VAT UPDATE
APRIL 2015

Covering material from January – March 2015

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VAT Update April 2015

Contents

1. INTRODUCTION ... 1
   - 1.1 Appeals pending ... 1
2. OUTPUTS ... 6
   - 2.1 Scope of VAT: linking supplies to consideration ... 6
   - 2.2 Disbursements ... 6
   - 2.3 Exemptions ... 6
   - 2.4 Zero-rating ... 15
   - 2.5 Lower rate ... 19
   - 2.6 Computational matters ... 21
   - 2.7 Discounts, rebates and gifts ... 23
   - 2.8 Compound and multiple ... 24
   - 2.9 Agency ... 24
   - 2.10 Second hand goods ... 26
   - 2.11 Charities and clubs ... 26
   - 2.12 Other supply problems ... 26
3. LAND AND PROPERTY ... 30
   - 3.1 Exemption ... 30
   - 3.2 Option to tax ... 30
   - 3.3 Developers and builders ... 31
   - 3.4 Input tax claims on land ... 33
   - 3.5 Other land problems ... 34
4. INTERNATIONAL SUPPLIES ... 35
   - 4.1 E-commerce ... 35
   - 4.2 Where is a supply of services? ... 36
   - 4.3 International supplies of goods ... 37
   - 4.4 European rules ... 39
   - 4.5 Eighth Directive reclaims ... 45
5. INPUTS ... 46
   - 5.1 Economic activity ... 46
   - 5.2 Who receives the supply? ... 47
   - 5.3 Partial exemption ... 48
   - 5.4 Cars ... 50
   - 5.5 Business entertainment ... 50
   - 5.6 Non-business use of supplies ... 53
   - 5.7 Bad debt relief ... 55
   - 5.8 Other input tax problems ... 55
6. ADMINISTRATION AND PENALTIES ... 63
   - 6.1 Group registration ... 63
   - 6.2 Other registration rules ... 64
   - 6.3 Payments and returns ... 65
   - 6.4 Repayment claims ... 66
   - 6.5 Timing issues ... 74
   - 6.6 Records ... 74
   - 6.7 Assessments ... 77
   - 6.8 Penalties and appeals ... 78
   - 6.9 Other administration issues ... 95

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 19 January 2015 after a gap since October.

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

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

1.1.1 UK appeals awaiting hearing or decision

- *Associated Newspapers Ltd*: HMRC are appealing to the UT against the FTT's interpretation of SI 1993/1507 on gifts of business services (hearing listed for 5 – 7 October 2015).
- *British Film Institute*: HMRC are seeking leave to appeal to the Court of Appeal against the UT's confirmation of the FTT's decision that the Institute was entitled to rely on the cultural services exemption in the period 1990 – 1996 in support of a *Fleming* claim.
- *Brockenhurst College*: HMRC have been granted leave to appeal to the Court of Appeal against the UT's confirmation of the FTT's decision that supplies of meals to outsiders were an essential part of the education of the students who prepared and served the meals (appeal scheduled for February 2015).
- *CCA Distribution Ltd*: HMRC have been granted leave to appeal in relation to 4 of 8 stated grounds against FTT's finding that fraud was not the only explanation of transactions in a MTIC case (hearing date set at 29 June – 1 July 2015).

- *Colaingrove Ltd*: HMRC's list includes separate entries for
  - TC02715 (removable contents/definition – UT decision in last update, HMRC's appeal allowed in part; taxpayer has been granted leave to appeal to the CA).
  - TC02701 (removable contents/apportionment – appeal stayed pending decision in TC02715, HMRC now applying for permission to appeal).
  - TC02534 (fuel – UT decision in favour of HMRC in this update).
  - TC02701 (verandas – UT decision in favour of taxpayer in this update).
- *Davis & Dann Ltd and Precis (1080) Ltd*: HMRC have received 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 (hearing listed for 5 March 2015).
- *DPAS Ltd*: HMRC have been granted 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 (hearing listed for 6/7 May 2015).
- *Finmeccanica Group Services Spa*: HMRC have been granted permission to appeal to the UT against the FTT's decision that services were not subject to UK VAT (hearing listed for 3 June 2015).
- *Iveco Ltd*: HMRC have been granted leave to appeal to the Upper Tribunal against the FTT's ruling that a claim for repayment was not subject to the cap (hearing listed for 24 – 25 November 2015).
- *Littlewoods Retail Ltd*: HMRC are appealing the decision on compound interest to the Court of Appeal – see R&C Brief 20/2014 (hearing listed for 23 March 2015).
- *Longridge on the Thames*: HMRC have been granted leave to appeal against the UT's dismissal of their HMRC appeal against the FTT's ruling that a charity was not in business and could receive building services zero-rated (appeal scheduled to proceed in the Court of Appeal between July and November 2015).
- *Mercedes-Benz Financial Services UK Ltd v HMRC*: HMRC have been granted leave to appeal to the Court of Appeal against the decision that the Agility product involved a supply of services rather than goods.
- *MG Rover Group Ltd*: HMRC have been granted leave to appeal against the FTT's decision about who is entitled to claim a refund where an overpayment was made on a group VAT return – case management decisions on this case and *Standard Chartered/Lloyds Banking Group* are in this update.
- *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 (hearing 4/5 November 2014, decision awaited).

- *Pendragon plc v HMRC*: HMRC have been granted leave to appeal to the Supreme Court 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 granted leave on 30 January 2014: hearing set for 11 – 12 March 2015.
- *The Chancellor, Masters & Scholars of the University of Cambridge*: HMRC have appealed against the FTT's decision that the costs of managing the endowment fund were residual and partially recoverable (hearing listed for 17 March 2015).
- *The Open University*: HMRC have appealed to the UT against the FTT's ruling that the OU was entitled to exemption in respect of supplies by the BBC (hearing 18 – 19 November 2014, decision awaited).
- *The "Spotting the Ball" Partnership & Others*: the taxpayers have been granted leave to appeal to the CA against the UT's overruling of the FTT decision in their favour in relation to the exemption of "spot the ball" competitions.
- *Vodafone Group Services Ltd*: HMRC have applied for leave to appeal against the FTT's decision that the trader could replace the reasons for an in-time but disputed claim with the grounds for an accepted but out-of-time claim.
- *Wakefield College*: HMRC have been granted leave to appeal against the FTT's decision (itself a finding on remittal from the UT) that the college's buildings were used for non-business purposes (hearing listed for 27 – 28 July 2015).

1.1.2 Other points from the list

The list also contains the following comments on cases which will not be appealed further:

- *DCM (Optical Holdings) Ltd*: HMRC appealed to the Upper Tribunal after the FTT accepted that a floor-area based special method could be appropriate. The latest list states that HMRC's appeal was allowed "by consent" – no further details are given.
- *South African Tourist Board v HMRC*: HMRC do not intend to appeal the UT's decision in respect of the claim for input tax in relation to supplies made for consideration to overseas businesses and the South African government.

1.1.3 Unresolved cases not on the list

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. The hearing has apparently been stood over pending the UT's decision in the *Colaingrove* (fuel) case.

- *Earthshine Ltd v HMRC*: taxpayer is applying for leave to Court of Appeal (hearing of request for leave commenced 11 March 2015) against UT's upholding of FTT's decision that it should have known of connection to MTIC fraud and was therefore not entitled to input tax credit.
- *Finance and Business Training Ltd v HMRC*: taxpayer is applying for leave to Court of Appeal (hearing of request for leave commenced 28 October 2014) 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".
- *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.
- *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 Court of Appeal (High Court applied the CJEU's judgment in Case C-591/10 in favour of the taxpayer, but HMRC have appealed).
- *Leeds City Council v HMRC*: taxpayer council's appeal to the Court of Appeal against the UT's decision that the three-year cap validly blocked a number of claims for repayment will commence in early December 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.
- *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.

1.1.4 Cases in the current update

The current update includes the latest developments in the following cases from HMRC's list:

- *Bridport & West Dorset Golf Club*: the HMRC list refers to the issue of R&C Brief 25/2014, and notes that the FTT heard applications in relation to "follower cases" on 22 January 2015. An Information Sheet about claims has been issued by HMRC and is examined in section 2.3 of this update.
- *Colaingrove Ltd* (verandas and fuel): Upper Tribunal decided in favour of the taxpayer on verandas, overturning the FTT's decision; and in favour of HMRC on fuel, overturning the FTT's decision.
- *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. The Court of Appeal has dismissed the appeal again.

- *GMAC UK plc v HMRC*: current update reports the reaffirmation of its decision in favour of the taxpayer by the Upper Tribunal on the basis of the CJEU decision (Case C-589/12). HMRC had until 2 February 2015 to seek permission to appeal to the CA.
- *Investment Trust Companies*: current update contains the decisions of the Court of Appeal on cross-appeals against the High Court's rulings about claimants with a direct cause of action against HMRC where they cannot recover overcharged output tax from the trader who made the supply to them.
- *National Exhibition Centre Ltd*: HMRC appealed to the UT against the FTT's ruling that services were exempt payment processing; UT decided to refer questions to CJEU).
- *Royal College of Paediatrics and Child Healthcare & Coleridge Ltd*: UT overturned the FTT's decision that a transfer of property constituted a VAT-free TOGC, but the assessment was out of time.

1.1.5 Other known developments on appeals

Other developments on appeals that have been reported include:

- *Airtours Holiday Transport Ltd v HMRC*: the Supreme Court has given the taxpayer leave to appeal against the UT's decision, upheld by the Court of Appeal, that it could not deduct input tax in relation to fees charged by professional advisers in relation to debt refinancing – the UT held that, in spite of the tripartite nature of the contract, the supply was made to the creditors rather than to the claimant.
- *Alpha Sim Communications Ltd (In Compulsory Liquidation) and others v Caz Distribution Services Ltd and others*: this is a civil claim for damages made by the liquidators of some companies against other companies which it is alleged were involved in carousel frauds. The High Court found in favour of the plaintiffs; an appeal to the Court of Appeal will commence on 15 October 2014.
- *HMRC v British Telecomunications plc*: Supreme Court refused the company leave to appeal against the CA decision in favour of HMRC. The CA held that the UK's application of bad debt relief had not infringed any directly enforceable EU rights.
- *Reed Employment Ltd v HMRC*: the Supreme Court has refused the taxpayer leave to appeal against the Court of Appeal's judgment that its repayment claim was barred by the defence of unjust enrichment and the three-year cap – it was not possible to argue further that the ruling that the amendment of the unjust enrichment rule in 2005 did not infringe the principle of equal treatment.
- *Shop Direct Group v HMRC*: Supreme Court has granted leave to the taxpayer to appeal against some aspects of the CA's decision that it was chargeable to corporation tax on VAT repayments and interest on VAT repayments.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

Nothing to report.

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Booking and payment fees – Upper Tribunal

The National Exhibition Centre (NEC) claimed exemption for ticket booking fees for concerts in the period 1 August 1999 to 30 April 2002. HMRC refused repayment by a decision of 27 February 2003. Separate disputed decisions were also subject to appeal in relation to different periods – a *Fleming* claim from 1976 to 1996, and separate claims for May 2002 to April 2004, May 2004 to April 2006, May 2006 to October 2007 and November 2007 to October 2009. The total VAT at issue was approximately £5m.

First-Tier Tribunal

In 2012 the FTT heard an appeal only in relation to the February 2003 decision to refuse repayment. The other appeals were stayed behind this one, as it was agreed between the parties that the principles would apply to all the other claims as well. The Tribunal noted this agreement, but did not support it, being reluctant to make a decision that would extend to periods and matters on which no evidence had been presented to it.

The NEC typically hires out its premises to promoters of events, and acts as a disclosed agent selling tickets for those promoters. It makes money in three ways:

(1) “Facility Fees” are charged by NEC to the promoter of the event for which NEC is selling the tickets on the promoter’s behalf in consideration for NEC’s agency services to the promoter.

(2) “Booking Fees” are charged to the ticket-buying public by NEC in relation to ticket sale transactions carried out over the telephone and the internet. They are set at around 10% of the price of the ticket, or higher for events where the market will bear a higher amount. The only method of payment accepted by NEC for sales by telephone or internet is credit card or debit card.

(3) “Transaction Fees” are also charged to the ticket-buying public by NEC, in addition to the Booking Fee. NEC describes this charge as follows on its website: “A transaction fee is a one-off charge per order. It covers the administration costs and overheads associated with each ticket sale.”

The dispute concerned only the booking fees in cases of credit and debit card payments. No booking fee was charged where payment was made by cheque (after 2007) or by gift voucher.

The FTT examined the background to the charging of booking and transaction fees, including the FAQs which were used to explain them to customers. Employees explained how the booking fees were set and what they covered – although they were high relative to the underlying credit card commission, the witnesses explained that they were set according to 'what the market would bear', and the level of the fees did not change what they were for. Although there were some incidental elements of other costs, they were in essence for processing credit and debit cards.

HMRC contended that the circumstances were different from those in *Bookit Ltd*, and the refusal of the claims was in line with Business Brief 18/06 which was issued following that decision. That Brief accepted that exemption would apply as long as the trader did all four of the following:

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

The HMRC officer who refused the claims appeared to rely on the fact that NEC received authorisation codes from its own merchant acquirer bank rather than the card issuers. He accepted that this was not stated in explicit terms as a requirement in the Business Brief.

HMRC put forward three arguments in support of its position:

- NEC in fact made a single supply to the promoter, retaining its fee out of amounts remitted to the promoter in respect of ticket sales, rather than making a separate supply to the customer;
- there was a single supply for all the charges made by NEC, and it was not exclusively in respect of a financial transaction;
- there was a separate supply for the booking fee but it was not exempt.

NEC argued that all the evidence presented to the FTT counted against the "supply to the promoter" argument. It was clear that NEC were selling tickets as agents for the promoter, and making clearly disclosed charges to the customers for doing so.

The "single supply" argument was likewise rejected. HMRC were attempting artificially to combine the different charges into consideration for a single supply, when in reality there were several different things happening that should be given their natural and distinct VAT treatments.

Lastly, NEC argued that there was no material distinction between what NEC did and what had been held to be exempt in *Bookit*.

HMRC relied on the decisions of the CJEU in *T-Mobile Ltd* (Case C-276/09) and *AXA UK plc* (Case C-175/09) as showing that the law as found by the Court of Appeal in *Bookit Ltd* was not entirely clear. In particular, AXA meant that the fees were taxable as "debt collection".

The company countered that AXA had charged dentists – the creditors – for collecting their income. NEC charged the customers – the debtors – for processing their payments. That was a completely different transaction.

The FTT concluded that HMRC's "supply to the promoter" argument failed. Even if the customer would not enter into a legal analysis of the transaction, it was clear that there were separate charges for the ticket (the face value) and other services, and that these were being levied by the promoter (paid through NEC acting as agent) and by NEC itself (as principal).

In respect of the "single supply" issue, the FTT noted that NEC appeared to supply nothing extra for the transaction fee – during the period actually under consideration in the hearing, it had not charged transaction fees, but only booking fees. So it appeared that there was a single supply.

The FTT noted five exceptions to the general proposition that booking fees were charged only to people who paid by card, and ruled that none of them were sufficient to displace that as the common rule. Even though the charge was much higher than the underlying cost, nevertheless the charge appeared to relate to the use of the card, and this would be how the customer would see it.

The FTT considered the question of exemption with great care, examining the way in which the various decisions related to each other. HMRC's emphasis on the importance of obtaining codes direct from the card issuer – as they put it, that was what made Bookit effectively 'step into the banking system' – was misplaced. It was not critical where the authorisation codes came from; it was only significant that NEC had taken steps which led to the transfer of funds.

The FTT also agreed with NEC that the distinction between services for a creditor (*AXA*) and for a debtor (*Paymex*) was significant and applicable here. The exclusion of "debt collection" did not apply to these charges.

The overall conclusion was therefore that NEC received the booking fees – and, by implication, the transaction fees, although they were not the subject of the appeal – for making an exempt supply to the customer. The appeal was allowed.

Upper Tribunal

HMRC appealed to the Upper Tribunal, arguing that the FTT had made errors of law in relation to its analysis of the "supply issue" – whether the charges were consideration for a supply of card handling services, rather than for booking and delivery of tickets. If HMRC succeeded on that issue, they would win (subject to further appeal); if they lost, they submitted that questions should be referred to the CJEU on the "exemption issue" (whether charges for card handling in this circumstance fell within the exemption). HMRC did not appeal against the FTT's finding that NEC made a supply to the customer as principal, rather than making a supply as agent for the promoter for which the card handling fees were part of the consideration.

The Upper Tribunal approved of the FTT's reservations about applying its decision to other periods that were not discussed at the hearing. The parties could resolve matters for other periods by agreement, but the

Tribunal should not make any direction about such periods without the presentation of evidence and argument.

HMRC's appeal on the supply issue was based on two assertions:

(1) HMRC contends that the FTT, in reaching its conclusion that the booking fees charged by NEC in the relevant period were consideration for a "payment card processing service" (rather than for the service of remote booking and delivery of tickets), asked itself the wrong question and adopted a legally unsustainable approach.

(2) HMRC contends (further and in the alternative to the first ground) that the FTT, in reaching that conclusion, in any event reached a conclusion which was not one that was reasonably and properly open to it based on the evidence before it and/or its own analysis of the facts. The conclusion therefore amounts to an error of law on Edwards v Bairstow [1956] AC 14 principles.

The Upper Tribunal considered the precedents concerning the distinction between matters of fact and matters of law, and the jurisdiction of the Upper Tribunal to hear appeals. It concluded that the "supply issue" was only a question of fact: the classification of that supply as exempt or taxable was a question of law, but the conclusion of the FTT that NEC provided a card handling service in return for the card charges was a finding of fact.

The Upper Tribunal then went on to consider in detail the relevance to an English court of the precedent set by the Court of Session in the *Scottish Exhibition Centre* case. It concluded that, while decisions of senior courts across the border did not create a binding precedent, it was best practice to follow the same approach to the factual analysis of the present case.

The judge stated that:

- the essential enquiry is as to the economic and commercial reality of the transaction;
- all the circumstances are to be taken into account, including the contractual relationship between the parties, but that will not necessarily reflect the economic reality (see, e.g. *Tesco plc v C&E Commissioners* and *HMRC v Paul Newey (t/a Ocean Finance)* (Case C-653/11)
- the enquiry is an objective one, the reference point being the typical consumer.

HMRC sought to rely on *Everything Everywhere Ltd (formerly T-Mobile (UK) Ltd) v HMRC* (Case C-276/09), in which the CJEU had found that charges levied by a mobile phone company for paying by cheque were not consideration for a supply separate from the mobile phone service. The Upper Tribunal considered that this was a very different situation. The FTT had found that there was a service supplied by NEC to the customers in return for the card handling charge. The FTT had asked the correct question and had applied the right approach, and had fallen into no error of law.

In relation to the second ground of appeal, the Upper Tribunal noted that HMRC had to clear a high hurdle to demonstrate that no reasonable Tribunal could have come to the decision it did based on the evidence

before it. While it was true that there was evidence that, had the FTT been so minded, might have led it to a different conclusion, that was very different from the requirement that the FTT must have come to a conclusion that was not supported by the evidence. The conclusion that was drawn was open to it on the evidence, and it could not be characterised as unreasonable or perverse.

Accordingly, HMRC's appeal was dismissed; the parties were directed to come to an agreement in 28 days on the wording of questions for the CJEU on the exemption issue.

Upper Tribunal: *National Exhibition Centre Ltd v HMRC*

2.3.2 Booking and payment fees – questions for CJEU

The FTT has referred the following questions to the CJEU in connection with the scope of the exemption for financial services and its application to processing of payments made by credit card for booking cinema tickets:

> With regard to the exemption from VAT in Article 135(1)(d) [PVD] as interpreted by the CJEU in Case C-2/95 *Sparekassernes Datacenter (SDC) v Skatteministeriet*, what are the relevant principles to be applied in determining whether or not a "debit and credit card handling service" (such as the service that is supplied in this case) has "the effect of transferring funds and entail[s] changes in the legal and financial situation" within the meaning of paragraph 66 of that judgment?
>
> As a matter of principle, what factors distinguish (a) a service which consists in the provision of financial information without which a payment would not be made but which do not fall within the exemption (such as in C-350/10 *Nordea Pankki Suomi*), from (b) a data handling service which functionally has the effect of transferring funds and which the CJEU has identified as therefore being capable of falling within the exemption (such as in SDC at paragraph 66)?
>
> In particular, and in the context of debit and credit card handling services:
>
> - Does the exemption apply to such services which result in a transfer of funds but which do not include the task of making a debit to one account and a corresponding credit to another account?
> - Does entitlement to the exemption depend on whether the service provider itself obtains authorisation codes directly from the cardholder's bank, or alternatively obtains those codes via its merchant acquirer bank?

The case may be combined with *NEC* by the time the CJEU hears them, because the questions are very likely to cover similar ground.

CJEU (Reference) (Case C-607/14): *Bookit Ltd v HMRC*

2.3.3 *Bridport* claims

HMRC have issued an Information Sheet aimed at non-profit sports clubs that wish to make claims for refunds of VAT in relation to sporting services supplied to non-members. The document starts by saying that "*HMRC accepts that supplies of sporting services made to both members and non-members by non-profit making members' sports clubs can be*

treated as exempt from VAT, HMRC introduced legislation on 1 January 2015 to reflect this change in policy."

The Information Sheet is based on an extensive review of claims so far made on the basis of the *Bridport* decision. A number of issues keep recurring, so HMRC want claimants to consider them before making their own claims, or in relation to claims that have already been made. HMRC point out that many are golf clubs but other types of sporting club may be affected. The Information Sheet is supposed to be read in conjunction with R&C Brief 25/2014, which mainly referred to reimbursement arrangements.

Those who have already made claims are advised to review what they have submitted and, if they want to continue to pursue the matter, make appropriate amendments. To ensure that all claims are dealt with correctly and appropriately, claimants who wish to proceed with their current claims are asked to provide a timeline of their claims and subsequent appeals so that HMRC can cross-check these to the details they already hold.

Those wishing to submit a new claim should be aware of the 4 year time limit and the other issues explained in the I/S. These include:

- need for claimant to be an "eligible body" within Group 10 Sch.9 VATA 1994;
- time limits for making claims (3 years up to 31 March 2009; 4 years after 1 April 2010; *Fleming* claims made before 31 March 2009);
- the need to calculate the VAT reclaimed for each individual VAT period, adjusting both output tax and input tax – "HMRC will not normally accept claims where figures are combined into one period, or claims where a global figure is used which is apportioned pro-rata across 4 periods or more", but "Where claimants have considerable difficulty in obtaining records for earlier periods, HMRC will consider each case on an individual basis".

HMRC then discuss the need for the service to have been supplied to an individual. The nature of supplies must be identified in the club's records. Some kinds of supply that may present difficulties include:

- corporate hospitality/"golf days";
- supplies to tour operators and travel agents.

For the supply to qualify for exemption, HMRC state that the cost must have been borne wholly or mainly by the individual, not by e.g. an employer or by a tour operator which uses the club's supply to make an onward supply of a package to someone else.

HMRC list a number of supplies that they consider are not exempt or that may present problems:

- buggy hire (arguable, if it enables someone to play sport who would not otherwise be able to do so);
- advertising;
- sponsorship;

- sports coaching provided by a professional – the professional will not be an "eligible body", so it will be important to establish who is supplying what to whom;
- competition fees, which are normally exempt as a sporting service but may not be in particular circumstances;
- club house income such as bar sales, food sales and room hire.

There may be issues of compound and multiple supplies to be considered where several of these elements are supplied as a package, particularly in relation to golf days and corporate hospitality.

The I/S goes on to consider the effect of the claim on input tax recovery. If the sporting facility is now only used to make exempt supplies, any costs directly and immediately linked to that sporting facility will cease to be recoverable. Other costs may be residual in nature, being used for exempt sporting supplies and other taxable supplies.

The effect may extend to Capital Goods Scheme calculations. The I/S is not as clear as earlier similar documents in relation to changes in categorisation of supplies: the "correct" baseline percentage should be calculated for the first interval, whether or not that results in an adjustment to the first interval's recovery (e.g. it will not do so if it is more than four years ago); that corrected baseline is compared with current actual use on the same basis in order to calculate CGS adjustments.

Example

Five years ago, a golf club incurred £100,000 of input tax on a capital item at a time when it was believed that 30% of its income was taxable, so 30% was recovered. It now calculates that only 5% of its income was taxable, if *Bridport* was applied. In the current year, taxable use is 6%.

The adjustment for the current year should result in additional recovery of 1% of 1/10 of £100,000, not a clawback of 24%. HMRC may resist the additional recovery on the basis that the club has already had an excessive repayment, but they cannot sustain the clawback because there has actually been a reduction in exempt use from 95% to 94%, not an increase.

Lastly, HMRC include a number of other factors that may put people off making a claim:

- they refer again to reimbursement arrangements, as in R&C Brief 25/2014, and say they are still considering whether unjust enrichment may apply in certain circumstances;
- they point out that an inaccurate claim could lead to penalties;
- they suggest that there may be direct tax implications if output tax is recovered and not paid to customers. For example, a surplus on trading income derived from non-members will be subject to corporation tax.

VAT Information Sheet 1/2015

2.3.4 Sporting services

A charitable boarding school set up two subsidiary companies which were registered as part of a VAT group with it. The subsidiaries managed the school's sports facilities, and made supplies to unconnected third parties of the use of those facilities. Output tax was accounted for by the companies; a claim for a refund of £427,000 was made to recover the excess of output tax over input tax for the periods 11/08 to 08/12. The school argued that the companies were "eligible bodies" because they were subsidiaries of a charity; there was no doubt that the school itself would have been an eligible body for the purposes of the sports exemption.

The companies had made covenants to pay over their profits to the school, enjoying corporation tax relief for such payments to a charity. 1993 and 1998 deeds were not located by the charity until just before the hearing, when they were produced as evidence that the companies were in effect "charitable".

HMRC argued that the companies did not have the articles or memorandum of association of a non-profit company. Their accounts were prepared on commercial lines. The overall business activities of the companies put them outside the category of eligible body.

The UK law permits a sports body to make a profit as long as that profit can only be distributed to another non-profit body. HMRC were effectively arguing that this had to be within the constitution of the companies rather than effected by deed of covenant and carried out in fact. The Tribunal considered the CJEU precedent of *Kennemer Golf & Country Club v Staatssecretaris van Financiën* (Case C-174/00): it was clear from that case that a sports body could aim to make a surplus, as long as it did not distribute it for the benefit of its members.

The Tribunal distinguished between "specific facts" that favoured the college, and the legal principles that favoured HMRC. The specific facts were that the companies had only ever paid their profits to the charity, and that the school expressed an intention never to dispose of the subsidiaries to anyone else who might operate them commercially. As a matter of legal principle, there was no bar to the school doing so; the deeds of covenant had expired some years before, so they were no longer binding on the companies. As there was nothing in their constitutions preventing the payment of commercial dividends, they were not in themselves eligible bodies. Profits had been retained rather than paid to the school in all the years from 2009 to 2013, with the stated objective of reassuring suppliers who might examine the accounts, but with the effect that the profits were not being applied in a way that was consistent with the exemption either under UK or EU law.

The appeal was dismissed.

First-Tier Tribunal (TC04247): *St Andrew's College Bradfield*

2.3.5 Abuse of sporting exemption

A married couple ran a proprietary golf club. On 1 February 1998, they divided its activities between the partnership and a newly formed company. The partnership let the land to the company, and the company provided membership and facilities for playing golf to its members. The

partnership and the company both treated their supplies as exempt from that point onwards.

HMRC decided that this was an abusive arrangement that should be recharacterised for VAT purposes. Alternatively, the company should not be regarded as an eligible body for the purposes of the sporting exemption.

The Tribunal noted that the law had changed on 18 March 1998 to exclude bodies "subject to commercial influence" from exemption under Group 10 Sch.9. There were further detailed changes to the law on 1 January 1999 and 1 January 2000. The history of the golf club was examined, going back to its origins in 1991. It appeared that HMRC had accepted the VAT registration of the company in 1998 and had raised no questions until 2010, when an enquiry led to the issue of assessments for the periods from 04/07 onwards amounting to nearly £250,000 on the partnership (plus interest). These were on the "preferred basis" that the partnership was still running the golf club as a whole, so all the income was subject to VAT; alternative assessments for £153,000 were raised on the company, on the basis that the preferred assessments failed, on the grounds that it was not an eligible body.

The Tribunal examined the precedent cases on abuse of rights, including *Halifax*, *Weald Leasing*, *Newey* and *Pendragon*. It concluded that the questions it needed to ask were:

(1) Did the arrangements entered into in February 1998 result in the accrual of a tax advantage that is contrary to the purpose of the provisions of the VAT Directive?

(2) If so, was the essential aim of the arrangements to obtain such a tax advantage?

(3) If so, are there any special features that should prevent the principle prohibiting abusive practices applying?

The appellants' representative argued that there was no tax advantage, because the partnership could have made exempt supplies of land to the members (for more than 24 hours at a time) under Item 1(m) and Note 16(a) and (b) Group 1 Sch.9. The Tribunal did not accept this: in reality, it was still acting as proprietor of the club, and could not separately make supplies of the land on which the club's activities took place.

The Tribunal noted the way in which the managing partner continued to run both operations effectively together and as proprietor. The arrangements were wholly artificial and did not reflect the commercial and economic reality of the relationship between the Partnership and the Company and the members of the Club. The appellants' representative also argued that the saving of VAT to the members was a motive that did not involve the club in obtaining a tax advantage; again, that was rejected. The club would have had to charge lower fees if it had to account for VAT on its receipts. The Tribunal was satisfied that the VAT advantage was contrary to the purpose of the VAT Directive, which provided that these types of supply should be subject to VAT.

The Tribunal rejected the appellants' submissions concerning other non-VAT reasons for setting up the arrangements in February 1998. In particular, they did more than merely formalise an arrangement that had

existed beforehand. They had been set up with the principal aim of obtaining a tax advantage, on the basis of clear evidence of Mr Hearn's motive in approaching WJB and implementing the arrangements as disclosed by the correspondence described above together with the nature of the arrangements.

No special circumstances had been put forward by any party, so the appeal in relation to abuse of rights was dismissed. The transactions should be recharacterised on the basis that the partnership continued to make all the supplies of a proprietary golf club.

In case the Tribunal was wrong on that issue, it also considered the alternative assessments, and concluded that the managing partner was a shadow officer of the company. This meant that it was subject to commercial influence, and excluded from the definition of "eligible body". If the appellants succeeded in overturning the preferred assessments, the alternative assessments would apply instead.

First-Tier Tribunal (TC04203): *Peter James Hearn & Jaleh Hearn t/a Hennerton Golf Club and related appeal*

2.4 Zero-rating

2.4.1 Clothing?

An item variously described as (amongst other things) a "baby lifting blanket" and a "hooded baby wrap" was the subject of a dispute about zero-rating. HMRC argued that it was not "designed as clothing for young children", but rather was a blanket.

The Tribunal examined an example and discussed the design. What the company's website calls a "lifting wrap for babies" has a hood and handles to assist with easy handling of the baby, particularly for a mother who may have mobility problems following a difficult birth. The only issue was whether it was "designed as clothing"; the Tribunal noted some precedents in the area (which the appellants lost), and cited *Brutus v Cozens* (1973) on the interpretation of words in statute:

"The meaning of an ordinary word of the English language is not a question of law. The proper construction of a statute is a question of law. If the context shows that a word is used in an unusual sense the court will determine in other words what the unusual sense is. It is for the tribunal which decides the case to consider, not as law but as fact, whether in the whole circumstances the words of the statute do or do not as a matter of ordinary usage cover or apply to the facts which have been proved."

The appellant's representative cited HMRC guidance that accepted babies' shawls and wearable push-chair rain-hoods as clothing. A baby could spend most of the day wrapped in the Snugglebundl. The fact that it also had a function in assisting lifting did not stop it being clothing: other items with a mixed function could qualify.

HMRC argued in return that the company's advertising material emphasised the carrying functions rather than the clothing aspects. They

suggested that the customers would regard it more as an aid to moving their baby than as an item of clothing.

The Tribunal considered the ordinary English meaning of "clothing": "*items (generally made of fabric, but sometimes of some other largely flexible membrane) that are worn with the purpose of covering (or assist in covering) some part or parts of the body, either for practical reasons (physical comfort in the face of cold, heat, rain, etc) or for other personal (including religious) reasons.*"

An item could serve some other purpose, even a more important purpose, without ceasing to be clothing – an example is a lifejacket, which HMRC accept as clothing. A distinction had to be made between something that was "worn, but not clothing" (e.g. jewellery) and something that enclosed the body (which might range from a tailored suit to a shawl). What constitutes "clothing" also varies with the context: something might be clothing for a baby that would not be clothing for an adult.

After this lengthy examination, the decision is very brief: the judge considered that the Snugglebundl was an item of clothing, in accordance with the ordinary usage of that word, and had been designed to be exactly what it was. Whilst it clearly has other functions as well, this was sufficient for the judge to conclude that it should be regarded as "designed as clothing for young children". The appeal was allowed.

First-Tier Tribunal (TC04209): *Snugglebundl Ltd*

2.4.2 Food sold for consumption on premises

A company sold cold takeaway food in the food court of the York Designer Outlet. It treated the supplies as "for consumption on the premises" and accounted for output tax. It later reclaimed £118,000 for the periods 07/08 to 01/12, arguing that the food should have been zero-rated. This was supported by the 2009 decision of the VAT Tribunal in *Made to Order* (VTD 20,959). HMRC refused the claim, regarding that decision as flawed, and the company appealed.

HMRC applied for the hearing to consider only the principle of liability and not the amount. After initially objecting, the appellant agreed to this.

By contrast, HMRC objected strongly to the admission of a witness statement that should have been served in February 2014 and was not delivered until December. The Tribunal considered that the late submission had prejudiced HMRC, but the statement was "*so sparse in detail that firstly it was highly unlikely that it could be utilised to underpin any argument on fiscal neutrality and, secondly, it added very little to the information which had been referred to in the review decision.*" It was therefore admitted.

HMRC also objected to the basis of the appeal being expanded at a late stage to include arguments based on fiscal neutrality. Once again, the delay in introducing this ground had prejudiced their preparation. Here, the Tribunal agreed: the original statement of case had not referred to it, and it was a fundamental point that could not be introduced as a minor amendment to the statement of case. In addition, the company had not produced convincing comparative evidence to support an argument based on fiscal neutrality. The Tribunal therefore declined to hear arguments on the subject.

The company argued that the food court was not "their premises". Customers of the shopping mall could eat their own food there, or eat food from other outlets; the company's own customers could take their food elsewhere to eat it.

Both counsel agreed that the food was not "supplied in the course of catering" in the general sense: the only question was whether it fell within the legal exception for "food supplied for consumption on the premises on which it is supplied". The FTT noted that the Court of Appeal in *Compass Contract Services* had said that the Tribunal should "… stick close to the language of the legislation and apply it with common sense to all the relevant circumstances of the particular case".

The FTT examined the layout of the food court and decided that the facts were very different from those in *Made to Order*, where the outlet had been separated from the seating by a public thoroughfare. A typical customer, unaware of the terms of the appellant's lease, would most likely think of the seating as "belonging to" the outlet. On the basis of the evidence, "the premises" was the food court, and the appeal failed.

First-Tier Tribunal (TC04279): *Bagel Nash Ltd*

2.4.3 Verandas

TC02746 was one of a series of appeals about the application of the lower-rating and zero-rating rules to caravans and caravan parks, all involving the same company. This dispute concerned the supply of caravans with 'verandas' – comprising '*a boarded area abutting at least two sides of the caravan. The level of the veranda deck corresponds to the level of the floor of the caravan*'. The company initially accounted for output tax on the supply of the verandas, but then reclaimed it, arguing that it was an integral part of the caravan, and not 'removable contents.' It was therefore eligible for zero-rating under Sch.8 Group 9.

The FTT considered precedents on compound and multiple supplies, as well as the decisions of the courts in *Talacre Beach Caravan Sales*. The judge accepted that the veranda was 'for the better enjoyment of the caravan'; but it was still not part of a single supply, because it was an optional extra. The veranda was of no use without the caravan, but the caravan could certainly be purchased without a veranda. It was therefore to be regarded as a separate item, and it did not qualify for zero-rating.

The company appealed to the Upper Tribunal. The judge noted that both parties agreed that, if the *Card Protection Plan* principles applied to the transaction, then the sale of a caravan with a veranda would be a single supply. The veranda was clearly ancillary to and for the better enjoyment of the caravan.

The Upper Tribunal noted that the FTT had considered the decision that it believed the UK courts would have taken in 1991, which was the date at which national measures of this type had to be in force to qualify for a derogation from the Directive. In its view, the UK precedents before *CPP* indicated that the courts would have held the veranda to be a separate supply. The company appealed on two grounds: first, that *CPP* should be applied to facts from both before and after that decision was taken; but if that was wrong, the UK courts would have held this to be a single supply even before *CPP*.

The UT quoted at length from the decision of Vos J in the UT in the *Morrisons* case and the Advocate-General's opinion in *Talacre Beach Caravan Sales* (Case C-251/05). The conclusion of both was that *CPP* applied in all cases in determining whether or not there was a single supply. *Talacre* was about whether part of a single supply could be taxed at a different rate, and did not affect the basic question of whether there was a single supply. There was therefore a single supply in this case.

The question was then whether *Talacre* required the veranda to be excluded from zero-rating. The UT's view was that *Talacre* had no application here. The CJEU had ruled that there was nothing in the Directive to prevent a Member State from restricting the scope of a derogated exceptional treatment such as zero-rating, either wholly or partially; so the exclusion from zero-rating of part of a single supply of "caravan with removable contents" was not contrary to the Directive. However, it would require explicit words in the UK law to have that effect. Similarly, the *French Undertakers* case (Case C-94/09) was about the exclusion of "concrete and specific aspects" of a category of supply from the scope of a lower rate – it referred to different parts of the VAT Directive, and had no application in this case.

The derogation that allowed zero-rating was a "standstill clause", but that did not mean it should only allow zero-rating on the basis of the existing case law in 1991. The decision of the CJEU in *CPP* showed what the law was and always had been. There was nothing specific in the UK law to exclude the veranda from zero rating; as it was part of a single supply, it qualified.

The FTT had also decided that a veranda did not fall within the meaning of the word "caravan". However, that was not the right question: the question was whether the "caravan including the veranda" fell within that meaning, which the UT was satisfied that it did.

It was noted that some caravans were sold with an integral veranda, and HMRC accepted that the whole of that supply qualified for zero-rating. The company added this – a fiscal neutrality argument – to its grounds of appeal only at the UT level. The UT declined to comment on it, as the FTT had heard no evidence about it.

The company's appeal was allowed.

Upper Tribunal: *Colaingrove Ltd v HMRC*

2.4.4 Updated Notice

HMRC have issued a revised version of their Notice *Reliefs for disabled people*. It has been rewritten to improve readability, as well as including new links to helpsheets and eligibility declarations, information about reduced rating of certain mobility products, and clearer guidance about what goods are eligible for the relief.

Notice 701/7

2.5 Lower rate

2.5.1 Energy supplies

In TC02534, a company supplied holiday accommodation in chalets, static caravans and caravan pitches to customers. It made a separate charge for the provision of electricity, but this was not metered or specifically related to the amount of electricity consumed by the particular customer paying it. It was accepted that the pitch hire was standard rated; HMRC ruled that there was no separate supply of electricity that could be lower-rated, or else that the supply of electricity was incidental to the SR supply.

The company had made reclaims in relation to supplies to mobile caravans in the early 1990s, and HMRC had agreed and settled these. It subsequently made another claim in relation to the supplies currently in dispute, which was also settled by HMRC. For a time it made manual adjustments to its VAT returns to reflect lower-rating of the electricity charges, but then decided instead to account for everything at the standard rate and make periodic voluntary disclosures. The current dispute started when one of these disclosures was refused in 2002.

HMRC's representative argued that it would be artificial to give different VAT liabilities to the two parts of the supply when the charge for electricity was simply a flat rate amount unrelated to actual consumption. In effect, there was a single supply of "fully serviced accommodation" for a single charge, and it was standard rated. He submitted that to give separate liabilities would make a nonsense of the *CPP* precedents and would "open the floodgates" to many similar claims.

The FTT did not accept this. The UK's legislation appeared specifically to provide for the application of the lower rate to supplies of electricity for consumption in a caravan. That was a specific and distinct circumstance in which the law provided for the relief to apply; allowing this appeal would not have a wide effect beyond that limited circumstance. Although there might be scope for abusive value-shifting between the two types of supply, the FTT found no evidence that this had occurred.

On that basis – that the UK legislation specifically provided for the lower rate to apply in this situation – the appeal was allowed. However, the FTT went on to make other findings in case its decision on this point was appealed and overturned. As a matter of general principle, it agreed with HMRC that there would be a single supply within *CPP*, because the customer was interested in buying a package from the company of "accommodation with electricity". That single supply would, if considered without the benefit of Sch.7A, be standard rated.

HMRC appealed to the Upper Tribunal. Their grounds of appeal (all on questions of law) were:

(1) First, HMRC contend that the FTT was wrong to conclude that this was a case to which the CPP line did not apply, and had misunderstood the French Undertakers case. More particularly, HMRC contend that the FTT failed to distinguish between (a) the court determining which elements within a category of supply (such as burial and cremation services) may properly be treated by Member States as attracting a reduced rate, thus giving an express differential rating to different elements of a category of taxable supply (the issue in the French

Undertakers case) and (b) whether or not, on a case-by-case basis, an element of an economically indivisible transaction should be artificially split into constituent parts with different rates of VAT being applied to different parts (the approach prohibited by the CPP line).

(2) Secondly, HMRC contend that the FTT erred in construing the UK's national legislation in question as enabling the application of a reduced rate to goods or services regardless of whether such goods were provided separately or as part of a single complex supply. HMRC submit that there is no provision of UK national legislation which could sensibly be interpreted as having that effect.

(3) Thirdly, HMRC contend that the FTT erred in concluding that the principle of fiscal neutrality would still be observed by 'carving out' a reduced rate for elements of a single complex supply, and failed in the process to take into account that if the French Undertakers case 'trumped' the CPP line, then in every case where some element of a single complex supply could conceivably attract the reduced rate, it would be argued that that element should be taxed at a different rate, and the CPP line (which is founded on the principle of fiscal neutrality) would seldom if ever fall to be applied at all. HMRC also submit that if the FTT was right, cases such as the decision of the House of Lords in College of Estate Management applying the CPP line would have to be considered to have been wrongly decided, given that in that case the supply of written materials and education was held to be a single supply of education services and the supply of books (which as a separate supply would be zero-rated) as an element of that single complex supply was not regarded as benefiting from the zero rate.

Shortly after HMRC had submitted their grounds of appeal in this case, Vos J issued the UT decision in *William Morrison*. That decision explicitly criticised the FTT decision in this case, and suggested that HMRC's grounds – in particular, that "*CPP* trumped s.29A", was correct. Colaingrove initially applied to have its appeal "leap-frogged" to the Court of Appeal, on the basis that the UT was likely to follow Vos J's decision and it would therefore be a waste of time to have the intermediate hearing when it would be necessary to go higher. The procedure for such a leap-frog was unclear, so the UT hearing proceeded. Meanwhile, the *Morrison* decision has not been appealed.

Hildyard J examined the competing arguments and declared that the situation was more difficult than that in *Morrisons*. The taxpayer's representative argued strongly that Parliament had intended to provide for fuel in caravans to be lower-rated even when part of a single supply, and his examples highlighted the fiscal distortions that arose if such supplies were not lower-rated. However, the judge's analysis of the precedents accorded with HMRC's. The *CPP* approach was the starting point. Once something had been identified as a single supply, it must have a single rate of VAT applied to it; unless the domestic legislation explicitly carved out a discrete and concrete element of the supply that would be taxed differently, as in *French Undertakers* and *Talacre*. There was no explicit provision of UK law that stated "fuel in caravans is lower-rated even when part of a single complex supply". As a result, it had to be taxed as part of that single supply, at a single rate. HMRC's appeal was allowed.

Upper Tribunal: *HMRC v Colaingrove Ltd*

2.6 Computational matters

2.6.1 Trade-in values

In TC02677, a motor dealer appealed against a refusal of a *Fleming* claim for overpaid output tax which arose because the value of trade-in vehicles was regularly overstated. The hearing was a test case for another 50 claims which stood behind it.

The company argued that, on a trade-in, the value ascribed to the part exchanged vehicle is generally overstated. In reality, this represents a discount on the sale of the newer vehicle, and this ought to be reflected in the VAT accounting.

An example transaction is described in detail, in which a customer negotiates an increase of £310 over the market value of the trade-in vehicle. The dealer is willing to accept this in order to secure the sale; it is in reality a reduction in the dealer's margin on the new vehicle. It has an adverse VAT consequence if the second-hand vehicle is then sold at a loss, because there is no reduction for losses in the second-hand margin scheme.

The FTT referred to the decision of the House of Lords in *Lex Services plc v C&E* [2004]. The HL held that the value, specifically agreed between the parties and reflected in the documentation, could not be recharacterised as something else. The appellants argued that the *Lex* decision depended on the wording of s.10 VATA 1983, which was amended in 1992. They contended that the original version should lead to a different decision. HMRC accepted that the change of wording meant that *Lex* was not a binding precedent, but they argued that the Tribunal should come to the same conclusion.

The original version of s.10(3) was:

If the supply is not for a consideration or is for a consideration not consisting or not wholly consisting of money, the value of the supply shall be taken to be its open market value.

This was replaced in 1992 by what is now s.19(3) VATA 1994:

The value of a supply for a consideration not consisting of money, or not wholly consisting of money, is taken to be such amount in money as, with the addition of the tax chargeable, is equivalent to the consideration.

Counsel for the appellants argued that the "subjective agreed value" which the House of Lords approved in *Lex* was not correct before 1992: the original wording required an objective assessment of the value of the supply. Although that was the newer car rather than the part exchange car, using the Glass's Guide value of the part exchange car, plus the other consideration given, would be a reasonable proxy for the value of the supply.

The FTT did not agree. The value agreed between the parties was a good measure of open market value, because it was agreed at arm's length: the fact that the parties were engaged in a transaction did not constitute a "relationship" which would undermine the open market according to s.10(5) VATA 1983. Further, the Glass's Guide price was not truly objective. It was not possible to recharacterise the part-exchange transaction as something else – a purely cash transaction – and put on it a

value that was different from that freely negotiated and agreed between the parties.

The appeal was dismissed, and the appellants proceeded to the Upper Tribunal. Warren J (sitting with Judge Sinfield) examined the precedent cases on valuation in great detail, and concluded that the FTT's decision was right: the value ascribed to the trade-in vehicle was the best measure of the price for VAT, because no other measure could be supported as more reliable. The appeal was dismissed again.

Upper Tribunal: *N & M Walkingshaw Ltd v HMRC*

2.6.2 Retail schemes

HMRC raised an assessment for £28,963 on a cafe in relation to its VAT periods from 06/08 to 06/11. The appellant had been making its returns on the basis that its percentage of standard rated sales were in the region of 30% of turnover. However, HMRC upon further investigation and after having made invigilation visits to the appellant came to the view the percentage of standard rated sales was around 90%.

The trader appealed, arguing that the firm's accountant had telephoned HMRC in 2004 and been told that it was possible to calculate output tax using an apportionment-based retail scheme. If so, output tax would be calculated by applying the proportion of purchases that were standard rated to the turnover – clearly that would be unfairly beneficial to a catering business, which buys a great deal of zero rated food and turns it into standard rated catering.

HMRC argued that use of an apportionment scheme required written approval, which had not been given. They also did not accept that the telephone conversation had taken place. The most appropriate retail scheme would have been a "catering adaptation"; the appellant did not comply with the scheme's conditions regarding sampling and producing a calculation which was fair and reasonable.

The appellant argued that HMRC's record-keeping is unreliable, that their conclusion that no approval to use the apportionment scheme was incorrect and that it would be unfair to penalise the appellant because HMRC could not find a record of the telephone conversation which the appellant's accountant says took place.

The Tribunal examined the Public Notices on retail schemes, many sections of which have the force of law. The conditions for the catering adaptation include a requirement to notify the local VAT office and to receive an acknowledgement of that notification.

The trader's accountant appeared as a witness and was cross-examined. He had a file note of a conversation with an employee of HMRC called "Victoria" on 4 February 2004, in which she "confirmed that given the description of the business, the apportionment scheme was an appropriated [sic] scheme to use." HMRC had carried out a full review of their files and could find no record of this conversation. The accountant produced a number of examples of problems with HMRC's record-keeping in relation to this and other clients, and also alleged that the officers carrying out the enquiry had conducted themselves improperly, stating that they "had to find at least £500 of duty" and making rude remarks.

The Tribunal remarked on the fact that the file note referred to "HMRC". In 2004, the department did not exist: an enquiry about VAT would have been directed to HM Customs & Excise. This suggested that the note was not contemporaneous, but had been added to the file at a later date. The accountant's oral evidence did not appear to be a fresh recollection, but rather a verbatim repetition of the file note. While not questioning the credibility of the accountant in general, this evidence failed to satisfy the burden of proof that the conversation had taken place.

The Public Notices were there to be read and followed. In effect, the appeal was only based on the unfairness of HMRC arguing that a different method should have been used from the one on which the VAT returns were based; there was no other dispute about the figures in the assessments. There was therefore no possible basis on which the assessment could be overturned or amended by the Tribunal, and the appeal was dismissed.

First-Tier Tribunal (TC04333): *R McDonalt and A McDevitt t/a The Picnic Basket*

2.7 Discounts, rebates and gifts

2.7.1 Discounts

A company (Kumon) operated a franchised educational method. It charged its franchisees for various services provided, and for materials (the zero-rating of which has been the subject of a different Tribunal case). The franchisees would generally be unable to recover VAT charged on the franchise payments.

In certain cases, "reward payments" were made to franchisees. The company decided that these ought properly to be treated as a reduction in the consideration paid by the franchisees for their services – a retrospective contingent discount – and should therefore reduce output tax. It reclaimed £36,053. HMRC refused, arguing that the payments were consideration for a separate supply by the tutors to the organisation, and they were therefore outside the scope of VAT (as the tutors were not registered).

The payment of rewards was based on three criteria: (i) "Quantity" – number of students and number of students retained; (ii) "Quality" – number of student attaining higher levels of achievement; and (iii) "Programme Knowledge" – the instructor's own technical level of training. HMRC argued that these were not linked to the services being provided by the company to the tutors, so they could not affect the consideration for those services.

The Tribunal noted that the way in which a payment is made should not affect its treatment for VAT. The fact that the rewards were paid to the tutors as a separate credit did not prevent it being treated as a reduction in the consideration flowing from the tutors to the company. In line with *Lex Services*, the method of calculation of a discount did not have to be clearly determined, as long as the intention of giving a discount was clear.

The Tribunal considered that the rewards were not for a separate supply made by the tutors to Kumon, but were for enhancing the basic service for which they paid the franchise fee. There was a direct link between the activities for which the reward was payable and the services provided for which the franchise fee was payable. The supplies should not be artificially dissected; HMRC could not provide a clear description of the supply that they alleged was being made by the tutors, and this was "telling".

The Tribunal concluded that the rewards were a contingent discount and should be deducted from the consideration for outputs for VAT purposes. The appeal was allowed.

First-Tier Tribunal (TC04291): *Kumon Educational UK Co Ltd*

2.8 Compound and multiple

Nothing to report.

2.9 Agency

2.9.1 Agent in own name

An individual was assessed to £73,050 in overclaimed input tax and underdeclared output tax for the periods 01/02 to 07/03. The assessment was raised in November 2004. A further assessment, and a refusal to repay input tax claims, totalling £46,455 for the periods 10/03 to 07/04 were issued in October 2006. The appeals against these assessments and decisions were heard by the FTT in January 2015.

The trader arranged for UK customers to buy UK-specification cars from dealers in other EU countries such as Germany and the Netherlands. He also helped them to register the vehicles in the UK, and he said they would pay the VAT under the "new means of transport" rules.

HMRC started to investigate his affairs after receiving an enquiry from the German authorities. They decided that there were more vehicles than were reflected in his VAT returns, and also asked for supporting evidence for input tax claimed. They were not satisfied with the responses, and the assessments and decisions followed. A long and slow correspondence eventually led to an appeal to the Tribunal. The main point raised by the appellant was that HMRC were wrong to treat him as a principal, liable for output tax on the entire sale of the car; he was acting as an agent and should only be liable for output tax on his commission; and, as his services were supplied to the selling dealer in another member state, there would be no UK VAT on that.

The trader had provided a number of documents that he said proved his case, but they were not in chronological order and he could not find the exact documents he needed. He asked for an adjournment to look for them; HMRC resisted, and the Tribunal agreed that he had had long

enough to make sure that his paperwork was in order. The onus of proof was on the appellant; and, in any case, the judge did not think that showing he was legally an agent would help his case.

This was because s.47 VATA 1994 would treat him as a principal in any case, because he was acting in his own name in the transactions. He was therefore liable to output tax on the full value, whether or not he was legally acting as an agent. He had also not produced any evidence to support the input tax claims, which were now so old that it was unlikely that documents could be found. His appeal was dismissed.

First-Tier Tribunal (TC04288): *Derek Collings t/a Engineering Unlimited*

2.9.2 Ticket sales

An individual ran a business sourcing tickets for events for people who wanted them. He regarded himself as providing a service as agent, only buying tickets to order and charging 10 – 15% of the ticket cost to reflect the time and expense involved in buying them (which might involve going to a venue and queuing in person). HMRC decided that he was buying and selling the tickets as a principal – the fact that he sold them at above face value, without separating out a charge for obtaining them, meant that the cost itself could not be treated as a disbursement. As a result, his turnover exceeded the registration threshold.

The appellant referred to a Tribunal decision which included a definition of agency: "agency is the relationship which exists between two persons, one of whom expressly or impliedly consents that the other should represent him or act on his behalf, and the other of whom similarly consents to represent the former or so to act" (VTD 4,927 *Dr R Nader t/a Try Us*). His self-assessment return showed the gross sales and the purchases of tickets, but he argued that for VAT purposes his turnover was the net figure.

HMRC argued that the trader's course of dealing did not meet the indicia of agency in their VAT Manual (VTAXPER3600):

(1) Title – In an agency relationship, title is with the principal: It is not clear whether Mr Asquith or his clients had title to the tickets.

(2) Identity of services – The goods or services provided by the agent must be clearly identifiable; the service provided (entry to an event) is specified on the ticket, but Mr Asquith's supply is of "the means of attending the event for the overall price charged".

(3) Value – The principal must know the exact value of the goods or services which have been bought: When Mr Asquith provided invoices these did not necessarily reflect the ticket price. In many instances he did not provide an invoice.

(4) Separation – The value of the agent's service must be separately identifiable and known to the principal: When Mr Asquith did provide an invoice the value of his services were separately stated, but there was nothing to stop him inflating the ticket price. In other circumstances the client would not have been able to clearly identify the value of Mr Asquith's service.

(5) No change – The main supply between buyer and the seller cannot be altered by the agent: There is no change in the supply of services made,

being entitlement to enter the event to which the ticket relates, but the supply is made by Mr Asquith.

(6) Nature and Value – The Agent cannot alter the value of the supplies which they arrange: Mr Asquith does not change the nature of the supplies to the customer, but there is no proof for the customer that the tickets were obtained at the price charged to them by Mr Asquith.

The trader did not act as a "disclosed agent" – that would have required the issue of invoices making the terms clear to the customers. Similarly, the conditions for treating a charge as the recovery of a disbursement (Notice 700 para.25) were not met.

The Tribunal noted that the onus lay on the trader to show that he was acting as an agent. Recent cases have focused on the contractual documents as a starting point; it was unfortunate that there was very little documentation to establish the nature of the appellant's contracts.

The Tribunal agreed that, on the basis of HMRC's internal guidance, the appellant was acting as a principal. The judge went on to consider the UK common law on agency. Contrary to HMRC's approach, not all of the indicia carried equal weight. The most important point was that an agent cannot manipulate the price of the subject matter of the transaction to the disadvantage of the client; this trader could set the price at whatever he thought the client would pay, and this was contrary to the nature of agency. He also bought and owned the tickets in his own name – this was a matter of convenience and practicality, and the risk of a client refusing to pay for it was small, but even so it meant he was buying and selling rather than arranging.

The Tribunal dismissed the trader's appeal against the decision to register him with effect from December 1999. Presumably a very large assessment for unpaid VAT, together with penalties, will follow.

First-Tier Tribunal (TC04319): *Ronald Asquith*

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Property transaction not a TOGC

In TC02617, a company had sold a building to a charity. This was treated as a VAT-free TOGC; HMRC ruled that it should not have been, and raised an assessment on the vendor, because it had opted to tax. In the alternative, they contended that the vendor should have adjusted its input tax. The FTT had to consider the proper treatment of the transaction, and also whether HMRC had raised its assessments in time.

The charity wanted to move from existing premises in which it had two sub-tenants. The company had redeveloped the property and was looking for a tenant or for a sale. Because of the refurbishments it was in possession of a capital item.

The charity and company entered into discussions, and took advice on how to structure the transaction in the most VAT-efficient way. The charity was partially exempt and partially non-business, so it could not recover all its input tax. It was decided to arrange for the sale of the building to be a TOGC. To this end, the charity introduced one of its sub-tenants to the company and an agreement for lease was drawn up. The charity also opted to tax the building.

The sale of the property was completed on 15 January 2008 on the understanding of both sides that it was a TOGC. The charity then entered into leases with both of the sub-tenants.

Because it had acquired a CGS item, the charity wrote to HMRC for informal clearance of the methodology for CGS adjustments. An officer visited the premises and discussed the CGS issue with an employee of the charity and its tax adviser. The adviser made a note at the time that the officer had accepted that the acquisition was a TOGC, but he had no recollection of this. However, the FTT found as a fact that, on the balance of probabilities, the adviser handed the officer a file of documents setting out the VAT treatment of the transaction. HMRC therefore had sufficient information to make an assessment the day after the visit in May 2009.

HMRC asked further questions later that year and into 2010, but only issued their rulings that TOGC treatment did not apply in July 2010. They argued that this was “in time” because they did not have enough information until they received the vendor company’s VAT return for November 2009, which included input tax claims in respect of the property.

HMRC’s alternative assessment was based on a “change of intention before first use” by the vendor company – that the agreement for lease changed its intention from “wholly taxable” to “mixed taxable and exempt”, triggering a clawback under reg.108.

The taxpayers cited Notice 700/9, which explains that an agreement for lease can constitute evidence of a letting business; and also that a transfer of a partially tenanted property can be a TOGC. The case of *Dartford Borough Council* (VTD 20,423) was very similar and showed that this type of transaction was a TOGC (and also showed, in that case, that HMRC could completely misunderstand property transactions).

HMRC’s counsel pointed out that the agreement for lease was conditional on the sale of the property from the company to the charity. If the sale had not gone ahead, the lease would not have been entered into. The impression that the company had a rental business in existence before the sale was artificially created.

The FTT did not accept this. The company was a VAT-registered property company with a substantial asset that it was actively marketing. There was no doubt that it was engaged in activities preparatory to renting the property out, which was enough of a business to make a TOGC possible. The *Dartford* case was indistinguishable, and the TOGC issue was decided in favour of the appellants.

On the time bar issue, the taxpayers' counsel observed that HMRC had known all the following over a year before the assessments were issued:

a. The identity of all the parties

b. That Coleridge had treated the sale of the Property as a TOGC

c. In consequence, Coleridge had not charged VAT on its sale

d. That the Property was sold with the benefit of an Agreement for Lease between Coleridge and BAPM

e. The amount of the sale consideration

f. The date of the sale; and

g. That Coleridge had made its return for period 02/08, in which the sale took place, without accounting for VAT on it

He contended that nothing further was needed to raise the assessments.

HMRC's counsel argued that certain essential information was not received until November 2009. The FTT considered this "disingenuous": HMRC knew in November 2008 that the company had sold the property, and had received a succession of VAT returns with no output tax. They must have been aware that it had treated the sale as a TOGC. The judge held that the assessment was out of time.

The judge rehearsed HMRC's argument about clawback of input tax before dismissing it in its entirety. It was based on the idea that reg.108 required the vendor company to make an adjustment based on the future exempt use by the transferee charity; this was a misunderstanding of the way the regulations worked. Reg.108 was engaged when there was a change of intention to make exempt supplies – but the vendor company never made any exempt supplies. Instead, the more precise CGS operated following the TOGC to require the charity to make adjustments to input tax for the remainder of the adjustment period. The precedent cases on which HMRC sought to rely (*Centralan, Briararch and Curtis Henderson*) were simply not relevant.

Upper Tribunal

HMRC appealed to the Upper Tribunal in relation to the time bar and the TOGC issue, but did not dispute the FTT's findings about clawback. The judge decided that there were issues of law in HMRC's appeal, including the question of whether the *Dartford* case was distinguishable from the present situation. The appellants' counsel argued that HMRC were in reality objecting to the arrangement on the basis that it was a sham or an abuse, and as they had not raised that argument in the FTT, it was too late to do so now; HMRC's counsel confirmed that he was not relying on those principles, but on the straightforward application of the law.

On the TOGC issue, the judge derived the following principle from the various mainly European precedents to which he was referred:

First of course an asset must be transferred. However something else has to be transferred as well. That further element is referred to variously as a business, an undertaking, or an economic activity (or part of such a thing). Merely transferring an asset on its own will never be enough to satisfy the test. In order to work out whether the necessary second element has been transferred, one needs to look at all the relevant

circumstances. The test is one of substance not form. The circumstances can include the intentions of the parties.

The judge decided that the *Dartford* case was distinguishable. There, the arrangements for the grant of the lease had been separate from the transfer of the landlord's interest. Here, they were part and parcel of the same transaction. There was therefore a pre-existing "business" in *Dartford* that was capable of being transferred, which was not the case here.

However, the fact that the situation was different did not in itself decide the appeal for HMRC. The judge went on to consider whether there was in reality a TOGC. He concluded that there was not. The tenants with whom arrangements for lease were made were never part of the vendor's letting business: they were introduced by the purchaser. The agreement for lease arose directly from and was simply part of the sale transaction. That meant that it was in reality a mere transfer of an asset, and HMRC's appeal on that point was allowed.

Note that the UT did not consider that the TOGC conditions were breached either by the fact that only a small part of the building was involved in the supposed letting business, or by the fact that the letting business comprised only an agreement for lease at the time of the transaction – it was the relationship between the purchaser and the sub-tenant, and the fact that the sub-tenant had been introduced by the purchaser in order to achieve a TOGC, that was the problem.

In relation to the time bar issue, the judge noted that the FTT had preferred the evidence of the appellants' witnesses over HMRC's in relation to when the file of documents had been handed over. As he had found as a fact that the file had been provided to HMRC in May 2009, it appeared that the appeal on this point was hopeless. HMRC's counsel relied on the evidence of the HMRC officer who actually raised the assessment, who only became involved in the case in January 2010, and who asked questions he considered necessary for the raising of an assessment. He was provided answers to these questions in February 2010, which would have validated the assessment raised in July. The FTT had not apparently considered this evidence at all.

The FTT hearing had not been recorded. Judge Demack's notes did not include the details HMRC wished to rely on. He declined to amend his notes to include the information from HMRC's counsel's own notes, because he said he did not recall the cross-examination of the officer. The UT judge applied precedent in following the record of the judge below in establishing what had been presented in evidence: he would not swear in both counsel and take evidence from them under cross-examination. As the evidence HMRC sought to rely on was only in their own counsel's notes, the appeal on this point had to be dismissed.

Upper Tribunal: *HMRC v Royal College of Paediatrics and Child Health and another*

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Football stadium

A local authority claimed for the deduction of all the input tax incurred on the purchase of a football stadium. It made it available to a football club for consideration: the tax authorities took the view that this was the letting of immovable property and was therefore exempt without the right of deduction. Some taxable supplies were involved, so on the principle of actual use, 36% of the input tax could be recovered.

The taxpayer appealed, arguing that the contract with the club stated that 80% of the consideration related to the supply by the authority (as owner/landlord) of various services, including maintenance, cleaning, repair and upgrading. Questions were referred to the CJEU.

The CJEU noted that the contract provided for football to be played on only 18 days in the year. This was not negligible, but it could be regarded as "occasional and temporary". It was for the referring court to consider and determine that question.

It also appeared that the role of the authority was more active than that of a mere landlord. Caretaking and supervision, management, maintenance and cleaning, repair and upgrading, all together comprising 80% of the consideration, had more of the characteristics of a supply of services than a supply of land.

The court decided that such a letting was not "as a general rule" a letting of immovable property, but it would be for the referring court to reach a final decision on the basis of the principles set out in the judgment.

CJEU (Case C-55/14): *Régie Communale Autonome du Stade Luc Varenne v État Belg*e

3.2 Option to tax

3.2.1 Revised option forms

HMRC have produced revised versions of forms VAT1614A and VAT1614H. Some notifications and applications are now dealt with in a different location than that which was shown on the previous forms so an address update was required. In addition, the wording of some questions on these forms (and also form VAT5L) have been revised as a result of feedback from customers, to reduce errors.

www.gov.uk/government/publications/vat-notification-of-an-option-to-tax-land-andor-buildings-vat1614a#history

3.3 *Developers and builders*

3.3.1 Building work

In TC02773, a company constructed a 72-bed nursing home on the site of a redundant church. Part of the church was retained as a reception area, and HMRC ruled that the work was therefore lower rated as the conversion of the church building rather than the construction of a new RRP property.

The FTT considered the relative sizes of the original church (315m^2), a new mezzanine floor in the retained church building (140m^2), the ground floor of the new residential wings (1,590m^2) and the first floors (1,320m^2). The new wings were self-contained and incorporated everything that was needed for the living requirements of the dementia sufferers who lived there; the church building, while sitting at the centre of the development, was in reality 'just one big entrance area'.

HMRC argued that Note 16 Group 5 Sch.8 VATA 1994 ruled out zero-rating. '*The legislation placed no upper limit on the size of the enlargement, size is not a material factor. It is not a question of degree. That is immaterial. Further, the demolition of all the other buildings on the site was purely and simply to make room for the extension.*'

The FTT derived the following principles from decided cases:

*(a) The test which we should apply to determine whether the works carried out constitute enlargement or extension involves two stages. It requires an examination and comparison of the building(s) as it or they were before the works were carried out and the building or buildings as they will be after the works are completed (*Cantrell No.1*).*

*(b) The answer to the two stage test must be given after an objective examination of the physical characters of the building or buildings at the two points in time, having regard (inter alia) to similarities and difference in appearance, layout and how they are equipped to Function (*Cantrell No.1*).*

(c) The terms of the planning permissions are in the main irrelevant.

*(d) The examination of the works involves a question of fact, degree and of impression. Whilst enlargement clearly involves some addition to the existing building and an increase in space, it will be a question of fact and degree whether something can properly be described as an enlargement of an existing building. The additional works may be so extensive in comparison with the original that that would be a misnomer (*Marchday Holdings*).*

The FTT disagreed with HMRC's view on the application of Note 16: there had to be a point at which the extent of new construction meant that it could not be regarded as an extension of what was there before. In this case, the new build dwarfed the original structure. HMRC had strongly argued that there was a single supply with a single liability, and the FTT agreed with that: it all fell within Group 5 Item 2 Sch.8, and was all zero-rated.

HMRC appealed to the Upper Tribunal, arguing that the FTT had erred in law in deciding that the term "extension" incorporated a question of degree. The term "construction" could only apply to the erection of a new

building as a whole (an amendment to HMRC's grounds of appeal made 13 days before the hearing, objected to by the taxpayer, but admitted by the Tribunal). The FTT had therefore applied the wrong test, and had come to the wrong conclusion. HMRC did not appeal against the FTT's decision that the work had not been a "conversion", but contended on appeal that this would entitle them to charge standard rated VAT instead of lower rated VAT if their appeal succeeded. Accordingly, the UT reviewed this part of the FTT's decision as well.

The Upper Tribunal considered that the FTT had applied the right test. Whether the work constituted "construction of a building" or "construction of something else" was a question of fact for the FTT to determine. HMRC had not appealed on the grounds that the FTT had come to a wrong conclusion of fact based on the evidence before it, so the conclusion had to stand. HMRC relied on an old House of Lords precedent, *C&E v Viva Gas Appliances Ltd* (1983); but that related to a different aspect of the legislation (concerning alterations), and the 1972 legislation was very differently worded. It did not apply here.

The FTT had also decided as a fact that the new building was not an "extension" of the existing church. If it was, it would not qualify for zero-rating because of Note 16(b) Group 5 Sch.8. The 1997 precedent case of *Marchday Holdings* confirmed that this was a question of fact, degree and impression. Only the dissenting judge in the CA referred to *Viva Gas*. The FTT had therefore been entitled to conclude that the difference in the relative sizes of the buildings meant that the new ones were not an "extension" of the original.

HMRC argued that Note 18 ruled out zero-rating in this circumstance: "A building only ceases to be an existing building when demolished completely to ground level". The UT did not agree that this meant that all work, no matter how extensive, done on the site of a building that is not completely demolished to ground level must be regarded as an enlargement or extension.

In its consideration of the question of conversion, the Tribunal also disagreed with HMRC's view that an enlargement of a building could not qualify for lower rating under Sch.7A Group 6. Although its decision on zero-rating made it strictly unnecessary, the UT also confirmed that it would have allowed lower rating on the work as a "special residential conversion".

HMRC's appeal was dismissed.

Upper Tribunal: *Astral Construction Ltd v HMRC*

3.4 *Input tax claims on land*

3.4.1 DIY: live/work unit

TC02601 concerned a dispute about the eligibility of a "live/work unit" for a DIY builder's claim. There were two commercial buildings on a site. One was converted to residential use, while the other remained subject to commercial use planning permission. There was a restriction on the occupation of the commercial building – it was only to be used by the occupier of the residential property. The effect of the condition was that in practical terms it was extremely unlikely that the residential dwelling would be used or disposed of separately from the commercial dwelling. It did not however on its face impose any express restriction on the separate use or disposal of the residential dwelling.

When asked to undertake a statutory review of their decision to disallow the DIY builder's claim, HMRC wrote to the council, asking for an explanation of the planning condition. The council replied:

"*Your interpretation of the planning condition is correct, and the Local Planning Authority consider the two buildings as a single live/work unit, and the separate disposal of the dwelling would not be permitted.*"

The FTT considered the recent *Kear* decision (TC02513) on the same issue, where the Tribunal had agreed with HMRC. The appellant argued that it was irrelevant, because in that case the planning consent was more explicit: it placed a restriction on the residential part. This consent only placed a restriction on the commercial part, which was not the subject of the DIY claim. It was possible – even if probably not sensible – to sell the residential part and retain the commercial part, leaving it empty, and still comply with the planning consent as it was written.

The FTT agreed with the appellant. The views of the planning authority carried no weight: they had not put any prohibition on separate use or disposal of the residential part in the planning consent, and they could not afterwards claim that it was implied by what they had included in relation to the commercial part. The appeal was allowed.

HMRC appealed to the Upper Tribunal, arguing that the description of the development as a "live/work unit" in the planning consent implied the restrictions that denied relief. HMRC's counsel suggested that a number of different external sources were necessary to interpret the bare words of the planning consent, including the council's policy, the application, and the council's subsequent comments to HMRC.

HMRC also applied to be allowed to rely on further documents that had not been seen by the FTT in the original hearing. The UT examined them, but did not agree that they added any restriction that the FTT had not seen. The expression "live/work unit" was not a "term of art" – that is, it was not statutorily defined, and did not therefore itself mean "something that does not qualify". It was necessary to interpret the documents in the normal way. The FTT had come to the correct conclusion, and HMRC's appeal was dismissed.

Upper Tribunal: *HMRC v Antony Barkas*

3.4.2 DIY: complete demolition

An individual demolished a bungalow and built a new one. The work was carried on in stages, with the remains of the old bungalow being used during the process to store materials and machinery. HMRC ruled that the planning consent only allowed an extension to the original building and denied a DIY claim.

The appellant's representative accepted that the planning permission referred to extension and alteration rather than demolition and new construction, but that was because it was necessary to make the application in that way to get it approved; the effect of successive applications, all of which were complied with, was that a wholly new building had been constructed, with the exception of an interior cavity wall that was incorporated in the new structure.

The Tribunal held that the law was clear, and the denial of relief was not some "minutiae in the legislation which this Tribunal can ignore". As the planning consent did not allow a new construction, the claim could not succeed. Applying for an upgrading of the consent would not help, because the work had been carried out under the consent issued at the time. It might be prudent to ask for a variation to the consent for planning reasons, but it would make no difference for VAT.

First-Tier Tribunal (TC04230): *James Radcliffe*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 POSMOSS article

In an article in *Taxation*, Alex Millar and Mike Thexton review the latest developments in HMRC's policy on POSMOSS, including the special arrangement for businesses to continue to benefit from the UK registration threshold. A number of uncertainties and anomalies are raised, with the hope that HMRC will clarify the details before anyone falls foul of them:

- how does a "special arrangements" business move to a "normal registration" when it exceeds the threshold?
- how does a currently registered business with total turnover over £81,000 but UK turnover below the threshold move onto the special arrangements?
- is it fair to require a business to determine the appropriate VAT rate based on the receipt of payment information, when that means the VAT element can only be identified after the customer has paid?

Taxation, 15 January 2015

A number of commentators, including the writers of the above article, have suggested that there should be a minimum threshold for the application of the new rules. The distance selling rules exist to deal with a similar problem in relation to supplies of goods, and the threshold is a significant simplification for small businesses. However, when a UK MEP raised the question, the European Commissioner for Economic and Financial Affairs, Taxation, and Customs, Pierre Moscovici, explained that EU member states are opposed to the introduction of a minimum threshold for suppliers of digital services to EU consumers.

He said that "the idea of having a minimum threshold was discussed in Council at the time these rules were negotiated but this was firmly rejected by member states." He referred to the benefit of the exemption threshold for domestic digital sales, including the high threshold in the UK which HMRC's arrangements have preserved; however, he does not appear to recognise that there is a disproportionate burden of complexity in relation to small businesses and digital sales across border.

http://tinyurl.com/kh7qpqd

4.1.2 Updated guidance

HMRC have updated their guidance with a revised version of the MOSS flowchart and further guidance on selling through third-party platforms. It is confirmed that micro-businesses can, until 30 June 2015, base customer location decisions on information provided by their payment service provider.

www.gov.uk/government/publications/vat-supplying-digital-services-to-private-consumers

HMRC's guidance on how to register and use MOSS has also been updated with links to templates and guides for completing union and non-union VAT MOSS returns and how to pay a VAT MOSS bill.

www.gov.uk/register-and-use-the-vat-mini-one-stop-shop

The Commission has published basic information for micro-businesses supplying electronic services. There is also a Commission report on the national rules for implementing the MOSS on the TAXUD website.

http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/telecom/information_microbusinesses_euvat_2015.pdf

4.1.3 Exchange rates

HMRC have published the usual table of exchange rates for traders registered under the pre-MOSS special scheme for e-traders for the quarter to December 2014.

For the future, HMRC's guidance says:

If you charge or invoice consumers in other member states in a currency other than pound sterling, and you record that price in your business accounts in that currency, you must convert the amount into sterling at the end of each calendar quarter using the conversion rate published by the European Central Bank on the last working day of that quarter.

However, if you automatically convert the foreign currency into sterling using an agreed daily or other periodic rate and you record these sterling amounts in your business accounts, you may use these figures to complete your quarterly VAT MOSS Return.

The implication of that is that a UK MOSS return must be in sterling, even if the money is received in euro and held in euro. MOSS payments must also be made to HMRC in sterling.

VAT Information Sheet 10/2014

4.2 Where is a supply of services?

4.2.1 System failure

It has been reported that the mobile phone operator EE will have to refund £1m to customers in respect of phone charges that were subjected to UK VAT even though the phones were being used outside the EU. The error was discovered during due diligence work for BT's £12.5bn acquisition of EE. The charges were levied for two years up to October 2014, and were blamed on a "system error". The company has apologised to customers and started to make refunds.

Daily Telegraph, 19 January 2015

4.3 International supplies of goods

4.3.1 Dental supplies

The CJEU has now given its ruling on the VAT treatment of dental prostheses supplied across EU borders and on importation. The PVD exempts the intra-community acquisitions and the importations of goods where the in-country supply of such goods is also exempt. The PVD also exempts "the supply of dental prostheses by dentists and dental technicians" (art.132(1)(e)), but Dutch law does not include the condition on the nature of the supplier.

A Dutch entity, which was not itself a dental technician, bought prostheses from another EU Member State and supplied them to dentists in the Netherlands. It claimed to recover input tax on the acquisition on the basis that it was taxable under the Directive, but exempted the onward supply on the basis of national law.

Another Dutch entity which was a dental technician claimed that the acquisitions across border were exempt, so there was no need to account for acquisition tax (which would have been irrecoverable because the onward supply was exempt).

Advocate-General Kokott considered that the judgment in *MDDP* (Case C-319/12) showed that a trader could not claim the benefit of a non-compliant national exemption and the benefit of deduction at the same time. Either the output was exempt under the national law and the input tax was non-deductible, or the output was taxable under the Directive and the input tax was likewise deductible.

The A-G went on to consider whether the importation of prostheses is exempt. The PVD exemption in art.143(a) refers to "final importation of goods of which the supply by a taxable person would in all circumstances be exempt within their respective territory". As the exemption in art.132(1)(e) is conditional on the nature of the supplier, this could not apply. Importations of dental prostheses are therefore VATable. This view was supported by reference to the Commission's proposals for the 6th Directive in the 1970s, which gave a great deal of detail about what was intended to be exempt on importation.

The exemption for acquisitions in arts.140(a) and (b) cross-refers to art.143, and therefore cannot apply for the same reason. However, the A-G considered that, on grounds of free movement of goods and prevention of distortion of competition, exemption should be extended to intra-community transactions where the supplier was a dentist or dental technician. Supplies from outside the community were not subject to the same principles because the supplier would not be governed by the treatment in the Directive.

Lastly, the A-G considered the situation in which some Member States continue to tax supplies of dental prostheses under transitional provisions. In her opinion, the exemption should apply to intra-community transactions which fitted the description in the PVD, even if the national law in the supplier's Member State would tax such a supply.

The full court confirmed the opinion in respect of the claim for input tax – a trader relying on a domestic exemption that was incompatible with the

PVD could not also rely on art.168 PVD to justify an input tax deduction on the same transaction.

In relation to the scope of the exemption for importations and acquisitions, the CJEU concentrated on the phrase “the supply of those same goods is exempt within the territory of the Member State of destination”. This would be the case wherever a dental technician or dentist imported or acquired prostheses: the onward supply by such a person in their own state would be exempt under the PVD, unless that state had exercised an option under art.370 to continue to tax such transactions. As the Netherlands had not done so, these transactions were exempt. It would make no difference whether the Member State of despatch had opted to tax dental prostheses – they would be exempt according to their treatment in the Member State of arrival.

The judgment does not appear directly to address the situation of the non-dental technician. The implication is that its purchases should be exempt, because in the Netherlands its onward supplies are “in all circumstances” exempt – but that relies on the domestic law, not on the PVD.

CJEU (Case C-144/13): *VDP Dental Laboratory NV, Staatssecretaris van Financiën*; (Case C-154/13): *X BV*; (Case C-160/13): *Nobel Biocare Nederland BV*

4.3.2 Simplification of Intrastat

The EU Commission’s Statistical Office (Eurostat) commissioned a programme of work to look at the modernisation and simplification of the Intrastat system with the objective of substantially reducing burdens on business, whilst maintaining the usefulness and quality of the statistics for their users. In the UK version of the consultation, HMRC offered alternative suggestions:

- the total removal of the requirement to submit arrivals data in line with the Commission’s proposal;
- adapting the Commission’s proposal by reducing the coverage for arrivals to somewhere around 90% to continue to meet national needs;
- an alternative illustrative proposal of reducing the coverage for both arrivals and dispatches to 93% (the current thresholds provide coverage of approximately 93% for arrivals and 97% for dispatches).

HMRC have now published a summary of responses to the consultation. The majority of those businesses who responded that are required to provide Intrastat declarations, told HMRC they were in favour of the total removal of the requirement to submit arrivals in line with the Commission proposal. However users preferred a reduction in coverage to both arrivals and dispatches to maintain the quality and timeliness of the statistical data available.

The Commission has now moved the project on and is now looking at alternative simplification measures. HMRC will lobby for the implementation of the preferred option of reducing coverage to 93%. Pilot testing of a system for mandatory exchange of dispatches data between member states is due to take place during 2015 and will be evaluated in 2016.

www.gov.uk/government/consultations/simplification-of-intrastat

4.4 European rules

4.4.1 Rates in the EU

The Commission has published an updated list of VAT rates throughout the EU. The following table shows the standard rates in January 2015 and what they were in August 2011:

	Jan 15	*Aug 11*		*Jan 15*	*Aug 11*
Luxembourg	17	15	Lithuania	21	21
Malta	18	18	Latvia	21	22
Cyprus	19	15	Italy	22	20
Germany	19	19	Slovenia	22	20
France	20	19.6	Ireland	23	21
Austria	20	20	Greece	23	23
Bulgaria	20	20	Poland	23	23
Estonia	20	20	Portugal	23	23
Slovakia	20	20	Finland	24	23
UK	20	20	Romania	24	24
Spain	21	18	Croatia	25	N/A
Netherlands	21	19	Denmark	25	25
Czech Republic	21	20	Sweden	25	25
Belgium	21	21	Hungary	27	25

11 countries have increased their rates in that time; 15 have remained the same; Croatia has joined the EU; and only Latvia has reduced its rate.

The Commission's document also sets out reduced and super-reduced rates, and the categories of supply to which they apply. It demonstrates that a unified system is some way off.

http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf

4.4.2 Passenger transport

The Commission has published a report examining the different application of the VAT rules to passenger transport in different Member States. The report considers possible options for reform to address distortions of competition that arise from the varying treatments.

ec.europa.eu/taxation_customs/common/publications/studies/index_en.htm

4.4.3 Rates in breach of the Directive

Poland applied a reduced rate of VAT to goods intended to provide fire protection. These are not mentioned in Annex III PVD, so the reduced rate could not comply with art.98. The CJEU agreed with the Commission that there was no justification for the failure to apply the Directive.

CJEU (Case C-639/13): *European Commission v Republic of Poland*

The Commission instituted proceedings in the CJEU against Luxembourg and France, asking for a declaration that they are in breach of articles 96 to 99 PVD in applying a reduced rate of VAT to electronic books. According to the Commission, Luxembourg breaches two rules – it applies a reduced rate to digital books when they are expressly excluded

by art.98(2), and its reduced rate at 3% is lower than the minimum prescribed rate in art.99 without qualifying for the exceptions in art.110 or art.114.

The Court agreed with the Commission's arguments and rejected Luxembourg's. The list of electronic services in Annex II was indicative, not exhaustive, so nothing could be inferred from the fact that electronic books were not included. Annex III, by contrast, was exhaustive, because it provided for an exception to the general rules of VAT: "books on all physical means of support" could not include electronic books. The various transitional provisions, and the principle of fiscal neutrality, could not override the clear requirement of the Directive to charge standard rated VAT on supplies of electronic books. The Commission's application was granted.

The ruling only refers to the rate of 3% as charged on electronic books. It does not declare that the rate is unlawful in itself. Luxembourg was ordered to pay the costs of both sides.

CJEU (Case C-502/13): *Commission v Grand-Duchy of Luxembourg*

France's 5.5% reduced rate was likewise found to contravene the Directive.

CJEU (Case C-479/13): *Commission v French Republic*

4.4.4 Missing traders and the law

Questions were referred by the Dutch courts to establish whether the tax authorities of a Member State have powers to counter missing trader fraud when such powers are not explicitly set out in national law. The Advocate-General gave an opinion that there is a general principle that traders will act in good faith in relation to VAT. If they do not, then the authorities have wide powers to deny them the rights that they have abused (*Halifax*, Case C-255/02 on input tax and *Mecsek-Gabona*, Case C-273/11 on exemptions).

The absence of national legislation did not restrict the application of this general principle by the national authorities. It did not make any difference if the fraudulent transactions were carried out in different jurisdictions – one of the appellants claimed that the fraud was carried out in Italy, and it had satisfied all the formal requirements to justify the relief in the Netherlands.

The full court confirmed and strengthened the opinion. The formal answers to the questions raised were:

[The 6th VAT Directive] must be interpreted as meaning that it is for the national authorities and courts to refuse a taxable person, in the context of an intra-Community supply, the benefit of the rights to deduction of, exemption from or refund of VAT, even in the absence of provisions of national law providing for such refusal, if it is established, in the light of objective factors, that that taxable person knew, or should have known, that, by the transaction relied on as a basis for the right concerned, it was participating in evasion of VAT committed in the context of a chain of supplies.

[The 6th VAT Directive] must be interpreted as meaning that a taxable person who knew, or should have known, that, by the transaction relied on

as a basis for rights to deduction of, exemption from or refund of VAT, that person was participating in evasion of VAT committed in the context of a chain of supplies, may be refused the benefit of those rights, notwithstanding the fact that the evasion was carried out in a Member State other than that in which the benefit of those rights has been sought and that taxable person has, in the latter Member State, complied with the formal requirements laid down by national legislation for the purpose of benefiting from those rights.

CJEU (Case C-131/13): *Staatssecretaris van Financiën, other party: Schoenimport 'Italmoda' Mariano Previti*

Two other cases were considered at the same time, because they also concerned questions about the power of the Netherlands tax authorities to deny relief to persons suspected of fraud. However, the CJEU ruled the questions inadmissible, because it was apparent that the national courts had not yet determined that there had been a fraud. The questions were therefore hypothetical; questions should only be referred when it is clear that the answers will have direct relevance to the proceedings.

CJEU (Case C-163/13) *Turbu.com BV*; (Case C-164/13) *Turbu.com Mobile Phone's BV*

4.4.5 Abuse of rights

A Portuguese company in the healthcare business carried out what would be in the UK a familiar (but ineffective) VAT planning exercise – the construction and fitting out of a hospital, followed by the taxable transfer of that facility to a group company. The Portuguese authorities disallowed the VAT recovery on the basis of an abusive practice. However, in assessing the tax it did not comply with a domestic law relating to avoidance of other taxes; the company appealed, arguing that it should have followed a procedure mandatory within Portugal, and therefore the assessment was legally flawed.

Questions were referred to the CJEU by the Portuguese court. It was of the view that domestic abuses had to be countered using the Portuguese law, but as VAT was based on EU law, perhaps different principles applied.

The Portuguese government questioned the admissibility of the reference on the grounds that the question was too vague – it did not identify the precise provision of EU VAT law which was in doubt. The court considered that this did not prevent it examining the question. It identified art.273 PVD as relevant: Member States may take the necessary measures to ensure the correct collection of VAT and to prevent evasion. In addition, under art.342, Member States have the power to lay down measures that ensure that taxable persons do not enjoy unjustified advantage or sustain unjustified harm. Other objections to admissibility were also rejected.

As regards the substantive question, the court ruled that the PVD did not preclude the mandatory application of a preliminary procedure in relation to determining VAT abuse, as long as the principles of effectiveness and equivalence were not breached. This appears to support the taxpayer: the state has to follow its own rules in relation to fraud, evasion and abuse,

and if it fails to do so, it cannot fall back on general principles that it has not incorporated in its domestic legislation.

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

The Hungarian court has referred questions about related party transactions that appear to have been arranged in order to generate a tax advantage. The individual creator of know-how owned two companies: one of them licensed the know-how to the other, but both were under his direct control, and the authorities took the view that the transactions between them were fictitious.

The questions referred are long and detailed – possibly the longest set of questions ever set to the CJEU, running to 17 separate questions and over 2,000 words in the English translation. They address a number of factors that could be taken into account in deciding whether transactions should be disregarded for VAT, determining the identity of the parties to a transaction, and the relevance of various alleged irregularities in the conduct of the investigation to the result.

CJEU (Reference) (Case C-419/14): *WebMindLicences Kft.Nemzeti Adó és Vámhivatal Kiemelt Adó és Vám Főigazgatóság v Nemzeti Adó és Vámhivatal Kiemelt Adó és Vám Főigazgatóság*

4.4.6 Supply of staff

Art.132(1)(g) exempts "the supply of services and of goods closely linked to welfare and social security work, including those supplied by old people's homes, by bodies governed by public law or by other bodies recognised by the Member State concerned as being devoted to social wellbeing". A staff agency supplied carers to establishments that supplied exempt care; the German tax authorities ruled that the supplies were taxable, which would create a sticking cost. The agency appealed, arguing that its own supplies should fall within art.132(1)(g), and questions were referred to the CJEU.

The CJEU commented, as usual, that the terms of an exemption must be interpreted strictly, but not so as to deprive the exemption of its intended effect. Precedent cases showed that it was for a Member State to determine the conditions for a body to be regarded as devoted to social wellbeing. Germany had not done so in respect of temporary staff agencies. The precedents suggested a number of criteria that might be applied by a Member State in this classification, but none applied here.

The "supplies" by the individual care workers could not be exempt because they were not taxable persons acting independently. The supply of staff was not covered by art.132(1)(g). The answer to the referring court's question was therefore that the exemption did not apply in this situation.

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

4.4.7 Enforcement and proportionality

A court enforcement officer sold some property to enforce a debt owed by the owner to a creditor. Under Polish law, the court enforcement officer was supposed to issue a VAT invoice and account for the VAT in the sale proceeds to the tax authorities by the normal time limits. It seems that he failed to do so, even though he did receive the appropriate share of the money; the case report is not clear what sanction he suffered as a result of the late payment, or the specific reason for the late payment.

The court officer appealed against the tax authority's ruling, and questions were referred to the CJEU. The court ruled that Polish law was not contrary to the Directive in imposing such obligations on a court enforcement officer making a sale on behalf of a debtor. The principle of proportionality was not infringed by the fact that his whole personal assets were exposed to liability to the tax authorities, provided that he actually had all legal means to discharge that obligation, which it was for the referring court to determine.

In addition, Polish law did not contravene the principle of fiscal neutrality in not allowing the officer to deduct input tax incurred by the debtor in the relevant period. That input tax was proper to the taxable person, not to the officer, who had only dealt with the sale of the property.

CJEU (Case C-499/13): *Macikowski v Dyrektor Izby Skarbowej w Gdansku*

4.4.8 Holding companies

The Advocate-General's opinion has been released in the joined cases of *Larentia + Minerva* and *Marenave*. There are several important issues:

- the extent to which VAT incurred on fees relating to the acquisition of subsidiaries is deductible – whether it can be attributed to non-business investment activities;
- whether a Member State can restrict VAT grouping to companies, or should allow partnerships and other taxable persons to join; and whether Germany was allowed to require that only a relationship of "control and subordination" should permit grouping.

The first issue was considered in the context of two different transactions:

- the acquisition of shares in the subsidiaries;
- the raising of finance in order to acquire shares in subsidiaries.

Advocate-General Mengozzi notes that the questions for reference ask about the specific method that ought to be used to calculate the recoverable VAT. Unusually, he chooses to answer a slightly different question. According to cases such as *Securenta* (Case C-437/06) and *Portugal Telecom* (Case C-496/11), the PVD does not prescribe any method for apportioning input tax between business and non-business activities. It is for the Member State to choose a method that produces a fair result. It is therefore not within the jurisdiction of the CJEU to suggest a particular method.

The companies argued that the question should be rather whether they were purely economic operators within the principles of the *Cibo*

Participations case (Case C-16/00). If so, all the VAT incurred should be attributed to their economic activities, and in the absence of exempt outputs, there was no reason to disallow any.

The Advocate-General agreed with this proposition. The CJEU has distinguished between two types of holding company:

- those whose sole purpose is to hold and manage shares in other companies and which do not provide those companies with any services for remuneration and thus do not involve themselves directly or indirectly in the management of other undertakings, other than by exercising their rights as shareholders (*Polysar*);
- those which have direct or indirect involvement in the management of the companies in which the holding has been acquired, without prejudice to the rights held by the holding company as shareholder (*Cibo*).

The first are regarded as merely acquiring and holding financial holdings, and are not engaged in economic activity. The second category, referred to as "management holding companies", are economic operators. There was no significant difference between the present cases and *Cibo* – and no reason to apportion any of the input tax incurred to the "*Polysar*-type" activity of merely holding shares.

In relation to the rules on grouping, the A-G noted that recent cases suggested that Member States had to either allow grouping or not allow it: they could not restrict grouping to particular types of company or sectors (*Commission v Sweden* Case C-480/10). The PVD provisions refer to allowing "persons" to be treated as a single taxable person; it does not refer to "legal persons" in this context, although it does so elsewhere. The court had held that such conditions could be lawful only if they were intended to prevent avoidance, evasion and abuse, and were proportional to that intention; in the Sweden case, no such intention could be discerned behind the legislation, so the provision was unlawful.

The grouping provisions in the PVD were not mandatory, so they could not have direct effect in the same way as a mandatory provision. However, national courts should interpret their own legislation, as far as possible, in a manner that was consistent with the Directive and with general EU principles.

The Advocate-General's suggested answers to the questions are:

1. Expenditure connected with capital transactions incurred by a holding company which involves itself directly or indirectly in the management of its subsidiaries has a direct and immediate link with that holding company's economic activity as a whole. Input value added tax on that expenditure should not therefore be apportioned between the economic and non-economic activities of the holding company. If the holding company effects transactions which are subject to value added tax and transactions which are exempt, the proportion method provided for in [art.17(5) 6th Directive] will be used to calculate the right to deduct input value added tax.

2. The second subparagraph of [art.4(4) 6th Directive] precludes a Member State, in the exercise of the option available under that provision, from making the formation of a VAT group subject to the condition that

all the members of that group must have legal personality, unless that condition is justified by the prevention of abusive practices or of tax evasion or avoidance, having due regard to EU law, in particular the principle of fiscal neutrality, this being a matter which must be determined by the referring court.

National legislation under which close financial, economic and organisational links, within the meaning of the second subparagraph of [art.4(4) 6th Directive], can exist only where there is a relationship of control and subordination between the members of the VAT group is liable to be compatible with that article, on condition that it is necessary and proportionate to the pursuit of the objectives of preventing abusive practices and tax evasion or avoidance in compliance with EU law, in particular the principle of fiscal neutrality, this being a matter which must be determined by the referring court.

3. A taxable person cannot rely directly on the second subparagraph of [art.4(4) 6th Directive]. It is, however, for the referring court, as far as possible, to interpret its national legislation in conformity with that provision of the Sixth Directive.

CJEU (A-G) (Case C-108/14): *Beteiligungsgesellschaft Larentia + Minerva mbH & Co. KG v Finanzamt Nordenham*; (C-109/14): *Finanzamt Hamburg-Mitte v Marenave Schiffahrts AG*

4.4.9 Penalties

The Italian court has referred a question about penalties to the CJEU. It asks whether a surtax and a 50% tax-geared criminal penalty can fairly be levied for the same omission. The underlying default relates to direct tax (making a payment without deducting withholding tax), but the principles of the answer could also be applicable to VAT. The taxpayer argued that the double penalty contravened the principle of “ne bis in idem” or double jeopardy in art.4 of the Seventh Protocol to the European Convention on Human Rights and in art.50 of the Charter of Fundamental Rights of the European Union.

In *Åklagaren v Fransson* (Case C-617/10), the CJEU ruled that this principle did apply to VAT, but art.50 “does not preclude a Member State from imposing successively, for the same acts of non-compliance with declaration obligations in the field of value added tax, a tax penalty and a criminal penalty in so far as the first penalty is not criminal in nature, a matter which is for the national court to determine.” It is only against the principle if two criminal penalties are levied for the same offence. The determination of whether something is a criminal penalty depends on three criteria: the legal classification of the offence under national law; the very nature of the offence, and the nature and degree of severity of the penalty that the person was liable to incur.

CJEU (Reference) (Case C-497/14): *procedimento penale a carico di Stefano Burzio*

4.5 Eighth Directive reclaims

Nothing to report.

5. INPUTS

5.1 Economic activity

5.1.1 Abuse to go to the Supreme Court

On 11 March 2015, the Supreme Court will start to hear the appeal of HMRC against the Court of Appeal's decision that the Upper Tribunal should not have overturned the FTT's decision in favour of the taxpayer in a case about abuse of rights. The company was involved in an arrangement to transfer demonstrator vehicles that resulted in accounting for output tax on the margin on sale rather than the full selling price; the FTT concluded that it was entered into for commercial reasons other than the avoidance of tax.

Supreme Court: *HMRC v Pendragon plc and others*

5.1.2 Business purpose

A company claimed input tax in relation to the construction of a "pavement fountain" in a public place in the town in which it is based. HMRC ruled that it had insufficient nexus with the business and disallowed the VAT (£89,193). The company appealed.

The company is responsible for redevelopment of Folkestone Seafront. The fountain was outside the redevelopment area but at its entrance: the company claimed it had been "built as a beacon to kickstart the regeneration of the seafront area and assist with the comprehensive redevelopment of the seafront site". HMRC argued that the "business" was marketing and sale, and the fountain only improved the general amenity of the area.

The Tribunal examined the history of the development and had no hesitation in finding that the fountain was a key part of it. Although there would be some public amenity, the economic reality was that the company had benefited and would continue to benefit. There was a marketing benefit in that a plaque displayed the name of the developer; and the increase in property prices resulting from the amenity also helped to make the rest of the project viable.

It was also clear that the subjective intention was to enjoy a business benefit (both parties agreed that, following *Flockton*, this was the correct test) – no sensible businessman would have incurred this expenditure without expecting a return.

The appeal was allowed.

First-Tier Tribunal (TC04306): *Folkestone Harbour (GP) Ltd*

5.1.3 Legal fees

An individual registered for VAT from 1 March 2011 with the stated trade of "property consultant". His VAT return to 08/12 showed output tax of nil and input tax of £16,979.50. HMRC carried out a visit and established that input tax had been claimed on earlier returns amounting to £17,410, all relating to legal fees in connection with a dispute about a property development dating back to 1996; an assessment was raised to recover

that amount, and £8,772 of the 08/12 input tax was disallowed. The trader appealed.

The trader's representative wrote to HMRC explaining that he had filed a legal claim against the developers of the St Pancras Hotel in London. He believed that he was due a finder's fee in relation to this development and should receive a quarter of the profits. This claim was in excess of the VAT registration threshold; he would account for output tax on the amount eventually received, and should be entitled to input tax credit in relation to the legal fees involved in recovering it.

The Tribunal agreed with HMRC that the legal fees were incurred in relation to something that the trader had done in 1996, at a time when he was not VAT registered. It could not therefore be input tax. The assessment and the decision to disallow input tax were confirmed.

First-Tier Tribunal (TC04334): *Charles Dorian Lissack*

5.2 Who receives the supply?

5.2.1 Raising finance

A company claimed £2,004 of input tax in relation to raising equity finance. The transaction involved a number of parties, and the lawyers acted in the interests of all of them. HMRC ruled that the company did not receive the supply of legal services, and therefore could not recover the input tax, even though it paid the bill.

The decision records that all parties turned up for a hearing in October 2014, but "due to circumstances beyond anyone's control" the hearing did not take place. Given the modest amount involved, and the bundles of evidence and statements of case that had been provided, the judge decided to proceed with a "paper appeal" instead.

No letter of engagement had been produced. Following the *Airtours* decision, this had to be the starting point in deciding who had received the supplies. The appellant's argument was that the company needed to raise the money, and it needed the lawyers to make the transaction happen, but this was not enough to show that it had received the supply of legal services. It would not have been difficult to provide a letter of engagement, or perhaps a short witness statement from the lawyers. In the absence of these, the judge had to dismiss the appeal.

First-Tier Tribunal (TC04296): *Finds You Ltd*

5.3 *Partial exemption*

5.3.1 Partial exemption and foreign branches

The Budget included a proposal to restrict the recovery of input tax on overheads of a UK business with foreign branches. The present rules allow traders to include supplies made by foreign branches in their T over T plus E calculation. This will be barred by a change in the regulations.

The change is explained by reference to the *Credit Lyonnais* decision (Case C-388/11). The CJEU ruled that the PVD did not authorise Member States to allow or require methods that based recovery on the turnover of foreign branches. The TIIN suggests that some businesses might manipulate their recovery by allocating their costs unevenly between branches. The estimated impact is a tax increase of £90m in a full year, so HMRC must believe that some traders do this.

A draft SI has been issued for discussion. The SI amends reg.101(3) to exclude supplies made by foreign branches from the overhead proportion, and also amends reg.102 to exclude such supplies from overhead recovery under special methods (whether agreed before or after the change). The changes will come into effect for the first partial exemption year starting on or after 1 August 2015 – in most cases, the years beginning 1 April, 1 May or 1 June 2016.

Inputs that are directly attributable to the supplies of foreign branches (that would be taxable in the UK) will still be recoverable under reg.101(1) and (7).

www.gov.uk/government/publications/vat-deductions-relating-to-foreign-branches; *SI 2015/Draft*

5.3.2 Academic costs and commercial research

Imperial College made a *Fleming* claim for £626,757 on 31 March 2009. It covered part of the university's residual input tax for the years from April 1973 to July 1994. Three previous repayment claims had been submitted in 1993, 1994 and 1995, effectively claiming the same amount; these had been refused when the three-year cap was introduced in 1996. A fourth claim, made in 1997, was agreed by HMRC, but the effect of the cap meant that input tax was only repaid for the period from 1 August 1994 to 31 July 1997. When the *Fleming* claims window opened, the university argued that the only bar to its claims for the earlier periods had been removed, and they should simply be settled.

The basis for all the claims was that some of the academic overheads of the university should have been allocated to its commercial research activities, which involved making taxable supplies and should therefore have created an entitlement to input tax recovery. The university argued that HMRC's acceptance of the 1997 claim implied the approval of a partial exemption special method which would have had retrospective effect. This was because the 1997 claim was for the inclusion of a category of overheads that had not previously been included; if those overheads should be included as a matter of principle, the operation of the agreed PESM would generate a repayment.

HMRC argued that no such agreement was implied by the 1997 repayment. If the university's 2009 claims were treated as new claims, all

earlier periods could be reopened by HMRC, with the most likely result being that no further input tax would be repaid to the taxpayer, because a "fair and reasonable" method would take further factors into account that would cancel the university's advantage (certain grant income that had previously been ignored would have to be included in the calculations as exempt). In HMRC's view, the earlier repayment had simply been an adjustment to the operation of the "CVCP guidelines", rather than the agreement of a special method to operate retrospectively.

The Tribunal examined the history of the dispute and the correspondence. In the view of the judge, this was more consistent with the university's version of events. There were many references to agreeing "a method" and none to the guidelines. The earlier claims did not fit the framework provided by the guidelines. The evidence suggested that HMRC had, in early 1996, given positive approval for a non-CVCP special method to be operated retrospectively, and the only reason for not paying it was the cap. The judge rejected an argument that such an approval was ultra vires and therefore ineffective: the officer who gave approval appeared to think so, but he was wrong, and his opinion was not relevant.

The Tribunal decided all matters of principle in favour of the university. The approval of the method and the earlier claim meant that the only bar to the repayment was the cap, and that had been removed by the *Fleming* case. However, the evidence was not strong enough to support a repayment for the periods up to and including 1980/81. The appeal was therefore allowed in relation to the years after that.

First-Tier Tribunal (TC04246): *Imperial College of Science, Technology & Medicine*

5.3.3 Special method rejected

A private sports and social club applied to use a special method, which HMRC refused. The club appealed against the refusal. The judge rehearsed the law, and noted that he had full jurisdiction to agree with or disagree with the decision, rather than simply considering whether it had been reasonably made.

The club had operated a special method since 1996, and updated it in 2007. It was based on "sectors", separating out input tax relating to the main clubhouse and the rest of the estate. The 2007 method included the provision that "For the avoidance of any doubt, any input tax incurred in relation to goods and services used on any part of the estate comprising sports areas and buildings is to be considered as directly attributable to the exempt supplies of membership."

In 2010, the club wrote to HMRC seeking to make a number of amendments, including the deletion of this clause. They argued that the sporting facilities were used to make taxable supplies of sporting facilities to non-members, so it was wrong to exclude all of this input tax in the exempt category.

However, HMRC responded that the FTT's decision in *Bridgnorth Golf Club* (TC00094) suggested that other aspects of the special method were unduly favourable to the club. In that case, expenditure on a club's lounge and bar (used mainly for the consumption of taxable food and drink) was held to be residual because it increased the attractiveness of the

club to members (who paid exempt subscriptions). Following further correspondence, the club asked to revert to the standard method, and this was agreed by HMRC in September 2010.

The club carried out a significant investment in its sporting facilities, enjoying a greater credit under the standard method than it would have done under the previous special method. It then applied in December 2012 to agree a new special method, similar to that previously adopted. This included a floor area-based apportionment in relation to the clubhouse. The standard method produced 36% recovery, but the proposed special method would produce 86.4% recovery in relation to the clubhouse. HMRC refused the application, stating that the club had not shown that this was more "fair and reasonable" than the standard method.

The Tribunal examined the reasons given for the refusal of the special method. These were:

- lack of reason for the standard method not producing a fair result;
- significant increase in recovery without explanation of why this is fairer than the standard method;
- exclusion of a third of the floor area of the clubhouse on the grounds that those areas are not directly used for making supplies or are used for mixed supplies;
- questions about the allocation of floor space to the different categories.

The FTT noted that the fact HMRC had in the past agreed a floor area-based method was not relevant – the new proposal should be considered on its own merits. The judge agreed in particular with the third of the above objections – the exclusion of such a large proportion of the area did not support the contention that the method would produce a more accurate result. The *Bridgnorth* decision also supported HMRC's fourth contention. There were difficulties with the allocation of several areas, including the plant rooms used for air conditioning and heating.

Lastly, the fact that the club had itself decided in 2010 to abandon the 2007 special method was indicative that it was not more fair and reasonable than the standard method. The appeal was therefore dismissed.

First-Tier Tribunal (TC04283): *The Hurlingham Club*

5.4 Cars

Nothing to report.

5.5 Business entertainment

5.5.1 Lawfulness of the entertainment block

PwC claimed for under-recovered input tax on meals and other refreshments provided to persons other than employees in all accounting periods from the introduction of VAT on 1 April 1973. HMRC refused

the claim in 2011 and, following a review, in 2013; PwC appealed. A hearing (before Judge Mosedale) considered a preliminary issue: whether the extension of the input tax block on entertainment expenditure on 1 August 1988 meant that the input tax block as a whole was invalid from that point on, because an attempt to extend a block removed the legal authority that had previously applied under transitional provisions. The hearing did not consider any evidence of the facts, but assumed that the firm had purchased goods and services after August 1988 that were used for strictly business purposes but on which no input tax was claimed because of the input tax block.

The Tribunal examined the history of the legislation. There was a block on certain input tax in the 1972 legislation; the Special Provisions Order 1977 provided in particular that "*Tax charged on the supply to a taxable person of goods or services used by him for the purpose of business entertainment shall be excluded from any credit under [the relevant statute] unless the entertainment is provided for an overseas customer of his and is of a kind and on a scale which is reasonable, having regard to all the circumstances.*" This provision was in force when the 6th Directive was implemented in the UK, and re-enacted a block that had been in force since the introduction of VAT in 1973.

By the time of the hearing, PwC had accepted that the block was lawful up to 1 August 1988, and they were no longer pursuing any claim to input tax incurred before that date. The 1988 change in legislation to remove the exception for overseas customers was by way of repeal and re-enactment; so the previous block was cancelled, and a new one was introduced. PwC argued that it was therefore not protected by the transitional rules, and had to be measured against the more stringent tests of business purpose as discussed by the CJEU in the *Danfoss* case.

The Tribunal noted that the government changed the UK law in 2011 to restore the pre-1988 rules, and – as far as the Tribunal understood – HMRC refunded input tax not claimed between 1 May 1988 and 30 April 2011 in respect of the kind of expenditure that qualified as "business". The question was whether all other business entertainment expenditure should also be refunded for the same period.

PwC relied on *Commission v France* (Case C-40/00). That concerned a block in France on diesel fuel. A 100% block was modified to allow partial right to deduct (going from 10% eventually up to 90% and back to 50%). Then in 1998 France reintroduced the total ban. The Commission challenged this in the CJEU, which agreed that the total ban could not be reintroduced after the scope of the block had been reduced.

The Tribunal did not agree with PwC that this judgment was authority for the proposition that the partial block became unlawful because of the attempt to reintroduce the total block. The decision did not say so in express terms, and if it had intended that effect, it would surely have said so. The natural reading of what the CJEU said was that the partial block remained lawful even though it was later unlawfully extended.

PwC also argued that the CJEU had referred to "that law" being unlawful, "that law" being the revised block in France that was introduced in a similar way to the UK's extended blocking order – by repealing the old law and introducing new law. The Tribunal did not accept this: in the judge's view, the CJEU was not interested in the mechanics of the

national legislative process, but in its effect. "That law" referred to the extended block, not to the particular legal instrument that purported to effect it.

The judge considered that the same conclusion should be drawn from the later decision in *Metropol Treuhand* (Case C-409/99). An Austrian block on cars was extended to cover minibuses; the suggestion that this meant the block on cars was not valid was not even considered, even though it would surely have been a very significant matter in the case if it had been relevant.

The judge also referred to *Danfoss* (Case C-37/07), the case that led to the change in the UK law and the various claims made for historical input tax on entertainment expenditure. The judge considered this case irrelevant to the present argument, because it concerned a different problem – the Danish authorities had allowed input tax by administrative practice, then tried to introduce a legislative block. It was not about the legality of an extension to an existing legislative block, nor about the proposition that the whole authority of a block fails if it is amended.

The judge briefly examined the decisions in *Magoora* (Case C-414/07) and *X Holding* (Case C-538/08), but again found little assistance in them. *Maritza East* (Case C-124/12) concerned an attempt by Bulgaria to extend a block immediately before joining the EU: it failed, because the blocking order had to have actually been in force before the Directive took effect in the country.

Van Laarhoven (Case C-594/10) concerned a Dutch law that allowed input tax on cars with private use, but charged a flat rate output tax in respect of it. The Advocate-General's opinion discussed the possibility that increasing the flat rate charge might breach the standstill order for input tax blocks, but the CJEU did not mention it – the standstill rule would not affect something that might achieve a similar result by a different route. The Tribunal judge did not consider the Advocate-General's opinion to be persuasive in favour of the appellants' case.

Ampafrance (Case C-177/99) concerned a block on hotel expenditure in France that was held to be unlawful even though a derogation had been applied for and granted; the CJEU held that it was clear that the derogation was not within the range permitted by the Directive and is should never have had effect. The judge considered that the CJEU judgment supported HMRC's view that replacing an authorised "standstill" block with a wider one meant that the extension was invalid, but the previous block remained lawful.

The judge declined to make a reference to the CJEU. In her view, the precedents showed no support for the appellants' view, and there was no real doubt about the matter.

First-Tier Tribunal (TC04219): *PricewaterhouseCoopers LLP and related appeal*

5.6 Non-business use of supplies

5.6.1 Pension fund costs

HMRC have issued another Brief on the subject of the deduction of input tax in relation to pension fund management costs, following up on R&C Brief 43/2014. The brief has been drafted following informal consultation with the pensions industry (including pension lawyers, managers and trustees) and outlines evidence that HMRC accept meets the requirements outlined in the previous Brief in order for employers offering defined benefit (DB) pension schemes to achieve VAT deduction in respect of the costs of pension fund management services; in particular it considers the use of tripartite contracts between the employer, the trustees and the manager.

The brief only relates to pension fund management services provided in respect of DB schemes. In specific circumstances pension fund management services supplied in respect of defined contribution pension schemes will be VAT exempt following the CJEU decision in *ATP Pension Services*. Readers are referred to R&C Brief 44/2014.

Further guidance will be issued later this year on the deduction of input tax on:

- other types of service (such as legal, actuarial and accounting services);
- other types of pension scheme (such as defined contribution and hybrid);
- VAT Groups that include a corporate trustee and a sponsoring employer;
- trustees that charge employers to run their pension schemes.

HMRC note that the special circumstances of a DB scheme are relevant to the deduction of input tax under *PPG* principles: because benefits arising from DB pension schemes often form a central part of the sponsoring employer's staff remuneration package and the employer carries the ultimate burden of ensuring that there are sufficient funds with which to pay the promised benefits, investment management services benefit the sponsoring employer as well as the pension scheme.

Since the publication of R&C Brief 43/2014, some employers have expressed a concern that directly contracting for pension fund management services may sometimes be difficult owing to the regulatory context in which they operate. Accordingly they have asked whether HMRC will accept that tripartite contracts between the supplier, pension scheme trustees and employer meet the condition that the employer must contract for the services. In the circumstances of DB schemes, HMRC will accept that an employer may be able to deduct VAT incurred on these services in line with its residual recovery position where, as a minimum, the contract with the service provider evidences that:

- the service provider makes its supplies to the employer (albeit that the contract may recognise that, in the particular regulatory context in which DB schemes operate, the service provider may be appointed by, or on behalf of, the pension scheme trustees);

- the employer directly pays for the services that are supplied under the contract;
- the service provider will pursue the employer for payment and only in circumstances where the employer is unlikely to pay (for example, because it has gone into administration) will it recover its fees from the scheme's funds or the pension scheme trustees;
- both the employer and the pension scheme trustees are entitled to seek legal redress in the event of breach of contract, albeit that the liability of the service provider need not be any greater than if the contract were with the pension scheme trustees alone and any restitution, indemnity or settlement payments for which the service provider becomes liable may be payable in whole to the pension scheme trustees for the benefit of the pension scheme (for example in circumstance where the scheme is not fully funded);
- the service provider will provide fund performance reports to the employer on request (subject to the pension scheme trustees being able to stipulate that reports are withheld, for example where there could be a conflict of interest);
- the employer is entitled to terminate the contract, although that may be subject to a condition that they should not do so without the pension scheme trustees' prior written consent (this can be in addition to any right that the pension scheme trustees may have to terminate the contract unilaterally).

In addition to the above, there should be evidence that the pension scheme trustees agree that it is the employer who is entitled to deduct any VAT incurred on the services will reduce the potential for disputes.

For an employer to be able to deduct any VAT, it will be necessary for them to be issued with a valid VAT invoice for the full cost of the supply and to pay the service provider directly for the full cost of the services. HMRC do not accept that an equivalent increase in contributions to the fund or any payment that is made by, or through, the fund constitutes payment by the employer. However, if an adjustment is made to the contributions to take account of the fact that the employer rather than the fund is paying for certain costs, that will not be regarded as indirect consideration for a supply by the employer to the pension fund. This is provided that there is no specific reduction equal to the actual costs that were incurred in any given period.

If an employer recharges the net cost of those services to the pension scheme, that recharge is consideration for an onward taxable supply and VAT is due accordingly. This amount is potentially deductible by the pension scheme to the extent that the pension scheme is engaged in taxable business activities.

Revenue & Customs Brief 8/2015

5.7 Bad debt relief

5.7.1 GMAC and British Telecom

The Upper Tribunal heard the *GMAC* and *British Telecom* cases together, as both were appealing against HMRC's decision to refuse claims for historic bad debt relief. It found in favour of both companies on the question of whether their claims were time-barred, but referred *GMAC* to the CJEU to establish whether there was any legal validity in HMRC's argument that the company would enjoy an unjustified windfall. The CJEU emphatically refused to agree with that proposition.

By the time the *GMAC* case returned to the UT, the *BT* case had been to the Court of Appeal, which overturned the UT decision on the time-bar issue in relation to bad debts incurred between 1 October 1978 and 31 March 1989. The Supreme Court also refused the company leave to appeal. Not surprisingly, HMRC argued that the *GMAC* case should now be decided in their favour on the same basis, even though they had lost the "windfall" argument. The company contended that the *BT* decision depended on its own facts, and the circumstances of the *GMAC* appeal were quite different.

The UT was not sure that its decisions were appealable matters, and invited submissions from the parties on the best way to proceed. Even after these submissions, the judge was not clear about the technically correct course. It might be possible for the UT to look at the case again; it might be necessary to refer the case back to the FTT for further findings of fact; it might be more efficient for the Court of Appeal to consider all of HMRC's arguments together and to make whatever further directions the judges considered appropriate. To resolve the issue, he affirmed his earlier decision of 3 August 2012 in its entirety, so all matters were found for GMAC. It would be open to HMRC to serve an application for leave to appeal to the Court of Appeal by 2 February 2015.

Upper Tribunal: *HMRC v GMAC UK plc*

5.8 Other input tax problems

5.8.1 Missing traders

In TC01798, the FTT confirmed HMRC's denial of £183,000 input tax in relation to two despatches of mobile phones to Denmark in July 2006. The appellant had earlier applied for an interim release of £100,000 of the VAT at issue, which the FTT had declined to authorise. In the substantive hearing, the FTT concluded that the only reasonable explanation for the deals was that they were facilitating a fraud, and the company knew all the facts that led to that conclusion at the time it entered into the transactions. It was therefore not entitled to claim input tax.

The company appealed to the Upper Tribunal. Its representative, Michael Patchett-Joyce, tried (as he has in numerous other MTIC appeals to the UT) to persuade the Tribunal that the FTT had misapplied EU law by reference to the CJEU decisions in *Mahageben*, *Peter David* and *Toth*. The UT dismissed this argument, holding that the Court of Appeal's

decision in *Mobilx* (applied by the FTT) was entirely consistent with those decisions.

Mr Patchett-Joyce also argued that the FTT's conclusion that the company had "the means of knowing" was unreasonable based on the evidence. It was involved in the "clean chain" of a contra-trading arrangement, and did not even deal directly with the contra-trader. The UT did not accept that this ruled out the FTT's finding; it had considered all the evidence before it and concluded that there was no error of law. The various criticisms of the decision were examined in turn and dismissed, as was the appeal.

The company appealed further to the Court of Appeal, where Paul Lasok QC put forward similar arguments on behalf of the taxpayer. He contended that the CJEU decision in *Bonik* meant that the *Kittel* principle only applied where the VAT loss was in the same supply chain as the trader's transactions; in addition, the trader had to have "the requisite knowledge" of the fraud, which required a finding that the trader had to be treated as a participant in that fraud.

The Court of Appeal confirmed that the Tribunals had applied the correct tests. The appellant's attempt to rely on *Bonik* was misplaced: in that case, the CJEU had considered the specific circumstances, and had not changed the underlying principles of the *Kittel* decision. It was for the national courts to determine whether there was a sufficient connection to the fraud to establish "means of knowing": the Court of Appeal in *Mobilx* had set out how the UK courts would approach that question, and the Tribunals had done so correctly. The trader had simply to know, or have the means of knowing, that fraud had occurred, or would occur, at some point in some transaction to which his transaction was connected. He did not have to know how the fraud was carried out in order to have that knowledge.

The appeal was dismissed again.

Court of Appeal: *Fonecomp Ltd v HMRC*

Two related companies appealed against HMRC's refusal of £11.7m of input tax in relation to purchases of mobile phones in 03/06 – 05/06. The judge noted that in the witness statements of 19 HMRC officers, there was "*comment, opinion and what can only be described as submissions on the conclusions to be drawn from their evidence.*" The Tribunal in *Megantic Services* had set out the correct approach to such statements: "*... such expressions of view, on matters which it is for the tribunal to determine, did not amount to evidence to which the tribunal would have regard. ... the tribunal itself is quite capable of distinguishing between the evidence on which a conclusion falls to be drawn by the tribunal and an attempt by a witness to draw that conclusion themselves.*" In addition to the witness statements there were over 100 lever arch files of documentary evidence.

The companies had been trading in mobile phones since 2000 and 2002. They had had substantial turnover and had made regular VAT repayment claims since then. There had been regular visits and correspondence with HMRC, and the company carried out checks on registration numbers in accordance with HMRC's instructions.

However, it was beyond coincidence that the companies had carried out 67 deals in these three periods, all of which led back to a tax loss; the funds were moved between FCIB accounts in sterling, regardless of where

in Europe the counterparties were; and the transactions were funded by an uncommercial loan from a mysterious Canadian who was willing to include a term in the loan that excused the companies from an obligation to repay if HMRC refused their input tax claims. All these suggested actual knowledge of involvement with fraud, but at the very least confirmed the "means of knowledge" – there was no other reasonable explanation for the transactions. The appeals were dismissed.

First-Tier Tribunal (TC04224): *Starmill UK Ltd and related appeal*

Two related companies appealed against the refusal of input tax claims totalling £2.6m for the period 06/06. The owner of both companies had previously been a clothing retailer and taxi driver, whose "knowledge of the mobile phone industry was attained from reading magazines purchased from WH Smith". The Tribunal weighed a range of evidence and concluded that the deals were "too good to be true"; that should have been obvious to the owner, who therefore "had the means of knowledge" because there was no reasonable explanation for the transactions if they were not connected with fraud. The appeal was dismissed, and costs were awarded to HMRC.

First-Tier Tribunal (TC04260): *Gold UK Consulting Ltd and related appeal*

A company appealed against the refusal of HMRC to repay £1m of input tax in relation to transactions in mobile phones in the period 02/06. The director claimed that he could not afford legal representation: some preliminary statements were made by counsel pro bono, and then the appellant was unrepresented. One of his grounds of appeal was that this could not constitute a fair trial, so HMRC's action against him should be dismissed. The director sought to withdraw his witness statement, but the Tribunal did not accept this application.

The Tribunal made the usual exhaustive examination of the history of the trade and concluded that the director not only should have known of the connection to fraud (because the transactions were too good to be true) but actually knew (because of inconsistencies in his witness statements and various documents about what the company would do on incorporation, on VAT registration and in dealing with bankers). The appeal was dismissed.

First-Tier Tribunal (TC04268): *Aleena Electronics Ltd*

A company appealed against a refusal of £359,000 of input tax in relation to purchases of CPUs in its 03/06 return period (the decision refers to "03/03", but later it becomes clear that is wrong). The director had been prosecuted for involvement in a MTIC fraud in 2002 but acquitted.

The company had traded for some years in CPUs. Its turnover increased dramatically in the year to March 2001, due to transactions in mobile phones which became the subject of the prosecution. Afterwards the company abandoned phones and reverted to trading in CPUs at a much reduced turnover. In the years to 2004, 2005 and 2006 the turnover rose from £523,000 to £8.176m to £21.806m. The March 2006 return was selected for extended verification and eventually most of the input tax claimed was denied.

The case is unusual in that the decision focuses on a 2005 report by EY commissioned by the company into its due diligence. EY considered that its procedures were in accordance with best industry practice at the time, but identified a number of risk areas and made a number of recommendations. Crucially, at a time when turnover was increasing by over 250% in a year, these recommendations were not implemented. The judge decided that either the director was a knowing accomplice in the fraud, or else ought to have known, because there was no other reasonable explanation.

First-Tier Tribunal (TC04307): *Imenex UK Ltd*

After a 2013 preliminary hearing in which HMRC were allowed to amend their statement of case (TC02770), the substantive hearing considered the company's claim to £28m of input tax for 05/06 and 06/06. As often, the appeal was presented by Mr Patchett-Joyce QC, who has consistently argued that the UK courts have misapplied the CJEU principles in missing trader cases. The judge said, "*While expressing the view that we consider that Mr Patchett-Joyce's case on the relevant legal principles was cogently argued, we also consider that it suffers from the defect that its consequences tend to absurdity.*" The argument was that only the objective factors relating to a transaction should be considered: this would mean that even a knowing participant in a fraud might benefit from input tax deduction if their particular transaction was in itself "regular", which was contrary to the CJEU judgment in *Kittel*. The Tribunal did not consider it necessary to refer the argument to the CJEU: the UK courts and Tribunals have consistently applied the *Kittel* test in the same way, and this Tribunal was satisfied that it was correct to follow them.

The Tribunal examined "a superabundance of evidence" which raised serious concerns that those responsible for the company's trading had actual knowledge of the involvement with fraud. To keep the decision a little shorter than it might otherwise have been (it still runs to 417 paragraphs), the judge restricts the basis of the decision to a small number of these concerns. These included the poor quality of the due diligence procedures, inconsistencies in the details of where goods were delivered, uncommercial aspects of shipping goods to which the seller did not have title, apparently fixed and contrived mark-ups, and the fact that the proceeds all arrived at the same time from apparently unconnected purchasers. All this gave the impression of a contrived and artificial set of transactions, for which there was no reasonable explanation other than a connection with fraud. The Tribunal was satisfied that several of the principals had actual knowledge.

Mr Patchett-Joyce also argued that s.26A VATA 1994 required HMRC to raise an assessment to deny input tax, and this had not been done; HMRC were out of time to do so now. The Tribunal disagreed – the effect of s.26A was to treat the trader as never having been entitled. The appeal was dismissed.

First-Tier Tribunal (TC04325): *Megantic Services Ltd*

A company was denied input tax of about £1.6m and assessed to £674,000 in respect of its periods 06/06, 07/06 and 08/06. The main participants were a father and son who claimed that the lack of due diligence for transactions between their company was due to family trust; the judge did not believe the evidence of either, finding that both actually knew of the

connection of a very contrived set of transactions with fraud. The appeal was dismissed.

First-Tier Tribunal (TC04316): *Digital International Solutions Ltd*

An amazingly long decision considered claims by two companies to £15m in relation to deals in April to June 2006. Over 915 paragraphs, Judge Demack examines the trading of the companies in great detail, and reaches the conclusion that the due diligence carried out was mere window-dressing: the directors knew that their transactions must have been connected with fraud, and none of the input tax should be repaid.

First-Tier Tribunal (TC04341): *BTS Specialised Equipment Ltd (in liquidation) and another*

A rare victory for the taxpayer came about in a case where it was agreed by both parties that deal chains had resulted in a fraudulent tax loss. The company was denied input tax of £428,525 in respect of the purchase of computer equipment in the period 09/06.

The Tribunal noted that the parties had applied to put their closing submissions in writing. HMRC's closing submission was "about 116 pages. It was wide ranging and much of it did not go to the essential issue in this case namely whether the test in *Mobilx* that the only reasonable explanation for the transaction in which the taxpayer was involved was connected to fraud bearing in mind the taxpayer's knowledge at the relevant time was satisfied. Much of it related to matters which were outside HMRC's knowledge let alone the Taxpayer's knowledge at the time in question. Much of it was not of assistance to the Tribunal. The Tribunal reread the document carefully a number of times before reaching this conclusion."

By contrast, the appellant's response was "to the point, of a sensible length and within time" – it was described as "helpful", which pointedly contrasted with the HMRC submission. HMRC then issued further submissions; as the appellant normally has "the last word", the taxpayer objected. The Tribunal issued directions allowing HMRC's further submissions as long as the taxpayer could respond to them again. Their document was submitted in accordance with the direction, and "At eight pages these were considerably more focussed and of greater utility than the somewhat unfocused HMRC document."

The Tribunal clearly preferred the taxpayer's witnesses to those provided by HMRC. The decision included several assertions that were disproved by evidence – for example, that the company did not issue terms and conditions to its customers, when these were printed on the back of the order forms. The HMRC officer who issued the decision appears to have discovered this during the hearing.

Overall, the Tribunal did not accept that HMRC had satisfied the burden of proof to show either than the company knew of the fraud, or had the means of knowing. The appeal was allowed, and the company was invited to apply for costs.

First-Tier Tribunal (TC04239): *Pacific Computers Ltd*

A company appealed against refusal of input tax credit of £1.1m in relation to its 05/06 period. Even though many of the usual features of MTIC appeals were present, including the involvement of FCIB in

processing the payments, the Tribunal judge (Adrian Shipwright) did not accept HMRC's view that there was no other possible explanation for the transactions than a fraud; he also did not consider that there was sufficient evidence to show that the director had known of the connection to fraud. Unusually, the appeal was allowed.

First-Tier Tribunal (TC04304): *Privin Corporation Ltd*

5.8.2 Not so missing trader

HMRC took action against companies run by a daughter (21 at the time of the hearing) and her father. It was alleged that he had made supplies from a number of companies under his control to a company controlled by his daughter; his daughter's company reclaimed input tax, but the father's companies failed to pay over the output tax to HMRC. HMRC were taking action against him for fraud, but they also refused deductions to the daughter's company on the grounds that she knew or ought to have known of the connection to fraud.

The Tribunal report opens with a history of the hearings – the daughter conducted the case herself, in spite of panic attacks and breathing difficulties. The judge expressed concern over her health and suggested that a lawyer should have been engaged to represent the company; the case was adjourned for a time, and further written representations were invited because they placed her under less stress.

The daughter was not a qualified optician, but she had worked in her father's optician's businesses from an early age and decided she wanted to set up the same sort of business. Many of the company's purchases, and some of its sales, were with the many companies run by her father. He had a number of long-running disputes with HMRC, many of them subject to appeal to the Tribunal.

The Tribunal examined a great deal of complex and somewhat unsatisfactory evidence about the transactions between the companies and the reasons for them. There are many quotations in the decision from interviews with the father by investigating officers. The judge concluded that the transactions with the appellant companies were all contrived, as they made no commercial sense if they were designed to assist an 18/19 year old to start her own business. The whole operation was fraudulent, and both parties knew that it was. The appeal about input tax was dismissed, and HMRC were invited to make an application for costs.

First-Tier Tribunal (TC04303): *Colour Blast and another*

5.8.3 Pre-registration VAT

An individual applied for voluntary registration in January 2013, requesting an EDR of 14 October 2012. Following the submission of his first return to 05/13, HMRC carried out a visit. The trader asked whether it would be possible to claim for the cost of obtaining a private helicopter pilot's licence – the training was undertaken from November 2011 to March 2012. The visiting officer explained that this was too long before his EDR, so the claim was not possible.

The trader discussed the matter further with the director of his flight school and with the visiting officer, and told her that he would claim it back on his next return. She explained that he could make a voluntary

disclosure, but her decision in relation to the 05/13 period would equally apply to the 08/13 period. The pilot made the claim for 08/13, which was as a result a repayment return. In due course HMRC raised an assessment to disallow £2,069 (reduced to £2,004 on review) and charged a penalty of £771. The trader appealed.

He argued that the acquisition of knowledge leading to his qualification was an "asset" of the business and was therefore "not a service". The Tribunal noted that HMRC had failed to explain the EU law adequately during correspondence; that is clearer than the UK law that only tangible property can give rise to a supply of goods. The appeal against the assessment had to fail.

There were procedural problems in relation to the appeal against the penalty. The penalty assessment was issued some time after the main assessment, even after HMRC's statement of case in relation to the main assessment appeal. Even so, the SOC referred to the penalty; as a result, it was understandable that the appellant did not realise that he had to make a separate appeal against the penalty. Once some procedural steps had been taken, the Tribunal was able to hear that separate appeal. In the circumstances, it agreed with HMRC that the trader's conduct involved "deliberate conduct" – he had chosen to claim input tax on a return when he had been specifically told that it was not deductible. His argument was that this was in order to have the point argued on appeal; but he could have made a voluntary disclosure to achieve that. The fact that he had told the officer that he was going to make the claim did not constitute "unprompted disclosure". HMRC's mitigation of the penalty by 90% of the difference between the maximum (70%) and minimum (35%) for "prompted deliberate" was reasonable, and the penalty was confirmed.

First-Tier Tribunal (TC04237): *Sam Smith t/a Heliops UK*

In an article in *Taxation*, Neil Warren discusses this decision and points out that a better choice of EDR would have avoided all the problems.

Taxation, 12 February 2015

5.8.4 Runners buying phones

The FTT has heard another case about the business of employing people to buy iPhones in retail transactions from Apple stores, then selling them on. The trader in this case was substantial – the company employed some 80 people, and purchased 7,000 iPhones in the two months to February 2011.

As in earlier cases on the same issue, the Tribunal decided that the individuals purchased the phones as principal and passed them on to their employer as a non-taxable person (s.47(2A) VATA 1994); even though the individual's VAT cost could be identified from the till receipts obtained, VAT deduction could not flow through such a chain of transactions.

The till receipt did not constitute a valid VAT invoice for the trader, and the FTT did not find that HMRC's refusal to accept it as alternative evidence was an unreasonable decision under reg.29 SI 1995/2518. If it were not for s.47, the FTT would have concluded that there was sufficient evidence to establish the appellant's claim that it had acquired the iPhones from Apple. The FTT concluded that the business model as described

"made sense" and, on the balance of probabilities, operated in accordance with the appellant's contentions. However, in relation to reg.29, the question was whether the officer's decision had been unreasonable, not whether the FTT agreed with it. Some of the evidence was unsatisfactory; another company that had been involved in MTIC transactions in 2006 was connected to the trade; many records that might have been expected to exist did not exist. "*When HMRC were considering the adequacy of secondary evidence, and there were all the gaps and uncertainties in the evidence that we have now listed, and no documentary evidence to confirm any audit trail of the goods, we cannot conclude that the case officer's three decisions were in any way unreasonable.*"

The appeal was dismissed.

First-Tier Tribunal (TC04249): *Scandico Ltd*

5.8.5 Refund bodies

A Statutory Instrument has been issued to specify the London Legacy Development Corporation under s.33 VATA 1994 as a government body entitled to recover input tax on non-business activities with effect from 1 April 2015.

SI 2015/449

In the Budget it was announced that VAT refunds would be extended to VAT on costs incurred on the non-business activities of palliative care charities, medical courier charities (e.g. "blood bikes") and "search and rescue charities". The new schemes will operate under new s.33C to s.33D VATA 1994, with effect from 1 April 2015.

A new s.33E is also proposed to give the Treasury a general power to add bodies to the list without requiring primary legislation.

www.gov.uk/government/publications/vat-refunds-for-palliative-care-charities; www.gov.uk/government/publications/vat-refunds-to-medical-courier-charities; www.gov.uk/government/uploads/system/uploads/attachment_data/file/385271/Refunds_of_VAT_to_search_and_rescue_charities.pdf

The Highways Agency has been entitled to refunds of VAT under s.41(3) VATA 1994. It is to be replaced under the provisions of the Infrastructure Bill; the replacement Strategic Highways Companies will inherit its reclaim rights by being added to the list in s.41(7).

www.gov.uk/government/publications/vat-refunds-to-strategic-highways-companies

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Further thoughts on *Skandia*

HMRC have issued a follow-up to R&C Brief 37/2014 in which they commented on the CJEU judgment in *Skandia America Corp (USA) filial Sverige* (Case C-7/13). The ruling was that transactions between a non-EU head office and its Swedish branch, which was a member of a Swedish VAT group, had to be taken into account for VAT: the group was liable for a reverse charge. This has raised concerns that there could be significant costs for non-EU financial businesses seconding staff to EU branches.

HMRC note that the Swedish grouping rules only allow the branch that was physically located in Sweden to belong to a Swedish VAT group. The head office, in spite of being part of the same legal entity, was not included. The UK's rules allow the whole entity to be part of the group as long as it has an establishment in the UK. The UK will therefore continue to apply the *FCE Bank* principle to supplies of services between a head office and a branch in this circumstance: such transactions do not constitute a supply, because they are not made between two different taxable persons.

The UK's rules were not considered by the CJEU in the case, and HMRC are satisfied that there is no need to change them. There must be a small chance that the CJEU would consider the UK's rules to be contrary to the Directive, but in the absence of a specific ruling to that effect, HMRC will continue to operate them as before.

However, if a UK entity has an establishment in another EU country which has similar VAT-grouping rules to Sweden, and that establishment has joined a group there, it will be necessary to apply the *Skandia* judgment to supplies of services between the UK and foreign establishments (whether or not the UK establishment is a member of a UK group). The consequences are:

- services provided by the overseas VAT-grouped establishment to the UK establishment will normally be treated as supplies made in the UK under place of supply rules, and subject to the reverse charge if taxable;
- services provided by the UK establishment to the overseas VAT-grouped establishment will normally be treated as supplies made outside the UK under place of supply rules. Therefore they will need to be taken into account in ascertaining input tax credit for the UK establishment. If the supplies are reverse charge services, they should be reported on the trader's European Sales Listing of such supplies.

If the UK establishment is a member of a UK VAT group, supplies between the foreign establishment and other UK group members will be subject to the same principles. This means that the anti-avoidance rules in s.43(2A) – (2E) will not apply, because the transactions will be chargeable in any case.

HMRC will confirm which other member states will operate Swedish-style 'establishment only' VAT grouping following the *Skandia* decision as soon as possible, and update guidance accordingly. This change in treatment must be applied to services performed on or after 1 January 2016. This will allow businesses time to adapt administrative and accounting procedures. Businesses may choose to apply the changes to services performed earlier than this date, provided they do so consistently for all services and establishments affected.

Revenue & Customs Brief 2/2015

6.2 Other registration rules

6.2.1 Registration date

HMRC issued a notice of compulsory registration on an individual with an EDR of 1 July 2000. An assessment was subsequently raised covering the period from 1 July 2000 to 31 October 2011 in the sum of £75,376. This was later reduced after review to £60,033. The trader appealed against the decision and the assessment, although by the time of the hearing the appeal against the EDR had been dropped.

The problem had been discovered from an examination of income tax returns in May 2011. This showed that the trader (who operated a cafe) had exceeded the threshold in the year to May 2000, but had not registered.

The trader cooperated with the investigating officer, but a number of disputes arose about the methodology adopted by the officer in calculating output tax and input tax. The basis of the calculations was examined by the Tribunal and no fault could be found with either. For example, the use of the month of August as a basis for extrapolation was advantageous to the taxpayer as customers were more likely to purchase zero rated cold foods in the summer. The appeals against both output tax and input tax figures were dismissed.

First-Tier Tribunal (TC04290): *Linda Sherratt t/a The Beeches*

6.2.2 Eligibility to register

On 1 October 2013, a company submitted an online application to register for VAT as an intending trader. The Business Activity Description was "wholesale beer, spirits, wines and liqueurs, and business consultancy activities." The registered address was a residential property. HMRC registered the company, but it did not submit its first VAT return for the period to 11/2013. It paid a centrally issued assessment for £264; HMRC wrote to say that failure to render a return meant the company had 30 days to satisfy HMRC that there was an entitlement to be registered. The trader responded with a nil VAT return for the period.

Some correspondence followed in which the trader stated that ill health had led to delays in starting the business. Some small transactions appeared to be entered into. HMRC decided to remove the company from the VAT register on 1 March 2014. Further correspondence followed, as

well as a meeting between the trader and the HMRC officer, and the trader lodged an appeal. She did not attend the hearing, although it appeared that she was aware of and had accepted the date.

The Tribunal went through the *Lord Fisher* tests and applied them to the circumstances. Although the stated activity was a recognisable trade that other people carried on for profit, the other tests were not satisfied. The activity was not "earnestly pursued"; there was minimal continuity or substance. The Tribunal confirmed HMRC's decision to cancel the registration from the outset.

First-Tier Tribunal (TC04338): *TL Step by Step Ltd*

6.2.3 Registration threshold

The Budget raised the registration and deregistration thresholds by £1,000 each to £82,000 and £80,000 with effect from 1 April 2015.

SI 2015/750

6.3 Payments and returns

6.3.1 Flat rate scheme

An appellant must have feared the worst when his representative contacted the Aberdeen Tribunal centre on the date of the hearing to say that his flight had been cancelled and he could not attend. The trader had to make do with the representative's skeleton argument and the assistance and sympathy of the Tribunal, who found in his favour.

HMRC had assessed a flat-rate trader for the difference between the FRS VAT he had declared and the charge according to their preferred categorisation. They had charged £4,272 for the periods 10/11 to 04/13. The appellant registered for VAT from 6 June 2011, giving his business as "design engineering services". His qualifications were in mechanical and electrical engineering, and his company specialised in pressure containing components such as undersea valves and pipe structures for the oil and gas industry.

HMRC had accepted his registration for the FRS in March 2012, and had allowed backdating to September 2011 (possibly a misprint for June). The first return was submitted on the basis that the 14.5% rate for "Architect, civil and structural engineer or surveyor" applied (even though the trader had not at that time formally applied for the FRS). When he applied, he entered "Any other activity not listed elsewhere" with a 12% rate. This followed detailed consideration of the list of sectors and discussions with his accountants.

The appellant argued that his choice was correct, or at the very least reasonable (in which case HMRC's policy is not to assess retrospectively). This had recently been borne out in the similar case of *Idess Ltd*, also featuring a mechanical engineer.

The Tribunal considered the precedent cases and also the law. It noted the brevity of reg.55K: "if Parliament had intended that all engineering fell

into that category there would have been no reason whatsoever to introduce the words 'civil and structural'."

HMRC had treated their own guidance as being authoritative, when they should have considered the underlying law and given it its ordinary meaning. HMRC's review had baldly repeated the decision without giving any reasons. The judge commented: "*Since HMRC's Skeleton Argument states that it was not a reasonable choice in light of 'the information published by them', presumably the assertion that the choice was unreasonable was on the basis that engineering design is listed in the Trade sectors, so it could not be said that 'Any other activity not listed elsewhere' applies. Patently that cannot be the case as the word 'elsewhere' relates, and can only relate, to the rest of the categories in [reg.55K].*"

HMRC's decision was unreasonable, and the appeal was allowed.

First-Tier Tribunal (TC04256): *SLL Subsea Engineering Ltd*

6.4 Repayment claims

6.4.1 Direct claim against HMRC

Following the CJEU judgment in *JP Morgan Fleming Claverhouse*, HMRC made repayments of VAT charged by investment managers to investment trust companies. This would have been subject to the principles of unjust enrichment – i.e. the managers would have had to pay the money back to their clients, the ITCs – and also subject to capping, in that only 3 years' worth would be repaid. Several ITCs claimed compensation directly from HMRC in respect of the amounts which were not repaid because of the cap.

High Court

In early 2012, the High Court considered that the issues were similar to those in a group action brought by other companies in respect of corporation tax (the "FII Group Litigation"). In that case, the Court of Appeal had held that the claims were time-barred because they were made more than 6 years after the periods concerned. Normally a restitutionary claim can be made within 6 years of the time that the loss could with reasonable diligence have been discovered by the plaintiff – in this case, it was accepted that this would have been the CJEU's ruling in *JP Morgan*.

The judge decided to hold over the litigation pending consideration of the FII Group case by the Supreme Court. In the light of that judgment, which was issued later in 2012, and also the CJEU ruling in *Littlewoods Retail Ltd*, both parties made further submissions to the High Court.

The judge gave a further judgment following these submissions, holding that one of the claims succeeded and another two failed – therefore making sure that both HMRC and the taxpayers were likely to appeal.

The judge was concerned that a claim by someone who bore the burden of the tax, but was not liable to pay it to the authorities (i.e. a customer rather than a registered trader), should be a last resort rather than a freely

available alternative. In his view, the precedents showed that, as a matter of EU law, those people should have an effective right to recover tax suffered in breach of the Directive, if no other right was available to them. They could not recover the tax outside the capped period through the suppliers, because those suppliers were subject to the cap; therefore they ought to be able to recover it directly from HMRC.

Three particular trusts were considered in detail: Kleinwort, which was VAT registered and in general recovered 58.4% of its input tax; and F&C and M&G, which were not VAT registered and therefore bore the full cost of any VAT charged. Diagrams were presented to illustrate the flows of fees and VAT in relation to a notional fee which generated output tax of £100; it was supposed that the investment manager might have recovered £25 in input tax as a result. The investment manager would therefore have been able to reclaim £75 under s.80, if a claim had been in time. The judge had to consider whether the claimants had a right to restitution from HMRC in respect of £100, or £75; and if £75, whether there was a separate right of restitution against the investment managers for the remaining £25.

The claims also related to different periods:

- the managers of F&C and M&G had made claims in 2004 for repayment of VAT in respect of the periods from 2001 to 2004, and these were settled by HMRC (and returned to the trusts) after the CJEU decision in JP Morgan;
- Kleinwort had been put into liquidation and had received no management services since 1998, so no claim was made in 2004 because the cap was thought to apply;
- the managers of all three trusts made further *Fleming* claims for periods up to 4 December 1996, and these were also settled by HMRC with interest;
- the claims before the court therefore related to the "dead period" from 4 December 1996 to 20 March 1998 (Kleinwort), 6 April 2001 (F&C) and 1 April 2001 (M&G). The amounts claimed by these three companies was £333,478, £262,289 and £1,790,850; the other claimants were asking for in total £4,844,817.

There were also slight differences in the amounts claimed:

- Kleinwort and F&C claimed the output tax for the dead period, although Kleinwort's claim would be restricted to 41.6% of the output tax as it would have recovered the other 58.4%;
- M&G also claimed the input tax not refunded by HMRC to its manager under the *Fleming* claim, i.e. the £25 in the above notional supply example.

The judge held that the claimants had a restitutionary claim for the full £100, even though HMRC could only have been "enriched" by £75. However, under domestic law, the claims were barred by s.80(7): "*Except as provided by this section, the Commissioners shall not be liable to credit or repay any amount accounted for or paid to them by way of VAT that was not VAT due to them.*" The judge held that this did not only apply to claims for overpaid VAT by the person who accounted for it to

HMRC – it would also prevent a claim by a customer who had borne the tax. If a claim could not be made outside s.80, the time limit in s.80(4) would apply.

The judge therefore considered the EU law position. The claimants had "San Giorgio" rights to claim directly from HMRC, either by (a) disapplying s.80(7); (b) allowing the claimants to choose between a "Woolwich" cause of action or a claim based on the principles set out in *Deutsche Morgan Grenfell Group plc* with its extended limitation period; but (c) limiting those claims to a three year limitation period by analogy with s.80(4). The judge decided that, applying these principles, only M&G's claim for the uncapped period could succeed – it should be repaid the £25 not recovered through the manager for the early 1990s, but none of the claims succeeded in respect of the output tax.

Court of Appeal

Both sides appealed. The Court of Appeal had to consider:

- whether HMRC had been unjustly enriched – this is fundamental to any claim for restitution;
- whether the claimants had a claim in restitution against HMRC, arising from the fact that they had paid VAT on the managers' services, even though they had not been accountable for it to HMRC;
- whether the judge had erred in his interpretation of s.80(7) as applying a bar to indirect claims for VAT as well as direct claims;
- whether the claimants could claim for the gross amount of the VAT overpaid to the manager, or could only claim for the net amount that the manager would have been able to recover after adjusting for input tax.

The court decided first that HMRC had only been "enriched" by the net VAT they would have had to repay – the £75. This is because they would have collected the £25 anyway if the UK law had been correctly transposed – it represented output tax properly charged on supplies to the managers, which would not have been credited to the managers if their supplies had been treated as exempt. Any claim for restitution in respect of the £25 could therefore only succeed against the managers, not against HMRC. This was not "virtually impossible or excessively difficult" under the domestic law, so the EU legal claims were not necessary.

The court also decided that the judge was wrong in applying s.80(7) to restitutionary claims. The wording of the section appeared to apply only to claims made by persons who had accounted for the VAT to HMRC, and the judge's construction was "surprising". A person who could claim under s.80(1) could not make any other sort of claim because of s.80(7); but a person who could not claim under s.80(1) was not restricted by it. As a result, the court decided that the claims for £75 in the "dead period" succeeded (reduced by 58.4% in Kleinwort's case).

In effect, both appeals were allowed – HMRC succeeded in reversing the repayment of "the £25" to M&G, but all the companies succeeded in establishing their claims to "the £75" for the dead period.

Court of Appeal: *Investment Trust Companies (in Liquidation) v HMRC*

6.4.2 Repayment supplement

A hearing was held to determine preliminary matters in three appeals that will otherwise proceed separately. All the appellants trade in alcohol; they moved stock from the UK to bonded warehouses in the Netherlands, but were not registered for VAT in the Netherlands at the time. However, they were required to be registered, because the Netherlands has no threshold for traders in excise goods.

The effect of Sch.4 para.6 VATA 1994 was that the traders were deemed to make a supply of goods, even though the goods remained in the same ownership. They all claimed a repayment of UK input tax on the basis that they had made a zero-rated despatch. HMRC refused the claims on the basis that the despatch was not made to a registered trader in another Member State; the companies applied for and were granted retrospective registration, whereupon HMRC refunded the input tax.

The hearing was to determine whether the companies were entitled to repayment supplement in respect of the delayed repayments. For the purposes of the hearing, the parties broke down the preliminary issues into four questions:

Issue 1: Whether an exporting trader is required to be registered for VAT in the Member State to which the goods are exported in order for the supply to be zero-rated under reg.134 SI 1995/2518, or, if different, under the PVD?

Issue 2: If the answer to the Issue 1 question is "yes", what are the consequences on the validity of the relevant VAT return in which a VAT credit was claimed in respect of the supply to the other Member State?

Issue 3: If the answer to the Issue 1 question is "no", having regard to the fact that Issue 1 has yet to be determined by the courts, does an inquiry by HMRC on the basis that the exporting trader was required to be registered in the other Member State amount to a reasonable inquiry under reg.198(a) SI 1995/2518?

Issue 4: If the answer to the Issue 3 question is "yes", how does this affect the determination of the beginning and end dates of the 30 day period in s.79(2A) VATA 1994 and any period left out of account?

Issue 1 turned on whether Notice 725 was entitled to insist that zero-rating was only available if the consignee was registered (imposing duties to check that the VRN was valid etc.). The PVD only requires that the consignee is a "taxable person in another Member State", which would include a person who is required to be registered.

The appellants accepted that the requirement in Notice 725 for the customer's VRN to be shown on a sales invoice was permitted by the PVD, so if there was a supply to a third party, it would not be zero-rated. However, this was a despatch without a change of ownership. No VAT invoice would be issued, so the requirement was not directly applicable. The company relied on the 1998 Tribunal decision in *Centrax plc* (VTD 15,743) in which despatches to an unregistered Italian branch were held to qualify for zero-rating.

After examining precedent cases including *'X' and Facet BV v Netherlands* (Cases C-536/08 & C-539/08), as well as HMRC policy as set out in manuals, Notices and their representative's argument, the

Tribunal agreed with the appellants that it was not necessary for the consignee of a self-supply to be registered at the time of the movement in order to qualify for zero-rating. Requiring registration of the taxpayer in the other member state is irrelevant to ensuring the correct and straightforward application of the exemption and preventing evasion and avoidance. This is because the identity of the person acquiring the goods in the other member state is self-evident, given that this is a self-supply. Evidencing the despatch of the goods is addressed by the other conditions. The requirement for the recipient to be "registered", rather than merely "taxable", went beyond the PVD; the FTT agreed with the *Centrax plc* decision.

The answer to issue 1 was therefore "no", and issue 2 fell away. In respect of issue 3, the essence of the question was whether it was reasonable for HMRC to open an enquiry into the appellants' claims for input tax. The Tribunal concluded that it was. The appellants had mainly argued that it was only fair for them to receive some compensation for the delay in making repayments to which they were entitled; but the Tribunal considered repayment supplement to be punitive (for unreasonable delay) rather than compensatory (for the loss of use of the money).

In respect of issue 4, HMRC stated that they will treat enquiries on zero-rating as raised the day after the date of the first letter inquiring about why the appellants treated the disputed supplies as zero-rated. The appellants submitted that the clock should restart at the earliest point when HMRC could have accepted the appellants' arguments that the returns were correct. HMRC submitted that the enquiries ended for the purposes of s79(4)(b)(i) when HMRC satisfied themselves that they had received complete answers – namely when HMRC were satisfied that the Appellants were in fact registered for VAT in the Netherlands. This would be some time after the responses were actually received from the traders, because HMRC would still have to "be satisfied".

The Tribunal noted that the start date in s.79(4)(a) is before that in reg.199(a) – it is when HMRC decide that it is necessary to make an enquiry. HMRC's actual approach is consistent with reg.199, which is more generous to the trader.

As regards the end date, the Tribunal ruled that both submissions were wrong. The consideration of responses by HMRC should be carried out within the 30 days. The clock should restart on the day that HMRC were satisfied that they had received full answers to the questions they had raised, not when they had completed their analysis of those answers.

The Tribunal decision ends with a summary of the issues and the responses, which should significantly clarify the rules on repayment supplement for the future.

First-Tier Tribunal (TC04200): *Global Foods Ltd and related appeal*

6.4.3 *Fleming* claims

A company made a *Fleming* claim for input tax of £331,000 incurred on professional fees relating to share issues it had made between June 1987 and March 1989. Before the CJEU decision in *Kretztechnik* in 2005, such input tax was regarded as irrecoverable.

There were several issues before the Tribunal, including the question of proving on a balance of probabilities that the company had not already recovered the VAT. The company accepted that it had the burden of proof to show that it had incurred the input tax, but argued that it should not have to prove a negative: HMRC should have to prove that it had already claimed the tax. The Tribunal examined decisions from a number of similar cases and decided that HMRC were right; this did not contravene the principle of effectiveness, because the taxpayer should always have to establish the right to recovery.

However, the Tribunal accepted a further argument by the taxpayer's counsel that once the taxpayer has established a prima facie entitlement, the burden moves to HMRC to displace it. HMRC's records relating to VAT visits and correspondence from so long ago could not be accessed or were incomplete. The Tribunal considered each share issue in turn and concluded that on some of them it was more likely than not that the VAT would not have been claimed in the first place, whereas on others it was insufficiently probable to make out the prima facie case. Accordingly, the appeal was allowed in principle in relation to some of the expenses, but dismissed in relation to others.

The Tribunal adjourned the hearing in relation to the issue of quantum, where it required submissions on whether it had a full appellate jurisdiction (as it was sure it had in relation to the principles considered above) or merely a supervisory jurisdiction, given that the dispute effectively concerned HMRC's decision to refuse alternative evidence under reg.29. HMRC's counsel was not prepared to argue this point because an officer who had relevant information was on sick leave. In the interests of fairness, the matter should be considered further at a subsequent hearing.

First-Tier Tribunal (TC04272): *Perenco Holdings*

The Tribunal had to consider a preliminary issue in relation to another *Fleming* claim, this time concerning the transfer of activities from one NHS body to another. The parties found it difficult to formulate the exact point to be determined: the judge directed them to come to an agreement on it. Eventually this was determined as the question of whether any right of the predecessor bodies had been transferred to the present body – it would be assumed, for the purposes of this hearing only, that all parties were VAT registered and had accounted for VAT that could be recovered under a valid *Fleming* claim by the right claimant.

The judge noted that HMRC at one point appeared to want to put the claimants to proof of whether the predecessors had been registered for VAT. He regarded this as extraordinary, given that HMRC kept the register. If they had checked it, it was "egregious conduct" to require the appellants to prove a fact that HMRC already knew; if they had lost the register (or part of it), it sat ill with HMRC's insistence that the appellants should have retained documents to prove their case after many years.

The judge examined the history of the transfers of the hospitals and the legal framework under which those transfers took place. He concluded that, even in the absence of specific documents recording the terms of those transfers, the appellant had made out a prima facie case that the Secretary of State intended each hospital to be operated in the same way at each stage, and this implied that all rights would be transferred along with the operations. The preliminary issue was therefore decided in favour of the appellants.

First-Tier Tribunal (TC04308): *Northern Lincolnshire & Goole Hospitals NHS Foundation Trust*

A third appeal by a Scottish Health Board has reached the FTT. In earlier cases, *Dumfries & Galloway Health Board* succeeded with a claim (TC03381); *Lothian Health Board* failed at the FTT (TC03397), but an appeal is pending to the Upper Tribunal. The present claim related to input tax incurred in relation to dining-room expenditure, residual revenue expenditure, and capital expenditure, over an extended period from April 1974 to April 1997.

The Tribunal heard evidence about the preparation of the claim. For example, input tax on dining-room expenditure was attributable to business activities in respect of staff and visitor catering; patient catering was non-business. The claim was based on extrapolation from current evidence of the amount of costs that were standard rated (about 20%) and zero-rated (80%), and the estimated proportion of business meals.

The Tribunal noted that both parties were public bodies; they were agreed about a number of principles, including that input tax had been underclaimed, but the areas of disagreement amounted to a very significant difference in calculation. The uncertainties in the evidence were difficult for the appellant to overcome: with misgivings, reflecting the conclusion in the *Lothian* case, the Tribunal dismissed the appeal.

First-Tier Tribunal (TC04324): *Greater Glasgow & Clyde Health Board*

6.4.4 Outside the scope of VAT?

A golf club made a claim for output tax of £614,000 accounted for from April 1973 to January 2013 in respect of supplies of food and drink consumed by the members of the club. The issue argued before the Tribunal was whether members' clubs, who buy food and drink for the private needs of their own members, act in a private capacity as the final consumers of their purchases. If this is a correct analysis the members' clubs would fall outside the scope of VAT, and output tax would not be due on the supplies made to the members. These included for this purpose "temporary members" who paid a daily green fee.

The club relied on cases such as *Armbrecht* and *Heerma* to support their argument that EU law did not regard an unincorporated association as a taxable person "acting as such" within art.2 PVD. The members were a "closed circle" who agreed that they would contribute enough to cover the costs of the club, but the club was not making supplies to them.

HMRC argued that members' clubs can enter contracts, including contracts with their members, and it was "wholly misconceived" to consider them incapable of making supplies to the members. It was "absurd" to suggest that the club, and the member supplied with food and

drink by the club, can be relieved of tax by virtue of having had the subjective intention when acquiring the goods or services used in making that supply of making that supply to the member, and to do so offended the principle that economic activities are to be established by objective criteria.

The Tribunal considered the concepts of "supply of goods", "taxable person" and "acting as such" in both UK and EU law, and agreed with HMRC that the claim was ill-founded. The appeal against refusal of the repayment was dismissed.

First-Tier Tribunal (TC04326): *Royal Troon Golf Club*

6.4.5 Directly effective rights?

A construction company reclaimed £33m, later increased to £60m, in relation to goods installed in new homes between April 1973 and April 1997, arguing that the "builders' block" on such input tax was contrary to EU law. Judge Mosedale refused the claim in TC03700. The "builders' block" probably did contravene EU law, in that it made the supply of items incorporated in new homes effectively exempt; however, the claim to rely on directly effective EU rights required the company to treat the outputs as standard rated. They could not rely on the EU law to make the input tax deductible and also take the benefit of the UK law to make the outputs zero-rated.

Judge Mosedale asked for further submissions on the following issue:

HMRC accepted that if the Claim Items were not incorporated and not part of a single supply and that therefore the supply of the Claim Items was a separate, standard rated supply it would automatically follow that the appellant would be entitled to recover the claimed input tax in principle. Nevertheless, HMRC considered the claim would have to be netted off against the output tax that should have been, but was not, accounted for on the standard rated sale of the Claim Items. I refer to this as [the] 'set off' question.

HMRC, like the appellant, however, had not come to Tribunal prepared to put their case on …whether input tax must be netted off against output tax when it was many years too late for HMRC to assess the output tax. …

The judge examined a number of precedent cases, in particular *MDDP* (Case C-319/12), in which the taxpayer provided education and training to customers. The CJEU ruled that it could not take the benefit of an EU right to deduction at the same time as enjoying a domestic right to exempt its outputs. This was directly in point, and decided the case for HMRC.

If the company had not accepted that its output tax would have been greater than the input tax incurred, the judge would have referred the case to the CJEU to determine whether she was right to regard the "effective exemption" in the builders' block to be contrary to EU law. However, as the company had accepted that its output tax would have been greater than its input tax, there was no remaining issue to be determined. The appeal was dismissed.

First-Tier Tribunal (TC04281): *Taylor Wimpey plc*

6.4.6 The cap fits

A trader submitted a claim for repayment of £1,199 in output tax from periods 12/08 and 03/09 on 12 February 2014. HMRC rejected the claim as being out of time. The overpayments had arisen because central assessments had been issued in the absence of returns; the trader only established the correct figures and submitted a claim in late 2013. HMRC did not dispute the amounts, but applied for the appeal to be struck out on the grounds that there was no possibility of it succeeding.

The Tribunal noted the trader's pleas in mitigation, involving poor health and financial difficulties. However, the cap was absolute: there was no possibility of varying or waiving it on the grounds of sympathy. The appeal was struck out.

First-Tier Tribunal (TC04309): *Roger Sanders*

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Self-billing

TC02548 considered a scrap metal dealer had operated a self-billing system for VAT for many years. There were no formal agreements in place with any suppliers, but HMRC had carried out a number of visits and were well aware of how the company operated. Between 2006 and 2008, HMRC deregistered four of the company's suppliers, and subsequently assessed to disallow £337,000 of input tax claimed by the company on its self-billing invoices in respect of supplies from these suppliers.

The FTT examined the background and concluded that the absence of self-billing agreements, combined with the regular visits, meant that HMRC had exercised discretion under reg.29 to allow the company's input tax claims on invoices which did not meet all the conditions of the regulations. Given that this discretion had been exercised for so long, it was not reasonable to withdraw it in relation to these particular invoices, where the company could not have been expected to know that the suppliers had been deregistered.

The case of *Boguslaw Juliusz Dankowski v Dyrektor Izby Skarbowej w Lodzi* (Case C-438/09) was referred to as authority for the proposition that a member state cannot disallow input tax just because a supplier is not registered for VAT: a trader who has received a taxable supply from a taxable person is basically entitled to deduct the input tax, unless other conditions are met (e.g. knowledge or means of knowledge of connection to fraud).

HMRC appealed to the Upper Tribunal. In a first decision, covered in October 2014, the judge commented that there is an important distinction

to be drawn between different types of "failure to exercise discretion under reg.29":

- considering the matter and deciding that discretion should not be exercised;
- wrongly deciding that the matter was not subject to discretion, perhaps because some precondition was thought to be required and not to subsist;
- failing to consider the question of discretion at all.

In each case, the Tribunal's jurisdiction is only supervisory, because it concerns the exercise of a power that the law allows to HMRC. However, it is an appealable matter because the trader's rights of appeal about the allowance or disallowance of input tax are not restricted by s.83(1)(c) VATA 1994.

The judge considered the background to the decisions by the HMRC officer and the decision of the FTT. He concluded that the officer had made two decisions – the initial one, to raise the assessment, and the confirmation of that decision on review. It appeared that he had improperly regarded the absence of a self-billing agreement as a pre-condition for reg.29 discretion on his review, but had only taken it into account as a factor in his initial decision to assess. It was possible that his discretion had been correctly exercised at that point, but this had not been argued before the UT. HMRC were invited to go away and consider whether they wished to justify that decision on the basis of a proper exercise of discretion.

If the discretion could not be justified on either occasion, it was not for the FTT or UT to exercise the discretion for HMRC, given that it was not obvious what the decision would or should have been if the power had been correctly applied. It would therefore be open for HMRC to exercise the discretion again. However, it would almost certainly now be out of time to issue new assessments if HMRC reconsidered the matter and came to the same decision on more justifiable grounds.

Further submissions were made on the basis of this decision, and have now been considered in a second one. The judge commented that the appeal was a statutory one against an assessment, and the jurisdiction of both the FTT and UT was fully appellate; however, in respect of the issue of whether HMRC had properly exercised their discretion, the jurisdiction was supervisory only. So if the Tribunals were not satisfied that discretion had been properly exercised, they should say so, but they should not then attempt to substitute a different exercise of discretion.

The distinction is made between a "process defect" (leading to an "unreasonable decision" in supervisory terms) and a "merits defect" (which implies that the Tribunal disagrees with the conclusion of the officer – but still within the supervisory jurisdiction, in that the decision is one that could not reasonably have been made by the officer based on the evidence). The judge examines the various HMRC decisions under review and considers the Tribunal's comments on each one.

After an exhaustive examination, the judge concludes that only a finding of a "merits defect" should lead the FTT to allow an appeal against the assessment. If there is just a "process defect", then it means that HMRC

have not properly exercised their discretion, but the FTT is not entitled to exercise it for them: the proper course of action is for HMRC to reconsider the matter, or for the appellant to try to persuade the FTT that there is a merits defect – possibly after the further exercise of HMRC's discretion.

The judge therefore reversed the FTT decision allowing the company's appeal, and remitted the case to a differently constituted FTT (as the original chairman had retired) for consideration of whether a merits defect could be established. HMRC suggested a very tight timetable for the company to provide further evidence and argument for the further exercise of discretion; the judge decided to leave the management of the case in the hands of the FTT.

Upper Tribunal: *HMRC v G B Housley Ltd*

6.6.2 Correction of invoices

The German court has referred questions to the CJEU to find out whether there are specific requirements for the correction of incomplete invoices so that deduction of input tax can be justified. The German court is asking for a reconciliation of two past decisions which seem potentially contradictory. The questions referred are:

Is the ex nunc ['from now on'] effect of the first issue of an invoice, as established by the Court of Justice in the judgment in Case C-152/02 Terra Baubedarf-Handel v Finanzamt Osterholz-Scharmbeck, qualified by the judgments of the Court of Justice in Case C-368/09 Pannon Gép Centrum v Központi Hivatal Hatósági Főosztály Dél-dunántúli Kihelyezett Hatósági Osztáy and Case C-271/12 Petroma Transports v Belgium as regards cases, such as the present, in which an incomplete invoice is completed, so that the Court of Justice ultimately intended to permit retrospective effect in such cases?

What are the minimum requirements for an invoice to be capable of correction with retrospective effect? Is it necessary that the original invoice bears a tax number or a VAT identification number, or can these be added later with the consequence that the right to deduction is retained on the basis of the original invoice?

Is a correction to an invoice in time if it is only made in the course of objection proceedings against the decision (amendment notice) of the tax authority?

CJEU (Reference) (Case C-518/14): *Senatex GmbH v Finanzamt Hannover-Nord*

6.6.3 Details on an invoice

The Portuguese court has referred questions to the CJEU to clarify the level of detail that is required for an invoice for services to meet the requirements of the VAT Directive. The invoices in the case contained only a vague description. The question referred is:

Must Article 226(6) of the VAT Directive be interpreted as permitting the Autoridade Tributária e Aduaneira [Portuguese Tax and Customs Authority] to regard as insufficient a description on an invoice which states 'legal services rendered from such a date until the present date' or

merely 'legal services rendered until the present date', where that body may, in accordance with the principle of collaboration, obtain the additional information which it deems necessary to confirm the existence and detailed characteristics of the relevant transactions?

CJEU (Reference) (Case C-516/14): *Barlis 06 – Investimentos Imobiliários e Turísticos SA v Autoridade Tributária e Aduaneira*

6.7 Assessments

6.7.1 Disputed turnover

HMRC assessed a franchised fast food outlet in respect of undeclared turnover of £481,356 over a period of 3 years and 4 months. Output tax of £76,483 was charged, together with a penalty of £58,960. HMRC's case was based almost entirely on two inspections of the till in May and September 2008; the owner of the business did not cooperate with the investigation and did not attend the hearing, leaving the Tribunal with the difficult task of coming to a conclusion on the basis of limited evidence.

Given that it was for the appellant to displace the assessment, the Tribunal concluded that HMRC's case was fundamentally made out; however, to allow for uncertainties and the possibility of extrapolation errors, the VAT and the penalty were reduced by 10%. There was no other reason to reduce the 80% dishonest conduct penalty.

The decision includes a detailed discussion of the operation of tills, including the procedure for taking "Z readings". It appears that the trader thought it was possible to zero the till and only record some of the turnover that had been rung up on it; however, the till will still record a grand total of turnover since it was first used, and will record the number of times it has been zeroed. The trader said that he took a Z reading every week, and the figures from these readings (13 each quarter) tallied with the VAT returns. However, the till showed that there had been 725 Z readings from May 2005 to May 2008, rather than the 156 that were said to have been taken over a 3-year period.

First-Tier Tribunal (TC04297): *Tennessee Fried Chicken (a partnership)*

6.8 Penalties and appeals

6.8.1 Consultation

HMRC are consulting on broad proposals for changing the way tax penalties are charged. The consultation is open until 11 May 2015. The document describes the purpose of penalties as follows:

"*Penalties are applied to encourage taxpayers to comply with their obligations, to act as a sanction for those who don't and to reassure the compliant majority that they will not be disadvantaged by those who don't play by the rules. We don't use penalties as a way of raising revenue, or to offset our running costs. In essence, we want compliance, not penalties.*"

Penalties are divided into three main categories:

- penalties for failing to meet a time-bound obligation, such as submitting a return or making a payment by a specified deadline. Such penalties are generally automated;
- penalties for failing to meet a regulatory obligation such as notifying taxable status or not complying with a regulatory regime, for instance by handling goods subject to unpaid excise duty;
- behavioural-based penalties for submitting inaccurate returns and documents.

The post-merger "Powers Review" identified the following principles as appropriate for penalties. They should:

- Influence behaviour
  - Reinforce legal obligations to encouraging compliance
  - Deter non-compliance
  - Help return people to compliance
- Be effective
  - Clear, easily understood and accessible to all
  - Set in statute
  - Simple and cost effective to administer
  - Separate from interest
  - Applied consistently
- Be Fair
  - Proportionate
  - Customer focused, recognising differences
  - Subject to appeal (where they cannot be overturned by taxpayer action)
  - Conform with Human Rights legislation

The document notes that there are concerns that some penalties at present are unfair or disproportionate, and this can lead to increased non-compliance. This is therefore contrary to the principles above. In relation

to VAT, the particular penalty identified is – not surprisingly – default surcharge, where the following comments are made:

4.6. The current system has several safeguards to ensure that we handle any non-compliance proportionately. For example, an initial failure to comply in a 12-month period attracts a warning rather than a penalty. Successive failures then attract stiffer penalties. This approach gives customers an opportunity to recognise, and put right, problems in their filing process, before they risk incurring a large penalty. However, in some cases it can have the opposite effect, so that customers simply ignore the early warnings and fail to act until they receive a large penalty.

4.7. The current system does not differentiate between payments that are a day or two late from payments which are many months late.

There are a number of specific questions for respondents to consider, and tables setting out the present rules across a range of penalties. Some of the more radical solutions include non-financial sanctions as an alternative to financial penalties; a progressive system based on accumulation of penalty 'points'; or basing penalties on the overall compliance position rather than on a tax-by-tax basis.

www.gov.uk/government/consultations/hmrc-penalties-a-discussion-document

6.8.2 Default surcharge

In an article in *Taxation*, Mike Thexton questions whether the system of default surcharge complies with EU legal principles of proportionality, following the CJEU decision in the *Equoland* case. The article suggests possible reforms, including the implementation of the unified penalty regime that already applies to late payment or filing for direct taxes under FA 2009.

Taxation, 8 January 2015

In this quarter's surcharge appeals, the score was HMRC 15.5, traders 0.5.

A company's appeal was found to be no more than a request for sympathy in difficult financial circumstances. This could not succeed, so the charge of £5,960 was confirmed. The appeal was heard in the absence of the appellant, who the judge was satisfied had been notified of the date.

First-Tier Tribunal (TC04198): *Permatt Fork Lift Trucks Ltd*

A company appealed against four surcharges for four successive periods. The total amount was over £30,000. The company's accountants wrote to the Tribunal four days before the scheduled date of the hearing to say that no one would attend, but put forward representations.

The company had had a number of TTP agreements; when it tried to make a further one for the period to 06/12, the director was told that it could not be agreed. Nevertheless, the accountants appealed, arguing that the company should be treated as if there was a TTP agreement in force for 06/12 and 09/12. That would have cancelled the DS regime, and the next default would only have caused the issue of a SLN.

The Tribunal did not consider that anything had been offered as evidence for anything that might constitute a reasonable excuse. The appeal was

dismissed. As the accountants had not turned up for a previous hearing and had made no representations after a wasted costs award had been made against them, the Tribunal confirmed that they should pay HMRC's costs of £322 in respect of the earlier hearing.

First-Tier Tribunal (TC04206): *Environmental Practical Solutions Ltd*

A trader appealed against surcharges, arguing that he had done as much as anyone reasonably could to fulfil his responsibilities. The recession, and his reliance on two customers for 70% of his business, were factors beyond his control. TTP had been requested but refused on the grounds that the business was constantly late paying its VAT.

The Tribunal noted that TTP had only been applied for once, and that after the due date for payment. The Tribunal had sympathy with the difficulties experienced by the business, but the business needed more working capital. The VAT system could not be relied on for this – the company had been late paying 50% of the time.

First-Tier Tribunal (TC04211): *Nassah Services Ltd*

A company appealed against surcharges totalling £45,784 for five successive periods. The company had been in a Company Voluntary Arrangement to settle debts to an invoice discounter and to HMRC, and had suffered the withdrawal of overdraft facilities and credit by suppliers as a result. This could not constitute a reasonable excuse, and an argument based on disproportionality was routinely rejected.

First-Tier Tribunal (TC04223): *Igloos Ltd*

A trader appealed against a series of default surcharges totalling £8,640. As a preliminary matter, the Tribunal considered the trader's protest about an earlier decision that had confirmed surcharges for the quarter to 05/12. The trader had not attended that hearing and said that he was unaware of the decision; the business had moved, and some items of post had gone astray. The judge said that he could only pursue that appeal by applying to the Upper Tribunal, but would have to explain the reasons for being late with the application.

Turning to the later periods, the Tribunal considered the trader's reliance on the *Steptoe* defence. The company's major customer was the NHS, which was often late paying. If he created too much fuss, he ran the risk of being dropped as a supplier. The company had also been pressured into buying an interest-rate hedging product by its bank, which turned out to be a financial disaster – compensation negotiations were still in progress, but the bank's offer of £265,000 was considered inadequate. The bank had unexpectedly reduced the company's overdraft facility from £150,000 to £110,000.

The Tribunal accepted that this combination of factors constituted a reasonable excuse for the lateness in the periods to 08/12 and 11/12. As the trader then managed to submit three returns and payments on time, and no further explanations had been offered for the period 11/13 which was late, the appeal was dismissed in respect of that period. However, that would in the circumstances only lead to the issue of a SLN and not a penalty, because there would have been five periods without a default.

First-Tier Tribunal (TC04229): *Robert P Slight & Sons Ltd*

A trader appealed against a 15% surcharge of £907 imposed for the 07/13 period. He had suffered severe financial difficulties for several years following a break-in which resulted in the loss of a considerable amount of stock which the insurance company would not pay for because of discrepancies in the type of alarm system that was fitted.

The Tribunal found no evidence that the shortage of funds in the current period was due to anything unusual or unforeseeable. An appeal on the harshness of the penalty could not succeed. The appeal was dismissed.

First-Tier Tribunal (TC04232): *Len Pang Cheah t/a LPC Shades*

A company paid a VAT liability of £173,482 by cheque. It arrived on 6 February 2013, 6 days after the due date of 31 January 2013. The company had continued to make payments by cheque after being mandated to pay and file electronically in January 2010, and had received a succession of surcharge liability notices. The penalty for the late payment was £26,022, charged at 15%.

The company's appeal was based on shortage of funds arising from difficulties with a particular customer paying late; the VAT liability for the quarter being unusually large; and the unfairness of the penalty when the company was only just late. The company had not asked for TTP because it expected to be paid on time by its major customer. The director said he was unaware that making an electronic payment on 6 February would have avoided the surcharge as it would have been on time.

The judge noted that HMRC's argument against the application of *Steptoe* was based on "foreseeability", but that was not the correct test of whether the defence applied: it should be "unavoidability with reasonable care". The late payment by the customer in January 2013 could have fallen within that category. However, failing to address the continuing compliance failure, failing to notice the repeated instructions to pay electronically, and failing to ask for TTP, did not constitute reasonable care. The appeal was dismissed.

First-Tier Tribunal (TC04236): *HCM Electrical Ltd*

A company appealed against a 15% surcharge of £5,607 imposed for the period 03/12. The company claimed that a computer crash on 4 May had led to its inability to provide the information to its accountants in time. HMRC argued that the company should have contacted them to explain the circumstances on that day; the company had also not started preparing the return until Friday 4 May, when the due date was the bank holiday Monday following.

The Tribunal agreed with HMRC that the appellant should have done more to help itself in the circumstances. It could have made an estimated payment prior to the due date, or asked for TTP. The appeal was dismissed.

First-Tier Tribunal (TC04242): *Molloy Metals Ltd*

A curious case involved an appeal initially against a 10% surcharge amounting to £750 for late payment in respect of the period 11/13. HMRC then decided to cancel the first surcharge in the "cycle" (because they accepted that TTP was in place for that period), which reduced the 10% to 5% and the surcharge to below £400, so HMRC proposed not to collect it. The company still wanted to establish a reasonable excuse.

The judge had to consider whether he had jurisdiction over a situation in which HMRC had decided not to assess a surcharge. He examined the law on when a trader can appeal against a "default that is material to the surcharge", including situations in which an appeal can plead a reasonable excuse for an earlier default in order to reduce the percentage on the current one. He distinguished between the trader being "liable to the surcharge" (which is the case on small surcharges up to £400) and being "required to pay a surcharge".

Technically, a trader who disagrees with a SLN being issued when not liable to any surcharge (e.g. for the very first default, or for a late repayment return) can wait until there is a surcharge before pleading reasonable excuse for the earlier period. However, if a trader wishes to dispute a SLN when liable for a surcharge, it is necessary to appeal it at the time it is issued. Disputing it later (because of its effect on a later surcharge) would require leave of the Tribunal to appeal out of time.

As a result, the trader's appeal against the 11/13 "surcharge" was sensible and legally proper, even though HMRC did not propose to collect it. For the same reason, the trader could not in this appeal properly plead reasonable excuse for 05/13 or 08/13, because those had both given rise to surcharges at 2% and 5% that HMRC decided not to collect. However, the Tribunal was likely to be sympathetic to requests for leave to appeal out of time in such circumstances.

Turning to the trader's actual grounds of appeal, these were dismissed in turn. He claimed to have always paid on the 10th of the month and believed that this was the due date. A misunderstanding of this type could not be a reasonable excuse. The trader also claimed not to have received the earlier SLNs, but the Tribunal did not consider it had discharged the burden of proof to support this claim. The judge said "Its entire approach to the discharge of its VAT liabilities and to the conduct of this appeal displays a degree of disorganisation and I do not feel able to accept the Appellant's letter (which states that the writer has 'no recollection of this' before going on to assert that he was never notified by HMRC of any non-payment) as sufficient evidence to persuade me."

The last ground of appeal was mere insufficiency of funds. Accordingly, the appeal was dismissed, which presumably confirmed the trader's liability to pay the next surcharge at 10% if it had not learned the lesson from this dispute.

First-Tier Tribunal (TC04250): *Workstation Farnham Ltd*

A company appealed against three surcharges totalling nearly £4,200 for the periods 02/13, 05/13 and 08/13. The excuse offered was disruption to the business arising from an accident suffered by a director in June 2011. This was too long ago; there was also another director and a firm of chartered accountants involved, and the director had returned to full time work in March 2012. The Tribunal had some sympathy for the director, but could not find a reasonable excuse.

First-Tier Tribunal (TC04269): *Rota Installations Ltd*

A company appealed against a surcharge of £16,248 for the period to 10/13. The company was too large to use cash accounting, and its main customer generally paid very late, after about 90 days. An unexpected growth in business placed a great strain on its finances. The judge did not

consider this to be a reasonable excuse: the cash flow problems could and should have been anticipated. The appeal was dismissed.

First-Tier Tribunal (TC04275): *Axiom NDT Ltd*

A company appealed against a 15% surcharge of £10,017 in respect of its period 12/13. The company had suffered 2%, 5% and 10% penalties totalling a little more than £10,000 in respect of the previous three periods. The company argued that it had posted its cheque on 28 January; HMRC had stamped it received on 19 February but only credited it to the company's account on 17 March, which suggested a problem with HMRC's systems. The Tribunal noted that in any case the payment could only have been in time if paid electronically, as it would not have arrived and cleared the bank by 31 January. There was also no proof of posting.

The company also argued that it had believed a TTP arrangement was in force, as one had been agreed for the previous period. The judge accepted HMRC's argument that TTP is always a short-term arrangement to deal with individual liabilities, and the taxpayer cannot rely on one continuing to the next period.

The appeal was dismissed.

First-Tier Tribunal (TC04277): *A Alexander & Son (Electrical) Ltd*

A firm of lawyers appealed against a surcharge of £5,697 imposed for the period 04/14. Surprisingly, they did not appear or arrange to be represented at the hearing: the judge noted that a legal practice should understand the importance of that, and proceeded with the hearing in the absence of the appellant.

The company had been in default in all four periods in 2013 (three of those periods were subject to TTP, but they were all negotiated after the due dates). In spite of this, the cashier responsible for making payment believed that payment due on Saturday 7 June 2014 could be made on the Monday; and compounded this mistaken belief by failing to do, but put this right on the Tuesday.

The Tribunal considered everything that could have been said for the company and dismissed the appeal.

First-Tier Tribunal (TC04280): *TQ Property Lawyers Ltd*

A company appealed against a 15% surcharge of £6,625 for 05/13, and a late appeal against another similar surcharge of £8,430 for the following period. Part of its cash flow problem was said to result from HMRC being slow repaying Construction Industry Scheme tax deductions. However, the Tribunal could find nothing in the circumstances to bring the company within *Steptoe*: it was undeniably late paying, and could have applied for TTP but had failed to do so. It did not have a reasonable excuse.

First-Tier Tribunal (TC04311): *MPH Joinery Ltd*

A company appealed against a 15% surcharge of £86,464 charged under s.59A on a late payment on account. The company had a history of late payments; the current company secretary represented it at the hearing, stating that he had only recently joined the company and had instituted new procedures to improve VAT compliance.

Evidence could not be found to explain the late instruction to the bank for the particular payment. It appeared to be either human error by the company's staff or a problem with its fax machine. In the absence of an explanation, there could not be a reasonable excuse.

The secretary argued that the penalty was disproportionate. It related to a balancing payment for the quarter, which was much larger than the payments due in other months – so the penalty was far greater for effectively the same mistake. The company sourced its products from France and Germany: this meant that its VAT payments were proportionately larger, because in effect it had no input tax on purchases (acquisition tax and input tax would cancel out).

The Tribunal did not accept that these arguments could overturn the principles set out by the Upper Tribunal in *Total Technology*. The company's penalty was so severe because of the history of defaults. The appeal was dismissed.

First-Tier Tribunal (TC04329): *Faun Zoeller (UK) Ltd*

A plumbing company appealed against four surcharges for successive periods from 11/12 to 08/13 totalling £6,677. The company argued that it had been paid late by a major customer, which had also terminated its contract unlawfully (which was now the subject of civil proceedings). The Tribunal noted that this contract did not commence until April 2013, so the excuse could not be relevant for the first two periods; and the amounts involved as a proportion of the company's turnover were not large enough to bring it within *Steptoe* for the remainder. Evidence of the actual insufficiency of funds was also not presented – the Tribunal noted that the company owned an investment property worth £200,000 that could have been used to meet its VAT obligations. The appeal was dismissed.

First-Tier Tribunal (TC04339): *Steve Guest t/a All Hours Drain & Plumbing Services Ltd*

6.8.3 Costs

A chartered accountancy practice appealed against VAT assessments disallowing various claims to input tax, including on the purchase of a motorhome, and penalties relating to alleged dishonesty and deliberate behaviour. A settlement was negotiated in which the practice agreed to accept the VAT liabilities (which would be settled by a different partnership) and HMRC dropped the penalties. This agreement was determined by a "consent order" of the Tribunal. The trader had applied for costs of the proceedings before the settlement was reached, and pursued this application afterwards.

The trader was particularly aggrieved that HMRC had alleged dishonesty, a potentially ruinous accusation for a chartered accountant. This should only have been done on the strongest possible evidence and with special care. HMRC had failed initially to find records of telephone conversations between the trader and their officers in which the basis of preparation of the returns had been agreed; had they done so earlier, substantial fees would not have been incurred in preparing for the hearing.

The judge stated that the question for him was whether "HMRC had unreasonably resisted the appeal before the First-tier Tribunal, or

conducted themselves during the course of those proceedings in an unreasonable manner."

On that basis, the application had to be refused. The background to the dispute was relevant in considering the conduct of the appeal, but it appeared to the judge that once the proceedings had commenced, HMRC had acted reasonably. Tracing the phone calls was only possible after the officer had requested further specific information that the trader had not already supplied, and this enabled the officer to bring the matter to a conclusion.

It was noted that a separate complaint had been made about HMRC's conduct of the matter, and that would proceed (presumably to the Adjudicator) once the question of costs had been determined.

First-Tier Tribunal (TC04207): *Marshall & Co*

In TC02876, a company made a *Fleming* claim for VAT in mileage allowances between 1 January 1986 and 30 April 1997. HMRC refused, and a hearing took place in June 2012. After the first day considered two preliminary issues, one allowing HMRC to amend their statement of case and the other refusing to accept HMRC's contention that the Tribunal only had supervisory jurisdiction, HMRC agreed on the second day to pay £112,000 of the £126,000 in dispute. The company applied for costs on the basis that HMRC had acted unreasonably.

The company's complaint may sound familiar to anyone who has taken an appeal to the Tribunal: '*...there was essentially no new information or evidence provided to HMRC at the hearing that they did not have before. They say HMRC did not engage with the submissions and evidence provided by the appellant prior to the hearing, and that if they had done so the case would have settled much earlier in the proceedings. The appellant also points to various other matters, as amounting to HMRC unreasonably conducting and defending proceedings including the fact that HMRC raised the jurisdiction issue late in the proceedings on a misconceived basis.*'

The judge went through the history of the dispute in detail, and considered the various points raised by the appellants one by one and all together. He was not convinced that HMRC had acted unreasonably in defending or conducting the proceedings, and dismissed the application for costs.

The company appealed to the Upper Tribunal. The judge expressed the proper enquiry in consideration of costs in the FTT as follows:

A tribunal faced with an application for costs on the basis of unreasonable conduct where a party has withdrawn from the appeal should pose itself the following questions:

(1) What was the reason for the withdrawal of that party from the appeal?

(2) Having regard to that reason, could that party have withdrawn at an earlier stage in the proceedings?

(3) Was it unreasonable for that party not to have withdrawn at an earlier stage?

The appellant sought to persuade the UT that the FTT had fallen into error in relation to the third question. It could not simply argue that the UT should disagree and substitute its own decision, because that was not the

function of the appellate Tribunal; it therefore put forward two arguments that related to the FTT's approach, rather than merely its decision.

(1) The FTT erred in law because it applied a test of "obviousness" rather than "reasonableness" in determining whether HMRC had acted unreasonably in not settling the case at various points in the proceedings at which certain information and explanations had been made available to them.

(2) The FTT had been led into error by the failure of HMRC to disclose, at the time of the costs hearing, that the real reason why HMRC had persisted with their case was their alleged misunderstanding (as set out in the Hearing Statement) over the difference between business mileage and mileage allowances.

The FTT decision set out in nine numbered points the approach it had adopted. The UT judge quoted the whole passage and agreed with it. He went on to consider the three points at which the company alleged that the information and explanations available to competent, trained HMRC officers at various stages in the proceedings prior to the June 2012 hearing had been sufficient to enable such officers, acting reasonably, to have been able to conclude that the claim ought not to have been defended further.

The FTT judge had referred to the conclusion not being "obvious" at an earlier stage. Although that would be the wrong test, the UT judge did not accept that the FTT had applied it, taking the decision as a whole. He was considering "obviousness" as part of the test of "reasonableness", not instead of it. The approach of the FTT was "*impeccable. It properly instructed itself in the relevant law. It set out the proper approach to be adopted. It applied that approach. Its references to matters not being obvious were nothing more than constituent parts of the FTT's exercise of a value judgment, applying the correct legal principles, and having regard to all relevant circumstances, and no irrelevant ones.*"

The second point, concerning the "hearing statement" (an oral explanation of why HMRC were abandoning the case), had not been raised in the FTT costs application. The FTT judge had been entitled to make his decision based only on the material put before him; although he had himself received the statement in the substantive hearing, the appellant company had also been present, and if it wanted to raise this in its costs application, it should have done so at the FTT. Even if it was admissible in the UT, the judge did not accept that it demonstrated an error in the FTT's approach or decision. The appeal was dismissed.

Upper Tribunal: *Market & Opinion Research International Ltd v HMRC*

In TC03250, a company succeeded in overturning assessments in relation to zero-rated sales of camper vans which had been adapted for use by wheelchair users. The company applied for costs on 13 May 2014; HMRC argued that this was too late, as the decision had been issued on 21 January 2014. As the case had not been classified as complex, the only basis for awarding costs would be that HMRC had acted unreasonably in bringing, defending or conducting the proceedings.

The judge was sympathetic to the circumstances of the trader. She had been represented in the substantive hearing, but her representative had told her that she would find it very difficult to claim her expenses. She

decided to pursue a claim herself; it was therefore not surprising that she would not have been given the appropriate Tribunal booklet or been made aware of the time limit. Her failure to enclose a schedule of expenses with the letter was also excusable.

The Tribunal went on to consider the basis of the dispute. HMRC's view of the legislation had been held by the FTT to be wrong, but it had not been an unreasonable one to hold or to argue. Although the judge could understand the appellant's sense of grievance, this was not a case in which costs could be awarded under rule 10(1)(b). The application was dismissed.

First-Tier Tribunal (TC04332): *Concept Multi Car Ltd*

6.8.4 Penalties

A partnership was assessed to disallow input tax of £204,000 on the basis that the transactions were connected with fraud. The traders appealed, but the appeal was withdrawn on 1 June 2011, 20 days before the date fixed for the hearing. HMRC issued a letter on 23 May 2013 charging a s.63 VATA 1994 penalty at 15% of the amount disallowed, mitigated by 5% for compliance history and cooperation. The traders appealed against the penalty, arguing first that it was issued out of time, and second that it should be mitigated by a higher percentage. There was no dispute that the potential error met the size criteria of s.63.

The time limit for a penalty assessment is given in s.76(3) VATA 1994 as the expiry of two years "beginning with the time when the amount of the VAT due for the prescribed accounting period concerned has been finally determined". Relying on precedent, the Tribunal concluded that this was 1 June 2011, when the appeal was dropped. It could not be the date on which HMRC had raised the assessment just because that figure was unaltered by the subsequent dropped appeal.

The judge also agreed with HMRC that there was no evidence to support a contention for greater mitigation. The appeal was dismissed on both points.

First-Tier Tribunal (TC04208): *Ragveer Singh and Balbir Kaur t/a R S Garments*

A company was charged a penalty of £57,768 under Sch.41 FA 2008 for issuing VAT invoices when not authorised to do so (known as a "wrongdoing penalty"). The company was incorporated in November 2012 and submitted a VAT 1 form on 5 December requesting an EDR of 1 January 2013. The business consisted of health personnel recruitment.

HMRC tried to contact the company by telephone and letter in December. The letter stated that the registration request would be cancelled if no reply was received within 5 working days. An e-mail was sent on 4 January telling the company to log on to the HMRC site to view communications. Had the director done so, she would have seen a message telling her that her application had been refused for non-reply to enquiries.

In August 2013, following an enquiry into a PAYE debt, the company's accountant asked why no VAT number had been issued. This led to a visit which revealed that VAT had been added to sales invoices. A fresh

VAT 1 was filed and a return required for the period from 1 January 2013 to 31 October 2013. The return was not filed, and an assessment for £116,684 was issued on 1 November. This was followed by the wrongdoing penalty on 9 December.

The company did not put forward any response to the penalty, even in the form of a skeleton argument or witness statements, before the hearing itself. It became apparent during the hearing that the business was not a complete start-up as the director had initially asserted, but was the fourth incarnation of a series of companies that had become insolvent. The Tribunal considered that HMRC's decision to regard the failure to respond to enquiries as "deliberate" was reasonable; even if it was true that the messages did not get through, it was unacceptable to carry on charging VAT to customers while unregistered without making some enquiry of HMRC to find out what had happened to the application. The penalty was confirmed, without mitigation.

First-Tier Tribunal (TC04244): *Lucam Consultancy Ltd*

A couple carried out a conversion on a property they owned with the intention of selling it as two separate flats. They misunderstood the rules and made a DIY claim for the VAT incurred. HMRC refused the claim, after which they registered for VAT and recovered the VAT on the basis of a zero-rated major interest grant. However, HMRC levied a 15% penalty of £1,408 in relation to the incorrect claim. The couple appealed.

Their accountant pointed out that the amount of VAT recovered by registration (£10,887) was greater than that claimed on the DIY form (£9,390). There had been no loss to the revenue, and never could have been any such loss. The form had fully disclosed the circumstances of the project, including stating that there was an intention to sell – it was clear from the form that the claim should be refused, as HMRC had immediately done. The form therefore contained no inaccuracy.

HMRC's representative argued that the submission of the form was itself the inaccuracy that led to a penalty. There were warnings on the form about making invalid claims that could lead to a penalty.

The judge commented: "*It is clear to this tribunal that the form has done nothing more than to serve the purpose for which it was designed. It had on scrutiny by HMRC identified the Appellant's claim as one which did not meet the conditions of the Scheme.*" The judge regarded HMRC's position as a logical absurdity – the accurate completion of the form meant that it should be subjected to an inaccuracy penalty. "*In the view of the tribunal this is a misreading of the relevant legislation which quite clearly addresses the issue of inaccurate replies in a form which cause loss to the Revenue and not accurate replies which simply disentitle the claimant to participate in the Scheme.*"

The appeal was allowed.

First-Tier Tribunal (TC04251): *CJ Palau & RC Loughran*

A company was charged a penalty of £14,773 in respect of an input tax claim for its 10/11 period amounting to £19,698 in respect of an invoice for £118,188 gross for work that was never undertaken. HMRC charged the penalty on the scale for "deliberate and concealed" behaviour, and did not give the maximum mitigation (half the difference between the full

penalty – 100% – and the minimum for a prompted disclosure – 50% – leaving a penalty to be charged of 75% of the potential lost revenue). The company appealed.

The company was involved in trading in silver granules. An inspection visit was arranged after some of its suppliers were discovered to be missing traders. During the inspection, the officers found two invoices relating to commercial property. The invoice at the centre of the dispute turned out to be a quote for work rather than an actual invoice: the work had not been carried out.

The Tribunal considered the background to the company's business, the size of the invoice and the fact that it did not relate to the main trade; it weighed this against the fact that the director who prepared the VAT return and met the officers at the meeting was not involved in that trade from day to day, but rather assisted his son. On balance, the Tribunal decided that his conduct had been "careless" rather than "deliberate and concealed".

Turning to mitigation of the now 30% maximum penalty, the Tribunal noted HMRC's guidelines: if the difference between 30% and the minimum 15% for prompted disclosure is set at 100, the mitigation available is "telling 30, helping 40, giving access 30". In the present case HMRC had allowed 10 for "Telling", 10 for "Helping" and the maximum 30 for "Giving Access". However, the director contended that the company should be given full credit or 40 for "Helping".

Under the HMRC guidance (at CH82450) "Helping" includes:

(1) Giving reasonable help in quantifying the inaccuracy;

(2) Positive assistance as opposed to passive acceptance or obstruction;

(3) Actively engaging in the work to accurately quantify the inaccuracies; and

(4) Volunteering any information relevant to the disclosure.

The guidance goes on to say that "There will be cases where the circumstances are such that little in the way of telling, helping and access is needed to establish the reasons for the person giving an inaccurate document and the amount of any additional tax due." The director argued that there had been no delay in providing the information required, so full credit should have been given for "helping".

The Tribunal agreed, and reduced the penalty to 60% of 30% rather than 75% of 100% – if full credit was given for "helping", the mitigation would be 80% of the difference between 30% and 15%, leaving an 18% penalty payable.

First-Tier Tribunal (TC04335): *Servbet Ltd*

In TC02727, the FTT allowed in part an appeal against penalties assessed on the management committee of a mosque. Because the claim had already been refused by HMRC before the committee submitted it again, HMRC had charged the whole amount on the "deliberate behaviour" scale, mitigated to 49% of the PLR. The judge decided that some of the claim had been "careless" rather than "deliberate", and reduced the penalty accordingly. He also allowed more mitigation.

The committee then applied to have the “careless” penalty suspended, and appealed when HMRC refused. HMRC may only suspend a penalty if compliance with a condition would help the appellant avoid becoming liable for further penalties for careless inaccuracy. The officer’s decision to refuse suspension was based on the fact that no such conditions could be set. She had been told that the committee intended to deregister and submit a DIY claim instead; there would therefore be no further VAT returns that could be accurate.

The judge considered that this was not a correct basis for such a decision. The conditions were to prevent a further error of the same kind: if it was possible to formulate a condition that would apply to a future DIY builders’ claim, the penalty could be suspended.

The other reason given for refusing to suspend the penalty was that the committee was late filing VAT returns. The judge did not consider that to be relevant to a suspension decision. The officer’s approach was therefore flawed, and the Tribunal had the discretion to order suspension.

The judge (who also heard the original appeal against the penalty) considered that there were several reasons not to exercise that discretion. There was no indication at the time that any DIY claim would be made within the two year suspension period: suspension is not usually allowed for “one-off” errors, because the purpose of the condition must be to improve the accuracy of later returns. The appellant’s conduct in relation to the errors was also taken into account – there had been deliberate conduct in relation to part of the error, and the level of help given to HMRC in quantifying the inaccuracies was not high. In all the circumstances, it was not appropriate to order HMRC to suspend the penalty.

First-Tier Tribunal (TC04331): *Bilal Jamia Mosque*

6.8.5 Procedure

A company provides “free to air” television programmes, and also sells CDs, DVDs and advertising space. It has received funding from a Nigerian church; initially there was no written agreement concerning these funds, but they were later formalised as a loan bearing 3.5% interest. The company registered for VAT with effect from 1 March 2005, and claimed back all its VAT on expenses from 2008 onwards.

HMRC ruled that the “free to air” broadcasting was not a business activity, and its input tax should be restricted accordingly. HMRC argued that the receipts from the Nigerian church were in reality a donation. They refused repayments totalling £616,000. The company appealed to the Tribunal.

On 5 September 2014 HMRC applied for the appeal to be stood over until 60 days after the publication of the CJEU judgment in *Sveda UAB v Valstybine mokesciu insoekcija prie Leituvos Respublikos finansu ministerijos* (Case C-126/14). As at the date of HMRC’s application, judgment in Sveda was expected “in the next 18 months”, ie by June 2016.

The company objected, arguing that this delay would cause it significant prejudice. The issues in its appeal were highly fact-sensitive – whether it was carrying on a business in relation to the broadcasting activities, and

whether the funds from the church were a donation, a loan or something else. There was adequate guidance in UK precedents for the Tribunal to come to a decision on these matters without waiting for a CJEU judgment on a case that was not directly comparable.

The Tribunal judge agreed with the taxpayer. HMRC were directed to produce a statement of case within 60 days, and the substantive hearing in the case should proceed.

First-Tier Tribunal (TC04255): *Open Heavens Media Ltd*

DPAS won an appeal in the FTT (TC03058) concerning the exemption of its supplies of payment processing services to customers of dentists. The FTT concluded that it had genuinely changed its arrangements to make its supplies different from those considered to be taxable by the CJEU in *AXA (UK) plc*. HMRC have appealed to the UT, but the hearing is not due to take place until May 2015.

After winning the first appeal on the principle, the company submitted a s.80 claim (having accounted for output tax on its supplies). HMRC refused and the company appealed. HMRC asked for a stay of this second appeal, on the grounds that the department would be wasting its time if it in any case won the appeal on the point of principle. Only a short delay would be involved, given that the UT hearing will follow soon.

Judge Mosedale considered that it was appropriate to examine the question in relation to the day on which the stay was applied for (August 2014) and the likely further delay before the UT decision is released (some 8 weeks after the UT hearing). It was agreed that the amount of any repayment claim was not considered in the first appeal, so there was no entitlement to a repayment as a result of the company's success in that hearing; the company argued that deferring a hearing of its second appeal could result in it not receiving a repayment for years, if the other litigation dragged on. The normal procedure was that a FTT decision would result in a repayment to the appellant, even if HMRC appealed to the upper courts.

The judge noted that the situation was similar to an appeal where a preliminary hearing on principles was heard, leaving the quantum to be disputed later if the appellant was successful in the preliminary case. The fact that this dispute had resulted in two separate appeals should not change the way in which the case was dealt with. If an appellant had won a preliminary appeal on principle, the substantive hearing on quantum would follow regardless of any appeal to the UT in relation to the principle decision. Judge Mosedale considered that there is clear policy that first instance decisions should be given effect and that is the case even if the giving effect to them involves parties in some expense.

She went on to refuse HMRC's application for a stay, and to make directions about the second hearing to make sure that HMRC did not abuse the appeals process by attempting to reopen matters that had been settled by the first decision (which should then only be re-argued before the UT).

First-Tier Tribunal (TC04278): *DPAS Ltd (no.2)*

6.8.6 Judicial review

A company applied for judicial review of HMRC's decision not to allow it the benefit of a concession set out in Business Brief 10/04. This was the permission for an employment bureau to account for VAT only on the commission element of its charges, by choosing to be treated as an agent arranging a transaction between a work-seeker and the client. This was intended as a temporary concession while HMRC reviewed the impact of the Conduct of Employment Agencies and Employment Business Regulations 2003, which in their view would change the legal relationships between agencies, work-seekers and their clients, and would eventually lead to the withdrawal of the staff hire concession.

HMRC directed the company to account for output tax on the whole of its charges between March 2007 and March 2008. The company's application for judicial review was based on two alternative arguments:

- first, that the supplies fell within the terms of the concession in BB 10/04, and HMRC had misinterpreted their own concession and misapplied it to the facts; or
- HMRC had failed to apply the law correctly and had misdirected the company to treat its supplies as supplies of education rather than giving it the option to be treated as an agent arranging supplies of staff.

The company had been in the business of supplying lecturers to colleges of further education. To start with it treated them as exempt, but HMRC wrote to the company in December 2005 to rule that it did not qualify as an "eligible body" in respect of educational supplies. Although the company itself was limited by guarantee and non-profit making, its surplus income was stripped out by means of intra-group charges to commercial companies, so it should not be regarded as eligible.

After this, the group restructured its operations, setting up a new company to act as an employment bureau. Many of the colleges agreed to transfer their supplies to this company. Where colleges did not agree to such a transfer (for a variety of reasons "including simple apathy"), the former company (ELS) continued to treat them as exempt education. The new employment bureau (PNL) treated its supplies as within BB 10/04.

HMRC were not satisfied, and negotiations continued to establish the correct VAT liability. Meanwhile, the CJEU issued its judgment in *Horizon College* (Case C-434/05) on 14 June 2007. This meant that the company could not be supplying "education", but only "supplies closely connected with education"; the grounds for treating "closely connectedAt a further meeting in September 2007, ELS maintained that it exercised control over the lecturers; the judge noted that this meant HMRC could not at this point have appreciated that the company was supplying staff rather than education.

This point was made by PNL in a letter to HMRC in December 2007; HMRC eventually accepted that PNL was supplying staff and was eligible to use BB 10/04, not only going forward but retrospectively. However, it was not clear to HMRC that ELS was also supplying staff. Further information was sought in early 2008 by meetings, correspondence and visits to colleges. Eventually, in July 2009 HMRC accepted that ELS's

supplies were “more likely to be of staff than anything else”, but they did not accept that BB 10/04 could be applied. This was confirmed in a letter of 14 December 2009: the reason was that the company did not do anything to indicate, at any time, to its customers that it was acting, or intended to act, as an agent. This position was maintained in spite of further information and submissions, up to a final ruling in December 2012, which was the subject of the application for judicial review.

The judge (Mrs Justice Proudman) examined the history of events and decided that the evidence suggested that ELS had not made an early choice to be treated as supplying staff, and had not complied with the invoicing conditions of BB 10/04. It seemed more likely that the company still regarded itself as supplying education as a principal. The invoices were not determinative of the question, but they provided some evidence of what the company thought it was supplying and what choices it had made: it charged a single VAT-exempt amount.

In the second part of the argument, the company maintained that HMRC had misdirected it in 2005. Had they been given clearer guidance at that time, they would have been able to change their arrangements to take advantage of BB 10/04. Once again, the judge examined the evidence and concluded that any misunderstanding on HMRC’s part arose from a lack of clarity in the disclosure of facts by the company. Until a number of issues were corrected by a letter of 26 November 2008, the company had consistently told HMRC that it was acting as principal. The company had therefore not “placed all its cards face upwards on the table”, and could therefore not insist on the fair treatment it might have enjoyed had it done so. The application for judicial review was dismissed.

Upper Tribunal: *R (on the application of ELS Group Ltd) v HMRC*

6.8.7 Strike-out

A trader had paid estimated assessments for 17 periods from 09/96 to 03/01, and claimed a repayment of £48,671 after submitting the returns in September 2012. HMRC refused as the corrections were all a long time too late. A Tribunal ordered in August 2014 that the appeals should be struck out unless the trader could produce convincing arguments based on the European Convention on Human Rights, because there was no scope in the UK VAT law for either HMRC or the Tribunal to waive the time limits. Submissions were made in September.

The Tribunal accepted HMRC’s argument that the time limits were within a Member State’s allowed scope for imposing restrictions, and the ECHR was therefore not engaged. The taxpayer appeared to be arguing that the real problem was a failure by HMRC to notify it of the time limits for correcting estimated assessments; if that could be supported, it should properly be directed to the Adjudicator, not to the Tribunal. The appeal against the refusal to make a repayment was struck out.

First-Tier Tribunal (TC04245): *Brent Newsagents*

6.8.8 Late appeal

A golf club applied for permission to make a late appeal in relation to a *Fleming/Bridport* claim. HMRC objected and applied for the appeal to be struck out.

The club's records showed that a claim was considered by the finance committee in February 2009, and was made by the accountants advising them on 23 and 24 March 2009. Separate claims were made in relation to membership subscriptions for the period from December 1973 to December 1989 (£140,983), and in relation to green fees for the periods 1973 to December 1996 (£494,389) and January 2006 to December 2008 (£153,794). The total amount claimed was £648,167.

HMRC wrote to "North Bewick Golf Club" in July 2009, refusing the claim and outlining the actions that should be taken if the club disagreed. There is no club of that name, but the address on the letter was correct. At no stage did HMRC write to the accountants. The club officials were adamant that the letter was not received. No further action was taken in respect of the claims until 2014, although there were four VAT visits during the period (January and May 2009 and June and July 2012).

The accountants wrote to make a further protective claim after the *Bridport* decision. This related to the period from April 2010 to December 2013, and amounted to £407,112. HMRC replied to the club, saying that there was no mandate in place, and pointing out that the earlier claim had been rejected in July 2009.

The failure to appeal the *Fleming* claim was pointed out by HMRC on 28 April 2014. A new mandate was put in place in early May; the accountants asked for a departmental review, which was immediately refused because HMRC said they had given an opinion, not an appealable decision. The club and the accountants submitted a notice of appeal with the Tribunal on 6 June 2014, asking for leave to appeal out of time.

HMRC argued that leave to appeal out of time, particularly where there was a very long delay should be wholly exceptional. However, the Tribunal stated that this could not be elevated into a principle that the circumstances had to be exceptional. The FTT had complete discretion, and must take account of all the relevant circumstances.

The FTT noted that HMRC were inundated with post at the time (because of *Fleming* claims). By contrast, the club had between 2 and 12 items of post a day, usually fewer in July than other months. On the balance of probabilities, it was more likely that the club had not received the letter (which was incorrectly addressed); and if it had been returned to HMRC, it was entirely possible that the return had not been recorded.

The FTT went on to consider whether the club or the accountants should have pursued HMRC after that, which would have revealed that the decision had been issued. The FTT was satisfied that there was no particular reason for them to do so. They would have been aware that *Bridport* was proceeding slowly to the CJEU; their inaction was entirely consistent with a belief that their claim was simply held over while waiting for the outcome of the other case.

Although the overall delay was very long at 4 years and 10 months, the club and the accountants acted very promptly once they discovered the problem. There would be substantial prejudice against them if they were barred from litigation. Although the time limits were there to provide certainty, there was a public interest in the correct tax being paid as well. HMRC's application for strike-out was refused.

First-Tier Tribunal (TC04289): *North Berwick Golf Club*

6.9 Other administration issues

6.9.1 The VAT Guide

A new updated version of the VAT Guide has been issued. There are several minor changes, but there is also a new paragraph about the place of supply of digital services to consumers and the MOSS arrangements applying from January 2015.

Notice 700

6.9.2 VAT Visits

In an article in *Taxation*, Neil Warren notes that VAT visits are rarer than they used to be, but they are still used by HMRC to police the system. They tend to be more focused than before – an anomaly identified in a return, or from some other enquiry, is more likely to lead to a visit than old fashioned random selection.

Taxation, 29 January 2015

6.9.3 Crime and punishment

On 14 December 2012, after a trial which heard the testimony of 57 witnesses over 46 days in the High Court at Edinburgh, an individual was convicted of five charges in connection with fraudulent schemes designed to generate repayments of VAT through transactions between companies he controlled. Three of the charges related to MTIC fraud; the other two related to the laundering of the proceeds of crime. The total VAT evaded as a result of the frauds was £5.4m. The defendant was sentenced to a variety of terms totalling 9 years.

The individual appealed against the conviction and sentence, arguing that the trial judge had misdirected the jury by failing to direct the jury to the expert evidence they would have to consider in order to find him guilty. It had been accepted that the judge had misdirected the jury in respect of one of the charges, and the sentence appropriate to that charge therefore could not stand; however, the Scottish High Court of Justiciary dismissed his appeal, holding that the trial judge's summing up could not be counted a misdirection; the sentence would have been even longer if various mitigating factors in the defendant's personal circumstances had not been taken into account already.

High Court of Justiciary: *Ramzan v HM Advocate*

An individual appealed against an order for his extradition to Poland to serve a sentence of four and a half years for various offences including drunk driving and VAT fraud. The High Court upheld the decision of the judge who had given the order. In particular, the judge had been entitled to find, on the evidence before him, that the appellant had fled Poland to avoid proceedings in relation to the VAT fraud of which he had been aware. He had heard the appellant give oral evidence and had been in the best position to assess his credibility. The judge had been entitled to conclude that it had been established, to the criminal standard, that the appellant had deliberately absented himself from his trial.

High Court: *Podlas v Koszalin District Court, Poland*

6.9.4 Winding-up petition

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 (which were for output tax on the grounds that goods had not left the UK – a *Teleos* dispute rather than *Kittel*); 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 judge 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 in good faith and on substantial grounds" until the FTT gave its decision.

HMRC appealed to the Court of Appeal, which overturned the High Court's decision. Although the proceedings in the tax tribunal would be relevant to the weighing up exercise for the Companies Court, the judge in the Companies Court still had a duty to consider separately whether the debt relied upon for the winding-up petition was disputed in good faith on substantial grounds; he could not abrogate that responsibility to the tax tribunal. The judge had been "*very reluctant to engage with the facts. If he had done so... he too would most likely have reached the clear conclusion that the debts in this case that underlie the dispatch assessments are not disputed in good faith on substantial grounds.*"

Vos LJ concluded that the facts of this case were quite exceptional: the judge ought to have formed a conclusion that differed from that of the tax tribunal, and should have granted HMRC's petition.

The company has applied for leave to appeal to the Supreme Court.

Court of Appeal: *Changtel Solutions UK Ltd (formerly Enta Technologies Ltd) v HMRC*

6.9.5 Security

A company appealed against a notice to require deposit of security. A predecessor business owed nearly £86,000 in unpaid VAT, including £50,000 that had been assessed on the company in 2009. The predecessor had appealed against this assessment, but withdrew it in January 2014. The shareholders (a married couple) argued that this was because they decided to avoid entering costly and time-consuming litigation and move on with their business; it was not because they accepted that HMRC had been right. In their view, the reasons for withdrawing had not been taken into account by the officer making the decision to require security.

The husband had been disqualified from acting as a director because of failures in filing accounts at Companies House. He had believed that he could not file while there were material amounts in dispute, but he now accepted that this could have been covered by disclosures in the notes.

The officer who made the decision had noted that the previous company had been sold in a "pre-pack" insolvency arrangement; it had owed not only the VAT but also default surcharges, interest, PAYE and corporation tax. She had come to the conclusion that there was no evidence that the new company would be any more compliant than its predecessor.

The FTT considered the arguments of the company and rejected them. Even on the basis of its view that the assessment was wrong, there was still a very substantial amount of VAT outstanding. As the appeal had been withdrawn, the assessment was a liability of the company that would not be paid. Given that it had been withdrawn, the reason for that withdrawal was not particularly important. The officer's decision to require security could not be said to be unreasonable.

First-Tier Tribunal (TC04270): *Repro FM Ltd*

A company appealed against a notice to deposit security of £26,900 (quarterly returns) or £17,950 (monthly) in 09/2013. The appellant could not afford for its representative to attend the hearing and cross-examine HMRC's witness, and did not feel able to conduct the hearing alone; the hearing therefore proceeded in the absence of the appellant, on the basis of a skeleton argument provided by the representative.

The officer who issued the notice explained that HMRC had identified a connection between the appellant and several other businesses that had failed owing substantial amounts of VAT. In particular, the sole director and shareholder had also owned a company with a similar name that was insolvent in July 2013 with a VAT debt of over £500,000 and a default surcharge of £34,000. There were three other companies with which the same man was connected that also owed substantial but lesser amounts.

The large liability related to an assessment for output tax in relation to a suspected MTIC despatch fraud. The appellant's case was based on the assertion that its trading style had completely changed from the previous business: as its purchases of mobile phones were now subject to the reverse charge, the same risks did not apply. In basing her decision only on the previous businesses, the officer had failed to take account of this relevant information. The arrears of the present business were only £100 when the decision was taken.

There was no evidence to support the assertion of a new business model, so the Tribunal could not make a finding on that matter, or whether that information had been provided to the officer when she made her decision.

The appellant further argued that an appeal against the MTIC assessment had been dropped because of the cost of proceeding with it; the officer had not taken that into account, but had rather simply considered that there was an unpaid assessment. The Tribunal considered that this could be a flaw in the decision; however, the withdrawal of an appeal means that the liability becomes final, and the connection with a business that owed £500,000 in VAT for whatever reason surely justified the notice. Even if all the relevant factors had been taken into account, the decision would inevitably have been the same. The appeal was dismissed.

First-Tier Tribunal (TC04317): *Mistral Promotions & Marketing (UK) Ltd*