefore allowed.

The judge made it clear that he did not approve of the withholding of VAT properly due by the appellant; it would surely be possible for HMRC to return and issue a new and valid notice of requirement, but it would have to be based on other criteria.

First Tier Tribunal (TC03410): *Aria Technology Ltd*