VAT UPDATE
JULY 2011

Covering material from April – June 2011

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VAT Update July 2011

Contents

1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The HMRC website section which reported the progress of appeals stopped being updated some time ago and for some time it was only possible to pick up clues to unsettled cases from Revenue & Customs Briefs which announced HMRC's intention to appeal a decision or to concede defeat. However, a new "VAT Appeal Update" appeared on 21 January 2011, and it is to be hoped that this will continue. It says that it will be updated monthly, but as the first update to appear arrived on 23 May. Several of the "appeal will be dropped" items are still on the list, but where they have already been reported they are not reproduced below.

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

Awaiting the CJEU:

- *Littlewoods/Grattan*: the entitlement of traders to interest on VAT overpayments (questions described in the last update).
- *Rank Group plc*: the exemption for FOBT gaming machines (the Upper Tribunal and Court of Appeal have referred questions which were described in the last update). The Daily Telegraph reported on 23 March 2011 that Rank had received a rebate of £74.8m in overpaid VAT and expected to be repaid a further £79.5m in interest shortly. The ECJ hearing took place on 30 June 2011.

UK appeals awaiting hearing:

- *DCM (Optical Holdings) Ltd*: HMRC have appealed to the Upper Tribunal after the FTT accepted that a floor-area based special method could be appropriate (awaiting hearing date)

- *GMAC UK plc*: HMRC appealed to the Upper Tribunal after the First Tier Tribunal held that the company was entitled to go back for many years in a bad debt relief claim because the UK rules were too restrictive – the last update included a preliminary UT decision, which was not to refer questions to the CJEU but to proceed with a substantive hearing (full hearing later this year)
- *Greener Solutions Ltd*: HMRC have appealed to Upper Tribunal after First-Tier decided that a trader did not have the means of knowing about a carousel fraud (awaiting hearing date)
- *Isle of Wight Council and others*: remitted to Tribunal to consider evidence again in light of CJEU's ruling on how "risk of distortion of competition" is to be applied
- *London Clubs Management Ltd*: HMRC have appealed to the Court of Appeal after the FTT and Upper Tribunal accepted that a floor-area based special method could be appropriate (Court of Appeal hearing in October 2011)
- *Newey (t/a Ocean Finance)*: HMRC have appealed to the Upper Tribunal after the First Tier Tribunal held that a scheme was effective in reducing irrecoverable VAT on advertising costs by moving a loan broking business to the Channel Islands (awaiting hearing date)
- *Pendragon plc*: HMRC will appeal to the Upper Tribunal after the First Tier Tribunal found a scheme "not abusive" [no longer on the update list, either as "dropped" or "appealed"]

In this update from previous lists:

- *BAA Ltd*: Upper Tribunal overturned the First Tier Tribunal's decision that a company was entitled to recover input tax on the costs of its holding company bidding to acquire it

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Flat-rate farmers and sales of land

Two cases on the liability of farmers to account for VAT on the sale of agricultural land (acquired VAT-free) have come before the Advocate-General. The two cases were slightly different:

- in one case, the farmer had used the land for agricultural purposes, then – in accordance with a change in the local urban management plan – reclassified it as private property before starting to sell it for development;
- in the other case, the trader was within the farmers' flat-rate scheme, and was therefore not in general a taxable person.

The Advocate-General has given an opinion that these transactions are in principle within the scope of VAT, provided that the person undertakes them in the capacity of a taxable person. A flat-rate designation does not stop a person being taxable in respect of activities that fall outside the flat rate scheme.

The redesignation of a business asset as a private asset, followed by the gradual realisation on a series of disposals, is something that should be considered by the local court. The activity will be "economic" if the aim is to realise income on a continuous basis. It makes no difference that the land was not purchased with the intention of resale, nor that it has been reclassified as private property after being used in a business.

CJEU (A-G) (Case C-180/10): *Jarosław Słaby v Minister Finansów and Emilian Kuć and Halina Jeziorska-Kuć v Dyrektor Izby Skarbowej w Warszawie*

2.1.2 Hotel deposits

HMRC have expanded the guidance in their online manuals in relation to hotel deposits. They confirm that a forfeited deposit for a hotel room is normally not consideration for a supply, in line with the ECJ's decision in *Société thermale d'Eugénie-ies-Bains*.(C-277/05). However, where a customer paid for a "guaranteed room" and was actually allocated a room which they failed to occupy, the "deposit" is in fact consideration for the supply of the room, in line with the High Court's 1993 decision in *Bass plc*. It appears that HMRC accept that "outside the scope" is the more normal situation.

www.hmrc.gov.uk/manuals/vatscmanual/vatsc42000.htm

2.1.3 Carrier bags

HMRC have issued guidance on the VAT consequences of the implementation of a 5p levy on "single-use" carrier bags in Wales. This will be introduced under Welsh Assembly legislation from 1 October 2011: retailers will be required to charge their customers at least 5p for a carrier bag.

HMRC regard the 5p as gross consideration for the supply of the bag. A VAT registered business will account for output tax at 1/6 of the 5p charge; a business that is not registered for VAT will charge the same 5p to the customer, but the supply will be outside the scope of VAT.

R&C Brief 23/2011

2.1.4 Shooting syndicates

An individual was a member of a farming partnership. He organised two shooting syndicates which had rights to shoot on two adjacent estates. He was a member of one of the syndicates and knew the members of the other syndicate personally.

HMRC formed the view that he was supplying shooting rights as a sole proprietor and should be registered for VAT. An assessment for £75,000 was raised, together with assessments for penalties for non-compliance.

The Tribunal considered the facts in detail and concluded that the only supplies made by the individual were the supplies of administering and managing the shoots. He did not supply the shooting rights themselves. The value of the supplies was below the registration threshold, so he was not required to account for any VAT.

The Tribunal distinguished the decision in *Williams* (VTD 14,240), in which a farmer had been held to be liable to register in respect of running shoots. The arguments were also not quite the same as those in the *Lord Fisher* case, which the facts clearly resemble, because there it was conceded that supplies were made for a consideration. Here, the appellant argued that he made no supplies at all, or if he did, they were not made for consideration. Lord Fisher owned the land over which the rights were granted; in this case, the appellant was granted shooting rights by the owners, but he argued that he held those rights in an agency or fiduciary capacity rather than as principal.

Unusually, the Tribunal went on to offer a number of further detailed considerations in case it was wrong on the basic finding that any supplies were below the registration threshold. First, it ruled that the circumstances of these shoots were very like those in Lord Fisher, so the same principle should be applied – if there were supplies, they were not in the course or furtherance of a business. Second, it ruled that the appellant had a reasonable excuse for failing to register because of the complexity and uncertainty of the issues, and the penalty ought therefore to be quashed even if he had to pay the VAT.

Finally, the Tribunal concluded that the transitional costs rules applied, and awarded costs to the appellant.

First Tier Tribunal (TC01205): *EG Harrison*

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 European rules on financial services

The European Council has taken note of a report on progress towards implementing the 2007 proposals to reform the VAT rules for insurance and financial services. The report considers that there are only four major issues outstanding:

1) transfer of insurance and reinsurance contract portfolios;

2) outsourcing;

3) management of investment funds;

4) derivatives.

The report summarises briefly the main issues in relation to these matters, which have been considered by the ECJ in past cases with results that are not consistently applied throughout the EU.

The Commission has also proposed a mechanism to establish cross-border cost sharing groups.

http://register.consilium.europa.eu/pdf/en/11/st11/st11092.en11.pdf; Council Press Release 11595/11 20 June 2011

2.3.2 UK rules on IFA charging

The UK is bringing in new rules on how independent financial advisers charge for their services (the Financial Services Authority's "Retail Distribution Review"). The objective is to increase transparency of charging and therefore improve consumer protection, but this has led to some uncertainty about the VAT consequences. As a general rule:

- IFA charges that are related to executing or arranging a transaction have generally been regarded as exempt under Group 2 or Group 5 Sch.9;
- IFA charges for advice (or management of investments) have generally been regarded as standard rated, but many IFAs do not exceed the registration threshold if these are taken on their own.

An HMRC policy adviser commented at a forum held by the Tax Incentivised Savings Association in June 2011 that HMRC wanted to work with the industry to produce new VAT guidance for IFAs, and invited submissions from trade bodies and representatives.

2.3.3 Postal services

Royal Mail has announced that VAT will be applied to some additional services from 1 August 2011. Some bulk account packet services will be removed from price control from that date and therefore will become subject to VAT, because they will no longer be within the universal service obligation which defines the scope of the "public postal services" for the purposes of the VAT Directive exemption. The change will apply to packets weighing more than 1kg sent via Royal Mail's Mailsort 3 1400, Presstream and Packetpost services.

www2.royalmail.com/customer-service/terms-and-conditions/vat-changes-2011#02

2.3.4 Portfolio management

The German Federal Finance Court has referred questions to the CJEU on whether portfolio management for individuals should be exempt from VAT. The questions are:

Is the management of securities-based assets (portfolio management), where a taxable person determines for remuneration the purchase and sale of securities and implements that determination by buying and selling the securities, exempt from tax

- *only in so far as it consists in the management of investment funds for a number of investors collectively within the meaning of Article 135(g) of Directive 2006/112/EC of 28 November 2006 on the common system of value added tax 1 or also*
- *in so far as it consists in individual portfolio management for individual investors within the meaning of Article 135(1)(f) of Directive 2006/112/EC (transactions in securities or the negotiation of such transactions)?*

For the purposes of defining principal and ancillary services, what significance is to be attached to the criterion that the ancillary service does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied, in the context of separate invoicing for the ancillary service and the fact that the ancillary service can be provided by third parties?

Does Article 56(1)(e) of Directive 2006/112/EC cover only the services referred to in Article 135(1)(a) to (g) of Directive 2006/112/EC or also the management of securities-based assets (portfolio management), even if that transaction is not subject to the latter provision?

CJEU (Reference) (Case C-44/11): *Finanzamt Frankfurt am Main V-Höchst v Deutsche Bank AG*

2.3.5 Individual voluntary arrangements

A company provided services in connection with the establishment and supervision of individual voluntary arrangements (IVAs) for people who were in financial difficulties. HMRC ruled that its supplies were taxable. The company argued that the services fell within art.135(1)(d) as "*transactions, including negotiation, concerning ... debts ... but excluding debt collection*".

The Tribunal examined in detail what is involved in an IVA. It concluded that the essential nature of the service is "*the provision to the client of the means whereby his debts can be restructured so as to provide him with protection from his creditors, an achievable cash flow and debt repayment schedule, and, if the arrangement reaches its planned conclusion, an element of release from part of his indebtedness*". This should be regarded as a single supply for VAT purposes, because the customer would regard it as a single aim: it would be artificial to split it.

The Tribunal considered whether the services involved "negotiation". It observed that the appellant described what it did using that term, but that was not conclusive: regard should be had to the economic reality. Following the ECJ decision in *CSC Financial Services Ltd v Customs and Excise Commissioners* (Case C-235/00), "*The purpose of negotiation is*

therefore to do all that is necessary in order for two parties to enter into a contract, without the negotiator having any interest of his own in the terms of the contract". The Tribunal decided that the appropriate tests were:

(1) Is the service one of a distinct act of mediation?

(2) Is Blair Endersby a person that does not occupy the position of debtor or creditor, or as a subcontractor of one or both of them?

(3) Are the services supplied by Blair Endersby not typical of the services performed by a debtor or creditor?

(4) Is the purpose of the activity undertaken by Blair Endersby to achieve a change in the legal or financial situation of debtor and creditors, or to create, alter or extinguish the rights and obligations of the debtor and creditors in relation to the debts?

The Tribunal considered that (2) and (3) were clearly satisfied, and after discussion of the detailed meanings, also concluded that (1) and (4) were.

The possible treatment of the payment handling services as taxable debt collection following the *AXA* decision was considered and rejected. The Tribunal considered that the identity of the recipient of the supply was significant: in *AXA*, the services were supplied to the creditor, while here they were supplied to the debtor. HMRC's counsel objected that this was an arbitrary distinction, as it would be common for the creditor to recharge the cost of debt collection to the debtor in any case; but the Tribunal found that the economic reality was that the establishment of the IVA was the main supply, and the company was not providing debt collection services.

The decision was based on the direct effect of the Principal VAT Directive, and the Tribunal considered it unnecessary also to examine the UK law.

First Tier Tribunal (TC01210): *Paymex Ltd*

2.3.6 Machine games duty

HMRC have published a consultation on replacing Amusement Machines Licence Duty and VAT on gaming machines with a new "machine games duty" (MGD) from 2013. Details are available on the Treasury website.

MGD will be due on the net takings from the playing of games where customers pay to play on a machine in the hope of winning a prize which is greater than the cost to play. AMLD will be brought to an end and all machine games subject to MGD will become exempt from VAT.

MGD will include certain machines not currently subject to AMLD. It will cover exempted machines, as well as certain machines not classified as "gaming machines" for regulatory purposes.

MGD will be a gross profits tax, which the Government believes will improve the future predictability and sustainability of the tax regime by making it more resilient to technological progress, regulatory changes and to inflation. Exempting machine games from VAT will also increase the stability of the tax regime as the playing of machine games will then have the same VAT treatment as other gambling activities. A GPT also

supports the Government's objective of a fairer tax system by ensuring the taxation of machine games is more closely linked to machine profits.

www.hm-treasury.gov.uk/consult_machine_games_duty.htm

2.3.7 Tuition?

An individual provided nutritional therapy. HMRC ruled that she was required to register for VAT. She appealed, contending that she was providing "private tuition" within Group 6 item 2 Sch.9 VATA 1994. The Tribunal rejected this argument and dismissed her appeal.

The case had arisen from HMRC noticing that the income declared on the appellant's self-assessment income tax returns exceeded the registration threshold. In preliminary discussions the trader was persuaded that she did not fall within the more immediately obvious "health and welfare" provisions of Group 7, so the argument turned to Group 6. She argued that she provided education to her clients. She claimed that she should be called a "nutritionalist", rather than a "nutritional consultant" or "therapist" (in spite of those descriptions being used in articles about her work). HMRC responded that she provided therapy. HMRC accepted that nutrition was a subject which may be taught in a school or university, but they did not accept that she was teaching it in the context of the majority of her business – private consultations with clients.

The Tribunal ruled that "that there is a clear difference between teaching the subject of nutrition in a school or university to future professionals on a vocational basis to that of practising and applying the skill". The appellant fell on the "application" side of the line. Her appeal was dismissed.

First Tier Tribunal (TC01207): *Mrs R Holmes*

2.3.8 Youth clubs

HMRC have published an updated version of their Notice on *Youth Clubs*, explaining what is a youth club or an association of youth clubs, and what supplies made by a youth club or an association of youth clubs are exempt from VAT within Schedule 9, Group 6, Item 6 (as amended by Statutory Instrument 1994/2969).

Notice 701/35

2.3.9 Major golf win

The UK law restricts the sporting exemption to services supplied by not-for-profit organisations to their members, if they operate a membership scheme. Accordingly, daily green fees charged by a golf club to visitors have been regarded as taxable. In 2009 a club submitted a "*Fleming* claim" for £140,000, arguing that this provision (or its interpretation by HMRC) was contrary to the exemption in art.132(1)(m) VAT Directive, and the restriction was not permitted within art.133(b) or 134(b).

There were also subsidiary issues concerning the application of the cap and compound interest, but the Tribunal agreed with the parties to leave these until the outcome of other litigation clarified the principles.

Art.132(1)(m) exempts "the supply of certain services closely linked to sport or physical education by non-profit-making organisations to persons taking part in sport or physical education".

Art.133 permits member states to restrict a number of exemptions, including this one, by setting conditions including "(c) those bodies must charge prices which are approved by the public authorities or which do not exceed such approved prices or, in respect of those services not subject to approval, prices lower than those charged for similar services by commercial enterprises subject to VAT; (d) the exemptions must not be likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT."

Art.134(b) provides that exemption shall be lost "where the basic purpose of the supply is to obtain additional income for the body in question through transactions which are in direct competition with those of commercial enterprises subject to VAT." Art.134 is mandatory, whereas art.133 gives member states scope to choose.

The provisions are transposed in Group 10 Sch.9 VATA 1994. The relevant provision is item 3: "The supply by an eligible body to an individual, except, where the body operates a membership scheme, an individual who is not a member, of services closely linked with and essential to sport or physical education in which the individual is taking part."

The chairman decided that the exemption had to be interpreted purposively, and that the restrictions on exemption were exhaustive – that is, a member state could not restrict the exemption in circumstances not envisaged by arts.133 and 134. The membership scheme restriction should not be applied to the normal activities of the club (i.e. supplying the right to play golf) because that was not "additional income".

Art.133(c) and (d) are not obviously transposed into the UK law. HMRC argued that the membership scheme rules are there to achieve the same objective – avoiding distortion of competition – but the chairman did not agree that this was an effective alternative. In doing so, he acknowledged that he was departing from his own earlier decision in *Keswick Golf Club* (VTD 15,493). He suggested that the parties should apply for the hearing to be continued (i.e. adjourned until a different day, but not treated as a separate case) to consider to the capping and interest issues.

First Tier Tribunal (TC01214): *The Bridport and West Dorset Golf Club Ltd*

2.3.10 Cost sharing exemption consultation

After a number of false starts over several years, HMRC have published a consultation to consider how the cost sharing exemption for non-taxable persons (VAT Directive art.132(1)(f)) might be implemented in the UK. The consultation started on 28 June and end on 30 September.

The executive summary in the document sets out the objectives as follows:

1.1 The purpose of this document is to examine how the VAT cost sharing exemption might be introduced into UK legislation and to develop a framework for its implementation - Stage 2 of the tax policy development

and implementation framework. In preparing it HMRC has taken into account representations received from interested parties over the past 12 months. The principles that have guided HMRC in developing the options for the way the exemption might be implemented are that it:

- *Could be used by a wide range of sectors.*
- *Is straightforward to operate, minimising compliance and administrative burdens.*
- *Does not create opportunities for abuse or avoidance.*

1.2 The principal benefit of the exemption is that by removing a VAT charge, it will facilitate efficiency savings for certain organisations wishing to work together. It is designed for use by businesses and organisations unable to recover all of the VAT they incur on their purchases, such as:

- *Charities*
- *Universities and Further Education Colleges*
- *Housing Associations*
- *Residential care homes*
- *Banks*
- *Insurance companies*

1.3 The exemption is however a complex legal provision impacting on a wide range of organisations and HMRC will need to consider the responses to this Consultation Document carefully.

1.4 Implementation will not be straightforward as there is no standard EU implementation that can be followed. Each Member State has implemented the exemption in a unique way.

1.5 The Commission have recently started infraction proceedings against some Member States in relation to the way they have implemented the exemption and have indicated that they will be issuing some detailed guidance for Member States later this year.

1.6 The exemption is a longstanding provision of European VAT legislation. Chapter 2 explains some background to the exemption and includes the European legislation.

1.7 Chapter 3 sets out how HMRC will define an 'independent group of persons' and asks a series of questions based on that stated definition.

1.8 Chapter 4 explains the requirement for members of cost sharing groups to carry out exempt and/or non-business activity and asks whether there should be a requirement for them to have a certain level of exempt and/or non-business activity before they can become members of CSGs.

1.9 Chapter 5 offers HMRC's preferred method of defining 'directly necessary' supplies. The approach taken to defining the services qualifying for the exemption is likely to have a significant effect on how it is used. HMRC would like to understand the impact of the suggested approach on organisations' ability to use the exemption. Alternative approaches are suggested and comments and suggestions are invited from respondents about any other method(s) they believe should apply.

1.10 Chapter 6 explains how HMRC believe the 'direct reimbursement of costs' condition could apply, inviting comments and alternative approaches.

1.11 Chapter 7 explains, using European case law, in what circumstances the 'distortion of competition' condition would apply and asks respondents for specific examples.

1.12 Chapters 8 and 9 set out HMRC's position regarding, respectively, cross border issues and process and compliance matters.

1.13 Chapter 10 details generally the impacts that would result from introducing the exemption into UK legislation and asks a series of questions to validate or otherwise the various impact assessments. In particular it seeks to identify whether or not there would be any equality impacts.

1.14 HMRC expect that many qualifying cost sharing arrangements will have no impact on VAT receipts because the affected services are currently provided in-house. However, where taxable outsourced services are brought in-house using the cost sharing exemption there will be an impact on tax receipts. HMRC's current estimate is £200m: however, HMRC hope to refine this using information obtained during the consultation process. HMRC will also seek to obtain information to prepare an assessment of the wider economic benefits that the exemption will facilitate. These details are also set out in chapter 10.

NAT 58/11

2.4 Zero-rating

2.4.1 Catering

A company made voluntary disclosures (*Fleming* claims going back to 1973) reclaiming VAT on what they argued were cold takeaway food sales. There were three appellants listed, but they were in effect the same company which had changed its name twice over the years. HMRC accepted some of the claims following the Court of Appeal's 2006 decision in *Compass Contract Services UK Ltd*, but other points were disputed before the Tribunal.

The Tribunal considered the possible relevance of the ECJ decision in *Manfred Bog* (Case C-497/09). It appears that both parties accepted that the decision does not undermine the validity of the UK law, because it was about a different principle of German law. The chairman confirmed that he agreed with that – a supply of food could be goods rather than services, but nevertheless could be "in the course of catering" and validly excluded from zero-rating under UK law. The UK law does not exclude "catering" (i.e. a service) from zero-rating – it excludes "food supplied in the course of catering" (i.e. goods, but related to catering). The chairman concluded:

"*...a supply in the course of catering is not a supply of catering and goods may be supplied in the course of catering. "In the course of catering" is a UK law concept, it was not considered in Bog, and in investigating its meaning we are (largely) limited to UK cases.*"

The Tribunal considered a number of UK precedents on the meaning of "catering" and "in the course of catering", and concluded that the following factors were relevant but should be considered in relation to each other rather than as a checklist:

- whether the food was supplied in connection with an occasion or other event and whether the supplier knew this;
- whether the food was made to order or merely prepared in anticipation of demand;
- whether the customer could suggest a menu;
- the degree of preparation which remained to be carried out by the customer before the food could be eaten;
- whether the food was well-presented and in a form where a person would ordinarily put in on the table with no further steps being taken;
- whether crockery and cutlery were provided along with the food itself or were available as an optional extra;
- whether and how and at what time the food was delivered by the supplier;
- whether a waiting service was provided by the supplier at the place of consumption;
- whether the food was a complete meal.

Applying these principles to the facts of the case, the Tribunal examined the supplies made by the company. These included supplies to people running stands at events and exhibitions (such as the Farnborough Air Show); a food delivery service to people's offices or homes; and supplies of picnic platters to the public at the Harrogate Flower Show. The Tribunal listed a number of indications one way and the other on each type of supply, but in each case concluded that the food was supplied in the course of catering.

The third example was the most similar to the *Safeway Stores* case in which "party platters" sold by a supermarket were held not to be in the course of catering. The Tribunal distinguished the circumstances as follows:

"*Our answer to that is that we have to take all factors into account and the facts of the two cases are not the same. In particular, in this case an entire ready-to-eat meal was provided with cutlery. All the flower show attendee had to do was collect their picnic tray, walk (within the confines of the flower show premises) to one of the picnic spots, sit down, and tuck in. The hostess in Safeway would have had to do rather more: collection (it was presumed) would be by car and the food would need to be laid out on a table, and some of the trays needed extra work. She may have provided her guests with plates, napkins or even cutlery. She may have provided her guests with other food. It was presumed Safeway would not have known the nature of the event for which the food was ordered: here*

the provision of the food was inextricably linked with the flower show. In summary, the facts although superficially similar were very different on close inspection."

The appeal therefore failed on all counts.

First Tier Tribunal (TC01189): *Value Catering and others*

2.4.2 Article

In an article in *Taxation*, Neil Warren examines recent case law on food and catering, including *Deliverance Ltd v Revenue and Customs Commissioners* (Upper Tribunal); TC00733: *Raza Rastegar trading as Mo's Restaurant*; and *Finanzamt Burgdorf v Manfred Bog* (CJEU Case C-497/09). HMRC have recently announced that they will focus on the restaurant trade for tax compliance visits, and a "disclosure opportunity" (i.e. promise of reduced penalties for those who come forward voluntarily) may be announced in this area.

Taxation 30 June 2011

2.4.3 Children's clothing

HMRC have issued a new version of Notice 714 *Zero-rating Young Children's Clothing and Footwear*. The introduction states that HMRC have made the following clarifications:

- The scope of the term "fur skin" – see paragraph 3.1;
- the eligibility of fur-lined headgear for zero rating – see paragraph 3.1;
- the fact that collars and cuffs can be zero rated – see paragraph 4.5;
- the VAT position on items of clothing for children's organisations – see paragraph 6.1.

Notice 714

2.4.4 Protective equipment

HMRC have issued a new version of Notice 701/23 *Protective Equipment*. It explains when protective boots and helmets for industrial use, motorcycle helmets and pedal cycle helmets are zero-rated; and when children's car seats and travel systems are reduced-rated at 5%. It has been updated to reflect changes in standard requirements, and developments in children's car seats and "lie-flat" travel systems.

Notice 701/23

2.5 Lower rate

Nothing to report.

2.6 Computational matters

2.6.1 Bespoke retail schemes

HMRC have issued a new version of Notice 727/2 *Bespoke Retail Schemes*, replacing the March 2006 version. The introduction states that HMRC have made the following amendments:

- *reflect the amended turnover limit for use of the published retail schemes*
- *include a suggested model framework for a bespoke retail scheme agreement*
- *withdraw the requirement for bespoke retail scheme agreements to include annual reviews*
- *introduce the option of signing up to a scheme gradually when we can't reach full agreement initially and*
- *explain the circumstances in which we may permit estimation of Daily Gross Takings (DGT) adjustments.*

Notice 727/2

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

2.8.1 Lease and leaseback

A college (QMC) entered into a lease and leaseback arrangement with a financial institution (LPIC) under which the institution would benefit from capital allowances on the cost of equipment fitted in the college's buildings. Because these were fixtures, it was necessary for the institution to have an interest in the land in order to claim the allowances. Accordingly, the following arrangements were put in place:

- QMC leased the site to LPIC for an immediate payment of some £735,000 (the cost of the equipment already on site) and an annual rental of £10,000, and opted that lease;
- the same day, LPIC granted a sublease back to QMC for an annual rental and a variable amount of rent which would depend on the value of equipment fitted to the buildings, also opted;
- the same day, the two parties entered into an agreement for QMC to supply equipment to LPIC – this would be incorporated in the building and would therefore be part of the asset leased back to QMC.

HMRC ruled that the whole of the consideration payable by QMC under the sublease was standard rated. QMC argued that some of it should be zero - rated under either Group 12 or Group 15 of Sch.8, as the college was a charity which carried out medical research and some (about 24%) of the equipment appeared to fall within the relevant categories.

The judge noted that the Principal Directive art.135(2)(c) excludes from exemption "the letting of permanently installed plant and machinery" where it would otherwise fall within art.135(1)(l) "the leasing or letting of immoveable property". These words are not reproduced in the UK legislation.

However, he was persuaded by HMRC's arguments that:

- the supply by LPIC to QMC was a single supply, which it would be artificial to divide;
- its essence was a supply of the use of the machinery, rather than a supply of the land;
- the machinery did not wholly fall within any of the headings of Sch.8;
- this was not a case similar to that in *Talacre Beach Station Caravans*, in which the UK law provided for a restriction on a zero-rated supply by apportionment – the normal treatment of something that did not quite fall within a zero-rating relief should apply, which is that it should be wholly standard rated.

If the supply did involve a supply of land, it would be standard rated because of the option to tax. However, it appeared that the land was incidental to the overall supply of machinery. In broad economic terms, the essential supply was one of financing, but it was also not possible to exempt it under that heading – it had been arranged as a leasing contract, and the VAT consequences followed from that.

First Tier Tribunal (TC01094): *Queen Mary, University of London*

2.8.2 Airport parking

Many years ago there was a standard plan for providers of airport parking: part of the fee was allocated to zero-rated transport in the bus to and from the car park. This was made ineffective by VATA 1994 Sch.8 Group 8 Note 4A(b) which provides that such transport cannot be a separate zero-rated supply.

Two companies accounted for tax on all income from parking from 1995 to 2006. They then submitted repayment claims, contending that the previous plan was effective, and that the change to the UK law was invalid under EC law because it breached the principle of fiscal neutrality.

The First Tier Tribunal rejected the companies' arguments. It held that the principles in *Card Protection Plan* meant that the companies were to be treated as making single supplies of parking facilities; the supplies of transport were incidental to those standard rated supplies.

The First Tier Tribunal specifically declined to follow the 1984 decision in *Courtlands Car Services Ltd* (1,778), on the grounds that that decision was inconsistent with the subsequent ECJ decision in *CPP*. The Tribunal also commented that "*the notion of saying that unfair competition is*

discernable between airport park-and-ride treatment, and the slightly far-fetched notion of a car driver parking in Reigate or Redhill and taking the local train, or the public bus, to Gatwick is far-fetched". There was no realistic possibility of distortion of competition between the services offered by the companies and alternative ways of achieving the same result.

The Upper Tribunal has now decided to refer questions in this case to the CJEU.

Upper Tribunal: *Airparks Services Ltd v HMRC*

2.8.3 Supply splitting

HMRC have published their response letter to comments received on the draft legislation on the zero rating relating to the splitting of supplies. This has now been incorporated into Clause 74 of the Finance Bill 2011.

The main concern expressed by respondents was that the draft legislation would have a far wider effect than intended. The response letter seeks to allay these fears by explaining HMRC's intended approach to applying the new rules: "connected with" is given a specific meaning which is well understood from VAT case law, in that the supplies would be treated as a single supply if they were made by the same person. The law will also only apply if the supply of printed matter is connected to a supply of services; it will not apply if it is connected with a supply of goods. This means that a supply which would, on a compound basis, be treated as goods (because the printed matter is the predominant element) will not be caught by the new rules.

A number of examples are given.

1. A company arranges exhibitions; it charges a fee for entry and offers a printed guide to the event for which separate charge is made. The customer can decline to purchase the guide and still be admitted to the event at the normal price. In the light of the principles described above there are two separate supplies, with the entry taxable at the standard rate and the guide at the zero rate.

The new measure would not apply here as the two supplies are not made by different suppliers.

2. The company provides exhibition services and guidebooks under the same arrangements as in Example 1. The guidebooks are also available from retailers local to the exhibition venue. Customers have the freedom to decide whether or not to purchase a guide and, if they choose to do so, can purchase one from either the company or an independent retailer.

In this case the legislation will not affect the zero rating of the guide by the independent retailers because the supply of the right of entry and the supply of the guide would not treated as a single supply if made by a single supplier (as the position would be equivalent to the situation in Example 1).

3. The company in Example 1 changes its arrangements and charges a single fee to cover the cost of entry and the guidebook. The customer does not have the option to decline the guidebook in return for a lower fee. As the principal aim of the customer is to attend the exhibition, and the guidebook is ancillary to that, this is a single supply of admission taxed at

the standard rate. The single fee that is charged is a relevant factor in pointing to a single supply, but it is not decisive (see Card Protection Plan, Case C- 349/96). Similarly, the fact that separate prices are stipulated for various elements is not decisive where the two elements have an objective close link such that they form part of a single economic transaction (Levob).

The new measure would not apply here as the two supplies are not made by different suppliers.

4. The company in Example 3 sets up a subsidiary to supply the guidebooks. The two supplies were previously treated as a single supply of admission when made by the same person, but the supply of the guidebook would now be zero rated under current law (subject to any challenge on abuse) following the decision in the Telewest case (CA [2005] STC 481).

These arrangements would be caught by the new legislation and zero rating would no longer apply to the supply of the guidebook.

5. The company in Example 3 changes its arrangements again and charges a fee for entry to the exhibition and the subsidiary again supplies the guidebook. In this instance the cover price of the guide is discounted against the price of the exhibition. However, customers who choose not to take a guide are still charged full price for entry.

The legislation would remove the zero rate from the guide in this instance because if supplied by a single supplier the two elements would be seen as a single supply of admission (see in particular the Levob principle quoted above).

Application of HMRC Analysis to the examples given in response to consultation

Many of the examples given were along similar lines so not all will be dealt with specifically below.

A) A person buys a television set from a technology store and they then go to a retailer and buy a subscription to a weekly television journal.

Both the supply of the television set and of the subscription to the journal are supplies of goods so the measure will not apply.

B) A person hires an electrical item from one supplier and decides to purchase a book on how to use it from an independent retailer.

From the customer's point of view, the supply of the electrical item on hire is connected with the supply of the book as he wouldn't need the book if he was not hiring the equipment.

But the two supplies are not 'connected' as defined in the legislation as they would not have been treated as a single supply if made by a single supplier. In particular it could not be said that the two supplies 'are so closely linked that they form objectively, from an economic pointy of view, a whole transaction, which it would be artificial to split'.

If the hirer of the item had a range of books for sale on the premises and customers could choose to purchase an instruction manual in addition to hiring the equipment that would not in itself be enough to create a single supply.

C) A tutor gives a reading list to a group of fee-paying students, who then buy the books from various independent booksellers. The booksellers would not necessarily know that the purchase was linked to an exempt supply of education.

The supply of books and the supply of education services are not 'connected' as defined in the legislation. As in example B the two supplies are not so closely linked that, from an economic point of view, they form a single transaction which it would be artificial to split.

More generally the legislation will not apply if the supplier of the printed matter is an unconnected third party who is unaware of the supply of the potentially related service.

D) A newspaper contains a promotional coupon offering a 10 per cent reduction on a restaurant meal.

This appears to be predicated on the assumption that the newsagent selling the newspaper is in a position to supply the promotional offer. We do not see how this can be the case. The newsagent can only sell the newspaper, a single supply of goods. The arrangement relating to the promotion is between the newspaper publisher, the restaurant and the purchaser of the newspaper. The newsagent is not involved either as supplier or recipient of the promotional offer.

E) We are unclear how note 1(b) interacts with the new note (2). Note 1(b) seems to say that if, say, the purchaser of printed music receives under his purchase a right granted by a subsidiary of the publisher to reproduce the music, that right is also zero-rated. However if the right to reproduce the music were purchased separately it would seem to be a taxable supply. Looking at the two supplies together, the predominant supply is undoubtedly the licence, yet the clear intention of note 1(b) is to regard the predominant supply as the purchase of the sheet music.

Note 1(b) of Group 3 of Schedule 8 to the VAT Act provides that transfers of any undivided share in property in goods covered by Group 3, and transfers of the possession of goods covered by Group 3 are included in the Items in Group 3. HMRC's view is that paragraph 1(1) only applies to transfers of tangible moveable property and that it cannot apply to the grant of a right to reproduce the music. It follows that Note 1(b) of Group 3 is not engaged and there is therefore no interaction between it and Note 2.

F) The publisher of a slimming book includes in it a number of vouchers to enable a purchaser to acquire vitamin supplements from a subsidiary company, but those supplements are also available, albeit normally at a higher price, from health food stores.

It is difficult to see how the person selling the book could ever be supplying the vitamins. The purchaser of the book is able to use the vouchers to purchase vitamins from someone else, presumably at a discounted price. On the assumption that the vouchers are not sold to the purchaser of the book, it is difficult to see how there can be a supply of them. Consequently in the abstract, it is unclear how the provision contained in the draft clause would apply in this circumstance.

HMRC Release 6 May 2011

2.9 Agency

2.9.1 Temp workers and unjust enrichment

Reed Employment Ltd won a dispute with Customs in 1997 which established that it should only have accounted for VAT on the commissions it received from clients, not on the whole of the consideration. It submitted a claim which went back to 1991, originally capped but paid by HMRC in 2003 following the first *Marks & Spencer* ruling in the ECJ.

The company then made a further claim, going back to 1973, in relation to customers who were wholly or partly exempt and who would therefore not have been able to recover the VAT that had been charged to them. As this was a new claim, HMRC refused it, and the company appealed.

In March 2009, the company made further claims going back to 1973 in respect of supplies to clients who were taxable. HMRC argued that these repayments would unjustly enrich the company. The rules on unjust enrichment were found to be faulty by earlier court decisions and were rectified in 2005.

The Tribunal examined the contracts and the history of the dispute, and concluded that the 2003 claim had to succeed. It was based on the same arguments as the 1997 claim and was made before the unjust enrichment rule was rectified. However, the 2009 claims were new claims, not amendments of the 2003 claims, and they failed to satisfy the new unjust enrichment rule. HMRC were able to refuse them.

Following the 1997 case, HMRC introduced the staff hire concession as a temporary measure to reduce the possibility of distortion of competition between different employment businesses which structured their contracts in different ways; the ESC was withdrawn in 2009 because HMRC believed it was no longer needed: changes in the law affecting temporary workers eliminated the possibility of distortion.

The Tribunal also considered the fundamental question of whether Reed was supplying the services of its workers as principal, or rather supplying an introductory service. If it was supplying introduction only, its taxable income would only include its commission, rather than the whole amount paid by the client. The concession allowed an employment business to account for output tax only on the commission, as long as certain conditions were met.

The Tribunal decided that the proper construction of the various contracts meant that Reed was supplying agency services as a matter of law, not as a concession. The workers supplied no services to Reed; the payment of their wages did not constitute a cost component of Reed's supply. Even if Reed invoiced the client for a single composite amount, nevertheless the worker made the supply of services direct to the client in return for the payment of their wages.

This appears to undermine the basis on which HMRC withdrew the staff hire concession, and further cases may follow to challenge the official view that the consideration paid by clients of employment businesses is taxable in full.

First Tier Tribunal (TC1069): *Reed Employment Ltd*

Graham Elliott, writing in *Accountancy* in July, says that HMRC have indicated that they will not appeal this decision. He says "this can only mean that HMRC do not see the decision as a threat to current policy". It could also mean that they do see it as such a threat, and would rather claim that it was decided on its own peculiar facts rather than having the principles confirmed by the Upper Tribunal or higher courts.

2.9.2 Temporary dental staff

A dental nurse established an agency in 1976. It made two types of supply: first, of temporary dental staff to dentists, which was the disputed supply, and secondly, of private permanent staff to dentists for an introduction fee. VAT was accounted for on fees for both types of supply.

In 2001, after the business had been transferred as a TOGC to a company, the proprietors discovered that a competitor was not charging VAT on similar supplies, and asked for a ruling from Customs on its own liability. The ruling was that supplies of dental staff would be exempt if made as principal. It was agreed that the temp staff were supplied as principal, and adjustments were made to current returns on the basis that the business was partially exempt.

Following a claim in 2005, the company reclaimed over £300,000 of output tax it had paid in relation to periods from 08/99 to 09/01. In March 2009 the previous owners of the unincorporated business (who still owned the company after the 1999 incorporation) made a *Fleming* claim for another £600,000 plus interest which was claimed to have been overpaid between January 1985 and December 1996. HMRC refused this claim, and the decision was upheld on review.

HMRC accepted that their interpretation of the law throughout the period under dispute was that the supply of dentists and dentist auxiliaries by a registered nursing agency constituted an exempt supply of dental care or dental services. However, they now argued that the law, properly construed, did not provide such an exemption: that should be applied only to supplies to patients, not supplies of staff. They changed their view of the law in 2007, but allowed the old basis to continue for businesses which had followed it before and continued to meet the same criteria. That was a concession, and a *Fleming* claim could not succeed on the basis of a concession.

HMRC also raised the issue of unjust enrichment, but the Tribunal considered that it would only be necessary to examine that issue if the appellant was successful on the first issue of the correct liability of the supply.

The appellant's case was based on HMRC's view of the law as set out in Notice 710/2/83, which describes the liability of supplies of nursing staff as agent and as principal. This was the policy throughout the period of claim. It was also clearly the policy which had led to the repayment of output tax to the company in respect of the supplies between 1999 and 2001.

The appellant also argued that the exemption applied to supplies of medical care by certain persons and should be neutral as regards the legal personality through which those supplies were made. The relationship between the appellant and the nurses was tantamount to employment; the

nurses could not make supplies for VAT purposes because of their status, so the supply of dental care that they were involved in was made only by the appellant as the quasi-employer.

The Tribunal examined the way in which the nurses operated. It was accepted by the appellant that they were entirely under the control and supervision of the dentist while they were working in the surgery; the appellant had no direct involvement in the work they did. The Tribunal considered that the supply was in reality a supply of staff made as agent, not a supply of services made as principal. The fact that HMRC had made a substantial repayment on the basis that the exemption applied, and had then accepted that it applied for a considerable further period, was not determinative of the current appeal.

The appellant did not raise the question of legitimate expectation. The Tribunal commented that this was not a case in which the jurisdiction of the Tribunal was in question, as it would have been if the appeal had been based on a concession; both parties agreed that the appeal should be determined on the basis of the law.

The Tribunal considered a number of precedent cases and decided that the case law did not give a clear and settled answer. However, it was clear enough to conclude that a supply of staff should be distinguished from a supply of services, and a supply of staff did not enjoy the exemption. It was not conclusive that the supply was made as principal or as agent: it was the nature of the supply itself that would determine the issue. On the evidence, the appellant was providing staff, and HMRC were therefore correct to refuse the claim.

First Tier Tribunal (TC1148): *Sally Moher t/a Premier Dental Agency*

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Private use of cars in the motor trade

HMRC have published an updated Information Sheet setting out the basis on which businesses in the motor trade should work out the private use charge in respect of vehicles on which input tax is deductible in spite of their availability for private use (e.g. demonstrators, cars held for daily rental).

For example, motor manufacturers are required to operate the following procedure for stock-in-trade cars which are made available to directors and employees:

Step 1	Identify those persons who use a company car for private journeys in the period.
Step 2	For each person: identify the list price of the car that they have typically used in the period.
Step 3	For each person: identify the appropriate price band in the relevant table to determine the VAT payable for private use.

The charge is then based on the list price of the vehicle. At the 20% rate, the following table gives the annual, quarterly and monthly amounts:

Price band No.	List price inc VAT band range	Average price including VAT	VAT due annual return	VAT due quarterly return	VAT due monthly return
1	0.00 – 8,999.99	7,470.00	70.86	17.71	5.90
2	9,000.00 – 11,999.99	10,320.00	93.12	23.28	7.76
3	12,000.00 – 16,999.99	14,620.00	126.72	31.68	10.56
4	17,000.00 – 22,999.99	20,470.00	172.42	43.11	14.37
5	23,000.00 – 30,999.99	27,590.00	228.05	57.01	19.00
6	31,000.00 – 39,999.99	35,600.00	290.62	72.66	24.22
7	40,000.00 – 49,999.99	44,500.00	360.16	90.04	30.01
8	50,000.00 – 64,999.99	58,500.00	469.53	117.38	39.13
9	65,000.00 – 79,999.99	72,000.00	575.00	143.75	47.92
10	80,000.00 upwards	Individual calculation based on actual cost prices.			

There are different tables for dealer demonstrators and daily rental cars.

Information Sheet 08/2011

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Storage facilities or just land?

A trader owned land on which standard containers were situated. Self-storage facilities were supplied to customers who could rent a container. They could have vehicular access to it during working hours, or by arrangement outside working hours.

HMRC took the view that this could not constitute a "letting of immoveable property", because the containers were moveable (albeit only with the appropriate lifting gear). The Tribunal considered that the questions were rather whether the supply could constitute a licence to occupy land, being the land on which the container sat, and whether there were separate supplies for VAT purposes of the land and the container.

The Tribunal agreed with the appellant's counsel that there was a single supply. The chairman went on to agree that the supply constituted a licence to occupy, taking some support from the fact that Parliament had thought it necessary to exclude similar types of supply in items 1(e), (f), (g), (h) and (k) of Group 1 Sch.9 VATA 1994 – these were supplies which Parliament had considered were possibly within the general exemption of "licence to occupy", and which therefore had to be explicitly excluded.

As a matter of contract law, there was no doubt that the agreement between the parties was for a supply of land. Although a separate (lower) charge was made for the hire of the container, it was incidental to the supply of land – a container with nowhere to put it would be useless (although there were a few customers who rented containers and kept them on their own land). The chairman said that "at first blush" it might appear that storage facilities were being provided, but a more detailed consideration showed that the predominant supply was a licence to occupy. The appeal was allowed.

First Tier Tribunal (TC01081): *David Finnamore t/a Hanbridge Storage Services*

3.2 Option to tax

3.2.1 Reader's Query

Taxation magazine features a Reader's Query about a landlord who opted to tax a property and charged VAT to a registered business tenant. The property has subsequently been let to a charity which is claiming that VAT should not be charged. The answers consider the circumstances in which the option would be disapplied on a letting to a charity.

Taxation 7 April 2011

3.3 Developers and builders

3.3.1 Not a building

A charity arranged for the construction of a skate park. HMRC ruled that the construction work should be standard rated. On appeal, the Tribunal agreed with HMRC that the conditions for zero-rating were not met, because the park did not involve the construction of a "building".

The appellant argued that the effect of standard rating his structure would be discriminatory and arbitrary, when it appeared that the one thing lacking for HMRC to allow zero-rating was a roof. However, the Tribunal considered the dictionary definitions of a building:

8. The word "building" is not defined in the statute and various tribunals have taken different approaches, but certain common threads can be drawn. The New Oxford Dictionary definition of a building contains the word "a structure with a roof and walls…". The Shorter Oxford Dictionary includes "a permanent fixed thing built for occupation". Tribunals have highlighted the sense of enclosure which would come with a building. Again, merely because a structure is built, it does not mean that the result is a building – for example a wall or a ship.

9. The skate park has clearly been built and is clearly a permanent structure. It is capable of being occupied in the sense of being used but beyond this in no sense can it be viewed as a building. There is no sense of enclosure, having neither walls nor roof. Further, although not in any way definitively, it is not a structure which anyone looking at it and attempting to describe it would term a building.

On this basis, the appeal could not succeed.

First Tier Tribunal (TC1069): *Wheeled Sports 4 Hereford Ltd*

3.3.2 Article

In an article in *Taxation* magazine, Mike Thexton examines a complex project for development of a taxpayer's main residence. The issues include trading and main residence exemption for direct taxes, but the VAT implications are also considered, including the possible need to register.

Taxation 14 April 2011

3.4 Input tax claims on land

3.4.1 Invoices disputed

The individual who established in TC00362 that a DIY claim could be made even though planning permission determined that the property was "holiday accommodation", not to be occupied throughout the year, returned to the Tribunal to dispute the quantum of her claim. HMRC refused to pay part of the claim because the document she produced from her supplier did not meet all the conditions of reg.14 SI 1995/2518. The Tribunal chairman concluded that the document contained enough

information to satisfy the evidential requirement of reg.201(b)(ii) (which does not specify that a DIY claimant should hold a VAT invoice) and allowed her appeal.

The chairman noted that the appellants had spent some time relying on the misconceived argument that they could benefit from SP 01/07, which deals with claims for input tax where a valid VAT invoice is not held, and describes the circumstances in which HMRC will exercise their discretion to accept alternative evidence under reg.29 SI 1995/2518. This SP was not relevant because a s.35 claim is not for "input tax", and HMRC did not propose to extend it to cover the analogous circumstance of a s.35 claim.

The chairman concluded that they did not have to, because the DIY regulations did not have the same starting requirement for a VAT invoice to be held.

First Tier Tribunal (TC01160): *IS Jennings (no.2)*

3.4.2 Not a dwelling

A married couple arranged for the construction of a farmhouse adjacent to some farm buildings. The planning permission contained the restriction "*The proposed development shall always remain ancillary to the existing agricultural use of the site and shall not be sold, leased nor otherwise disposed of separately from, the remainder of the premises*". HMRC accordingly refused their DIY refund claim on the basis that the separate disposal of the property was prohibited so it did not qualify as a dwelling.

The appellants argued that the property was not connected to an existing dwelling or building, but only to the agricultural use of the site. The chairman did not accept that this was the statutory requirement of s.35: because there was a restriction which prohibited disposal separate from "something else", the claim failed.

It is interesting that the chairman's conclusion was expressed with the words "*As a result section 35 of the Act does not apply and the supplies are to be standard rated*." Fairly obviously the supplies were standard rated; the question was whether a refund claim was possible. It is not clear whether this could constitute grounds for an appeal.

First Tier Tribunal (TC01179): *D & E Sherratt*

3.5 Other land problems

3.5.1 Article

In an article in *Tax Adviser* magazine, Neil Warren discusses issues for pub chains selling pubs to tenants or developers for conversion – including SDLT, and also the conditions for the transaction to be a TOGC.

Tax Adviser June 2011

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Exchange rates

HMRC have issued the usual Information Sheet setting out exchange rates to be used by traders registered under the special scheme for electronic services for the quarter to March 2011.

Information Sheet 07/2011

4.2 Where is a supply of services?

4.2.1 Reader's Query

Taxation magazine features a Reader's Query about a Swedish architect who has charged Swedish VAT (at 25%) to private customers in Surrey. The answers comment that this is probably not correct: under the place of supply rules both before and after 1 January 2010, the place of supply should have been the UK, the architect should have registered here, and the lower rate of UK VAT should have applied. It is less clear how the clients can now enforce that.

Taxation 18 May 2011

4.2.2 Guidance

HMRC have made changes to four of their online manuals (Place of Supply – Services; Place of Supply – Goods; Time of Supply; Single Market) to reflect changes in the VAT treatment of natural gas, electricity, heat and cooling.

www.hmrc.gov.uk/manuals/vatpossmanual/vatposs13050.htm;
www.hmrc.gov.uk/manuals/vatposgmanual/VATPOSG4140.htm;
www.hmrc.gov.uk/manuals/vattosmanual/vattos2325.htm;
www.hmrc.gov.uk/manuals/vatsmanual/vatsm4210.htm

Another manual has been updated to give guidance on the treatment of supplies of admission to events which are made to relevant business customers.

www.hmrc.gov.uk/manuals/vatpossmanual/vatposs08250.htm

4.3 International supplies of goods

4.3.1 Acquisitions: fallback rules

HMRC have issued a Brief to comment on the CJEU decisions in *X* (C-536/08) and *Facet BV* (C-539/08). These confirmed that the use of a VAT registration number to exempt an intra-community despatch rendered the user liable to account for acquisition tax in the country which issued the VRN, even if the goods went somewhere else. This is sometimes referred to as the "fallback" rule.

HMRC confirm that use of a UK VRN will trigger a liability to UK acquisition tax, but this can be adjusted if the trader can show that the VAT was correctly accounted for in the country in which the goods arrived. If the VAT is payable in the UK because there is no evidence that the acquisition tax has been accounted for elsewhere, it is not deductible in the UK because the conditions for deduction are not met – the goods are not used for taxable supplies in the UK, and the absence of evidence means that it cannot be established that they are used for supplies elsewhere which would be taxable if made in the UK.

The Brief comments that the decisions do not affect the triangulation simplification procedure. However, they do change a policy operated by HMRC since 1997 (BB 12/97) on yachts, where a UK trader could account for UK acquisition tax – and recover it – even if the yacht never came to the UK. From 1 June 2011, acquisition tax on a yacht that does not arrive in the UK will no longer be recoverable as input tax. Traders who have already entered into contracts on the basis of BB 12/97 will be allowed to rely on the previous practice even if delivery takes place after 1 June, but they will have to hold evidence of the contract and when it was entered into.

R&C Brief 20/2011

4.3.2 Travelling salesman

A UK-registered clothing retailer made sales of goods while at exhibitions in Germany. He accounted for UK VAT, but then reclaimed it, arguing that the supplies should have been zero-rated in the UK. The Tribunal dismissed his appeal, holding that he made a deemed supply of goods when he travelled with stock from the UK. As he was not registered in Germany, that deemed supply was standard rated. He should have accounted for output tax on the cost at the time of travel, rather than on the sales price at the time of sale. The Tribunal left the parties to negotiate how much could be repaid on this basis (as it had only been raised late in the argument, and no submissions were made to the Tribunal on the matter).

Presumably he is also potentially in some trouble with the German authorities.

First Tier Tribunal (TC01173): *M Cudworth (t/a Cudworth of Norton)*

4.3.3 Inward processing

A company imported goods under Inward Processing Relief (IPR), under which import duty and VAT are suspended subject to conditions. The goods were processed and re-exported, but bills of discharge vouching re-export of the goods were not submitted within the time limits applicable. HMRC raised an assessment for duty and VAT because the conditions were breached.

The company appealed, arguing that it could benefit from provisions in EU legislation allowing remission of the duty otherwise due where there has either been no 'obvious negligence' on the part of the importer, or where the latter has found itself in a 'special situation'. It also argued that it was not the person liable for the duty under art.204(3) of the Customs Code.

The company had received a warning in relation to an earlier failure to submit bills of discharge on time. The disputed consignment had already been questioned by HMRC on the expiry of the normal 6 month IPR period, and the company had applied for and been granted a 12 month extension. It failed to meet the extended deadline, and also failed to inform HMRC that this would happen. When HMRC raised the matter again, the company supplied documentation to show that the goods had finally been exported within 30 days of the extended deadline, but HMRC refused to cancel the demand.

The Tribunal decided that the company had been 'obviously negligent', because it had been warned after earlier failures and had not taken due care. However, the appeal was allowed on the grounds that the transport agent had entered the goods into the IPR scheme without the company's knowledge, and had been recorded on the customs entry as both the declarant and the paying agent. The company itself was therefore not the person liable for the customs debt.

First Tier Tribunal (TC01169): *Bradgate Containers Ltd*

4.3.4 Consultation

As announced in the Budget, HMRC are consulting about measures to be introduced in 2013 to prevent vehicles entering the UK for permanent use on the roads without suffering an appropriate VAT charge. The idea is that they will have to be notified to HMRC before being registered with DVLA; the consultation concerns the implementation of a new online system which will be used for this reporting.

http://www.hmrc.gov.uk/consultations; http://nds.coi.gov.uk/content/detail.aspx?NewsAreaId=2&ReleaseID=419757&SubjectId=2

4.3.5 Article

In *Taxation*, 6 April 2011, Neil Warren considers the VAT measures in the Budget, including the reduction in low value consignment relief.

Taxation 6 April 2011

4.3.6 End of freedom

HMRC have publicised the expiry of the following Free Zone designation orders on 10 August 2011:

- Southampton
- Prestwick
- Sheerness
- Liverpool

Traders must be ready to assign goods in these zones to another customs procedure, or else to pay the suspended duty and VAT when the status of the zone expires.

JCCC CIP(11)49

4.3.7 Guidance

HMRC have issued a new version of Notice 143 "A guide for international post users". It includes information about Low Value Consignment Relief, where the £18 threshold is due to fall to £15 with effect from 1 November 2011.

Notice 143

There is also a new April 2011 version of the Intrastat Notice 60. It has been restructured to improve readability and changed in relation to amended EU Regulations, Nature of Transaction Code 17, codes for reporting goods delivered to offshore installations, industrial plant classification simplification, and newspapers and periodicals.

Notice 60

HMRC have also issued an updated version of their information pack *Guide to Importing & Exporting – Breaking down the Barriers* (April 2011, Version 30). The introduction describes it as follows:

This information pack has been created as a basic guide to anyone wishing to import or export goods. It acts as a guide to help anyone get started on importing and / or exporting, and also provides a better understanding of the procedures involved in these activities.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageImport_ShowContent&propertyType=document&resetCT=true&id=HMCE_PROD_008051

There is also a new May 2011 version of *Sailing your pleasurecraft to and from the United Kingdom.* It has been rewritten and restructured to improve readability and includes changes following the introduction of the UK Border Agency.

Notice 8

4.3.8 FAQs

HMRC have published Frequently Asked Questions about imports and exports, covering the following issues:

- How do I obtain copies of Customs forms?
- Where can I see the book that contains all the code numbers and duty rates?
- How do I obtain a duty rate?
- How do I obtain a commodity code for my goods?
- I am importing a car from the EU, will I have to pay duty and VAT?
- What documents do I require to declare my goods to customs?
- I have been charged VAT and duty for goods bought over the internet, why is this?
- What do I do if I think I have been overcharged Customs Duty on my parcels/goods?
- What is the 'through-put period' for Inward Processing Relief?
- Do I have to account for any Import Duty or VAT if I import a product from outside the EU for repair or modification and re export it?
- If I send goods to a non-EU country for repair and return, and they are under guarantee do I have to pay duty and VAT?
- I am changing my place of residence from outside the EU to the UK, will I be entitled to relief of duty and VAT?
- I have rejected the goods that I imported from outside the EU as they are faulty, can I claim repayment of duty?
- I wish to import an aircraft from outside EU do I need to pay duty?
- What is CIF and why does it apply to me?
- How do I calculate the value of my goods at import?
- Do I have to declare cash amounts that I bring into the UK?
- I wish to reimport goods that I previously exported from the EU, will I be required to pay import charges?

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageImport_FAQs&propertyType=document&columns=1&id=HMCE_PROD_008654

HMRC have also published Frequently Asked Questions about importation of low value goods, dealing with the £18 postal packet limit and the correct customs procedures for entry.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageImport_FAQs&propertyType=document&columns=1&id=HMCE_PROD1_031239

4.4 European rules

4.4.1 Another type of fraud

The Commission has been made aware that traders in some member states are being offered "valid VAT numbers" for payment. The offer comes on what appears to be an official EU document.

The Commission points out that only tax administrations in individual member states can issue VAT numbers, and there is not normally a charge for doing this.

4.4.2 Horses

The Commission has obtained judgments against Germany and Austria for applying a reduced rate of VAT to supplies of horses, in particular race horses (which are not used for agricultural production and are therefore nothing to do with food, especially not intended to become food). Following the decision in *Commission v Netherlands* (Case C-41/09), this seemed inevitable, but the two other countries continued to argue the case.

CJEU (Case C-441/09): *Commission v Germany*; (Case C-453/09): *Commission v Austria*

The Commission is now taking Ireland to the CJEU over the application of a lower (4.8%) rate to certain supplies of greyhounds and horses "not intended for the preparation of foodstuffs".

CJEU (Application) (Case C-108/11): *Commission v Ireland*

4.4.3 Cost sharing

The Commission has formally requested Germany to amend its rules in relation to the cost sharing exemption for groups of non-taxable persons (which the UK has never implemented at all – see 2.3.10). German law restricts the availability of this exemption to services in the medical and healthcare sector; the Commission does not believe that the Directive permits such a restriction on the scope of the exemption. If a satisfactory response is not received within two months, infringement proceedings will follow.

Press Release IP/11/428

4.4.4 Public sector and public interest exemptions

The Commission has published a study on the VAT exemptions which apply to the public sector and to activities which are carried out in the public interest (VAT Directive art.132) in EU member states. The study compares the exemptions with those which apply for VAT/GST in key OECD countries outside the EU.

The report suggests a number of possible options for the future to remove the distortion between the public and private sectors:

- Full taxation of public bodies (possibly limited to services where a charge is currently made);
- A refund system for public bodies (as currently applies in the UK under s.33 VATA 1994 and in certain other Member States);

- Public bodies being treated as taxable persons as a rule, with certain exemptions;
- Public bodies being treated as taxable persons as a rule, with certain exemptions and an option to tax for exempt taxable persons.

http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat_public_sector.pdf

4.4.5 Human rights

A company director was questioned about possible involvement in a carousel fraud in August and September 1995. He was indicted in March 2000 and convicted in September 2002. He appealed against conviction, but in April 2005 his appeal was dismissed and his two-year sentence was extended to three years. On release after two and a half years, he applied to the European Court of Human Rights for a ruling that the length of the proceedings against him breached art.6(1) of the Convention.

The court agreed that nearly 10 years was too long, but he was only awarded token damages of €8,000.

ECHR (Case 33951/05): *Meidl v Austria*

4.4.6 Reduced rate in France

The Commission has taken infringement proceedings against France for its application of a super-reduced rate of 2.1% to the first performances of concerts in establishments where refreshments may be obtained during the performance. Before 1 January 2007, the rate was 5.5%. This was permitted under a transitional provision which allowed member states to continue to apply super-reduced rates in force on 1 January 1991, but member states are not allowed to further reduce the rate. France also restricted the derogation in 1997 and extended it again in 2007, which again is not permitted under the Directive.

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

4.4.7 Reduced rate in Spain

The Commission is taking infringement proceedings against Spain for applying a reduced rate to general medical equipment, appliances to alleviate the physical disabilities of animals and substances used in the production of medicines. A reasoned opinion was sent in November 2010 pointing out that the Directive permits a reduced rate only for appliances which are "normally intended to alleviate or treat disability", and which are "for the exclusive personal use of the disabled", which does not extend to general medical equipment and appliances for animals. Also, the Directive permits reliefs for medicines, but not for the ingredients used in the production of medicines.

As no satisfactory response has been received, infringement proceedings will now commence.

Press Release IP/11/605

4.4.8 Spanish alternatives to the open market rule

The Directive provides for the possibility of a market value ruling where supplies are made between connected persons and one cannot deduct input tax in full. The Spanish rules attempted to deal with the possible VAT loss in a different way, by extending the rules for application of goods and services for private use. As no derogation had been applied for under art.27 6th Directive, this alternative to art.11A(1)(a) was not permitted.

CJEU (Case 285/10): *Campsa Estaciones de Servicio SA v Administracion del Estado*

4.4.9 Connected persons in Bulgaria

The Bulgarian court has referred questions about the provisions of the Directive that deal with substitution of open market value for actual consideration on some supplies between connected persons. Art.80 of the Directive provides:

1. In order to prevent tax evasion or avoidance, Member States may in any of the following cases take measures to ensure that, in respect of the supply of goods or services involving family or other close personal ties, management, ownership, membership, financial or legal ties as defined by the Member State, the taxable amount is to be the open market value:

(a) where the consideration is lower than the open market value and the recipient of the supply does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177;

(b) where the consideration is lower than the open market value and the supplier does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177 and the supply is subject to an exemption under Articles 132, 135, 136, 371, 375, 376, 377, 378(2), 379(2) or Articles 380 to 390;

(c) where the consideration is higher than the open market value and the supplier does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177.

For the purposes of the first subparagraph, legal ties may include the relationship between an employer and employee or the employee's family, or any other closely connected persons.

2. Where Member States exercise the option provided for in paragraph 1, they may restrict the categories of suppliers or recipients to whom the measures shall apply.

The Bulgarian questions (references to Directive 2006/112/EC) are as follows:

Is Article 80(1)(a) and (b) ... to be interpreted as meaning that, where there are supplies between connected persons, in so far as the consideration is lower than the open market value, the taxable amount is the open market value of the transaction only if the supplier or the acquirer does not qualify for the full right to deduct the input tax chargeable on the purchase or production of the goods which are supplied?

Is Article 80(1)(a) and (b) ... to be interpreted as meaning that, if the supplier has exercised the full right to deduct the input tax on goods and services which are the subject of subsequent supplies between connected persons at a value which is lower than the open market value, and that right to deduct input tax has not been corrected under Articles 173 to 177 of the Directive and the supply is not subject to a tax exemption within the meaning of Articles 132, 135, 136, 371, 375, 376, 377, 378(2), 379(2) and 380 to 390 of the Directive, a Member State is not permitted to adopt measures whereby the taxable amount is exclusively the open market value?

Is Article 80(1)(a) and (b) ... to be interpreted as meaning that, if the acquirer has exercised the right to deduct in full the input tax on goods and services which are the subject of supplies between connected persons with a lower value than the open market value, a Member State is not permitted to adopt measures whereby the taxable amount is exclusively the open market value?

Does Article 80(1) ... constitute an exhaustive list of cases representing the circumstances in which a Member State is permitted to take measures whereby the taxable amount in respect of supplies is to be the open market value of the transaction?

Is a provision of national law such as Article 27(3)(1) of the Zakon za danak varhu dobavenata stoynost (Law on VAT) permissible in cases other than those listed in Article 80(1)(a), (b) and (c) of Directive 2006/112?

In a case such as the present does Article 80(1)(a) and (b) ... have direct effect, and may the domestic court apply it directly?

CJEU (Reference) (Case 129/11): *OOD Provadiinvest v Direktor na Direktsia "Obzhalvane i upravlenie na izpalnenieto"*

4.4.10 Italian ships

The Commission has sent a formal request to Italy in respect of the state's rules on exemptions for ships. Italian legislation goes further than the Directive and applies a VAT exemption to commercial vessels that are not used for navigation on the high seas. It also excludes some services that should be covered and exempts from VAT vessels intended for public bodies, which is contrary to the VAT Directive.

The Commission asked Italy to change the rules in May 2009, when Italy agreed to do so. However, no action has followed, so the Commission has asked again. If the law is not changed within two months, infringement proceedings will commence.

Press Release IP/11/604

4.4.11 Bulgarian rules

Bulgaria changed its rules on refunds of overpaid VAT with retrospective effect, with the result that the period during which interest would accrue in favour of the taxpayer was restricted. A company appealed against this and its complaint was upheld by the CJEU – the rules contravened EU principles "in so far as that legislation deprives the taxable person of the right enjoyed before the entry into force of the legislation to obtain default

interest on the sum to be refunded". A provision which delayed the start date for accruing interest to the completion of a tax investigation was also ruled unlawful.

However, art.183 did not preclude a "normal period" for making refunds of 45 days, nor did it preclude VAT refunds from being offset against other liabilities instead of being repaid on their own.

CJEU (Case 107/10): *Enel Maritsa Iztok 3AD v Direktor Obzhalvane i upravlenie na izpalnenieto NAP*

The Bulgarian court has referred questions about the right of a trader to deduct immediately input tax incurred on the purchase of property which has not yet been used for the taxable business. The questions ask whether the allocation of an immoveable property to the business assets means that there must be an assumption, in the absence of evidence to the contrary, that it will be used for taxable purposes. It appears that the property concerned is a maisonette in Sofia, so it is not surprising that the authorities are sceptical.

CJEU (Reference) (Case 153/11): *OOD Klub v Director of the Varna Office 'Appeals and the Administration of Enforcement' - Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite)*

4.4.12 Hungarian rules

A case has been referred to the CJEU by the Hungarian courts in relation to restrictions on the right of a trader to claim a refund of VAT in a situation in which the trader cannot guarantee that subcontractors have complied with the law. The questions appear similar to those considered in the *Kittel* case, in that they ask whether the authorities have to undertake procedures to be satisfied that the claimant knew that its counterparties were acting unlawfully, or possibly colluded in their conduct.

CJEU (Reference) (Case 119/11): *Péter Dávid v Nemzeti Adó- és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága*

Similar issues appear to arise in another case also referred by Hungary.

CJEU (Reference) (Case 80/11): *Mahagében Kft v Nemzeti Adó és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága*

4.4.13 Dutch tours

As reported in the last update, the Commission is pursuing action against 8 member states for breaches of the TOMS rules, in particular dealing with sales by one tour operator to another within the margin scheme. The Commission commented that it found in 2006 that 13 member states were not in compliance, but four have corrected their legislation (including the UK). The Netherlands has now been added to the list of defaulters against which the Commission intends to take action.

IP/11/716

4.4.14 Hungarian cars

The Commission has asked Hungary to amend its rules which prohibit a VAT deduction on the open-ended leasing of a passenger vehicle (from the description, this appears to be similar to a UK hire purchase contract – ownership in the goods passes at the end of the lease on payment of a final instalment). As this restriction on input tax deduction was introduced after Hungary joined the EU, it breaches the general principle that input tax on business expenditure is deductible.

4.5 Eighth Directive reclaims

4.5.1 Third time of asking

In 2009 the Tribunal (TC00171) refused an appeal against HMRC's denial of a 13th Directive claim by an American organisation. The claim related to the payment of a guarantee on premises leased in London to a subsidiary of the organisation; the Tribunal was no more satisfied than HMRC had been with the evidence presented to show that the claimant carried on any business within the EU law meaning of that expression, and was therefore entitled to a repayment of VAT. In spite of the large amounts involved (£262,500) and the representation by a large firm of international lawyers, it was impossible for the Tribunal to establish the precise background to the organisation or its subsidiary, or the relationship between them.

The organisation appealed, and the First-Tier Tribunal re-examined the matter in even more detail than before, as well as considering at length whether it had the jurisdiction to do so (TC00495). It concluded that the appellant had the burden of providing evidence to support a claim, and had failed to do so: the appeal was dismissed again.

On appeal to the Upper Tribunal, the case came before Sir Stephen Oliver. He observed that the FTT had concluded that there was insufficient evidence of SRI carrying on a business, and no evidence that the guarantee payment had a direct and immediate link to any such business. That second conclusion was incorrect in law: the requirements of the 13th Directive only extend to demonstrating that the VAT would be "input tax" if the trader was established in the UK, not to demonstrating a link to particular transactions.

Sir Stephen pointed to findings of the FTT that SRI guaranteed the lease with the intention of generating an income stream by providing services to its subsidiary (Atomic Tangerine). That was a finding that was incompatible with the overall decision that SRI was not in business. The only possible conclusion was that the 13th Directive claim should be allowed.

Upper Tribunal: *SRI International v HMRC*

5. INPUTS

5.1 Economic activity

5.1.1 Holding company expenditure

In Spring 2006 a Spanish company formed a new subsidiary (ADIL) to make a takeover bid in respect of BAA plc. After this bid was successful (July 2006), the new holding company joined BAA's VAT group registration (September 2006). BAA then claimed an input tax deduction for some £6.7m incurred in respect of the costs of making the bid and in refinancing the group operations afterwards. HMRC refused the claim, arguing that there was no direct and immediate link between these inputs and any taxable supplies made or to be made by the group.

The company appealed, contending that the activities of a holding company are "economic activity" in European law, and the preliminary activities of the bidder were regarded as such in line with cases going back to *Rompelman*. The new holding company actively managed the acquired business, and obtained finance to fund the group's capital expenditure programme.

The First Tier Tribunal accepted this argument and allowed the appeal. Even though the new holding company never made any supplies in its own right, it was regarded as a single taxable entity with BAA, and the arrangement of group finance facilities was an economic activity linked to the whole trade. The decision includes a detailed consideration of the meaning of "economic activity" in the context of holding companies. Fiscal neutrality also required that the input tax was deductible.

The Upper Tribunal summarised the issue as follows:

Put shortly the main question is whether the VAT incurred by ADIL on the professional services supplied to ADIL have a sufficiently direct and immediate link to taxable supplies made by ADIL (or which may be attributed to ADIL) in the course of an economic activity. If so, and to that extent, the appeal fails (and the VAT incurred by ADIL is recoverable). If not (again to that extent), the Commissioners' appeal succeeds. ADIL also pleads that the application of specific provisions (Regulation 111 of the VAT Regulations) demands that ADIL recover the relevant VAT.

HMRC offered three reasons why the FTT's decision was wrong:

- ADIL was only an acquisition vehicle which never intended to make taxable supplies in its own right;
- the FTT failed to take account of its own findings that ADIL did not make or intend to make taxable supplies;
- the FTT relied on an analogy with the *Faxworld* case (C-137/02) which was inappropriate because the facts were materially different.

The company offered four reasons to uphold the FTT's decision, any one of which would, in its contention, be enough to dismiss HMRC's appeal:

- the FTT correctly found a link between the input tax incurred by ADIL and the supplies made by the company that it acquired and always intended to manage;

- whatever its subjective intentions at various stages, ADIL objectively did use the inputs in making taxable supplies after the takeover, once it had joined the VAT group;
- reg.111 SI 1995/2518 required that input tax in this situation should be recoverable;
- ADIL always intended to join the VAT group (contrary to a finding of the FTT – the taxpayer cross-appealed on this particular finding of fact).

The Upper Tribunal examined the arguments and the FTT's findings in considerable detail. The judges concluded that ADIL did carry on an economic activity rather than an investment activity, but that:

- there were no taxable supplies made, or intended to be made, by ADIL before the takeover succeeded, and as a result none of the fees – which related solely to the takeover – could be directly and immediately linked to an onward taxable supply;
- as HMRC argued, the correct time to consider deductibility of input tax is when it is incurred, not retrospectively when the output to which it is allegedly related (i.e. after ADIL has joined the group) takes place;
- the deeming of all inputs and outputs of group companies to be made by a single entity only applies once all the companies are members of the group, and it therefore does not automatically bring in input tax incurred before the company joined the group;
- reg.111 was of no assistance because the VAT was not attributable to making onward taxable supplies;
- the FTT had found no evidence in relation to an intention of ADIL to join the VAT group before the takeover – so it was not possible to conclude that its decision was unjustified on the evidence, because its conclusion was exactly that: there was no evidence to support such a conclusion.

Accordingly, HMRC's appeal was allowed, and the cross-appeal was dismissed.

Upper Tribunal: *HMRC v BAA Ltd*

5.2 Who receives the supply?

Nothing to report.

5.3 Partial exemption

5.3.1 New Notice

HMRC have issued an updated version (June 2011) of *Partial Exemption*. It has been revised to improve readability and to take account of a number of changes to the rules since the last version (December 2006). These include:

- changes to simplify the standard method;
- changes to simplify the de minimis rules;
- the combined business/non-business and partial exemption (PE) method;
- changes to the Capital Goods Scheme (CGS) and clawback/payback rules.

Notice 706

5.3.2 Lease and leaseback

A Jewish theological college entered into a lease and leaseback transaction which, in 1996, secured repayment of input tax on an extension to its buildings. The arrangement would have been ineffective following the introduction of the current version of the disapplication of the option to tax in 1997, but it was accepted at the time that it worked. The counterparty was a company which was claimed to be unconnected; the Tribunal chairman suspected that this would not have turned out to be the case had the facts been examined in detail, but the presence or absence of a connection was not relevant to the present dispute.

It appeared that the two parties to the lease paid and received rent, and accounted for output tax and input tax on it, for about the first two years of the arrangement. Then they stopped doing so. The company was dissolved and struck off the company register on 20 July 1999; it was reinstated with retrospective effect a few days before the hearing in 2010, but for ten years it had not existed.

HMRC discovered in 2002 that rent had ceased to be paid under the lease and leaseback, and they raised an assessment for capital goods scheme adjustments for the years to 30 November 1999, 2000 and 2001. There were a number of procedural problems with the appeal against this assessment, and the further assessments that followed, but eventually the First Tier Tribunal had to consider the question of whether the CGS was engaged by the failure to collect the taxable rent under the opted lease.

The college argued that the lease continued to exist, even if no rent was collected, and therefore taxable supplies continued to be made. Certainly no exempt supplies were made. The Tribunal chairman rejected this reasoning. As the counterparty had ceased to exist, there could not have been any supplies at all. The CGS regulations require an adjustment where there is a reduction in the extent of taxable use; where the reduction is to zero, the full adjustment must be made. The appeal was dismissed (TC00541).

The college appealed to the Upper Tribunal, arguing that the FTT had erred in its interpretation of the CGS rules. Firstly, the continued

existence of the opted lease (which HMRC accepted) meant that the property was still used to make taxable supplies, even if they were not generating income. Secondly, no exempt supplies had been made with the property, because the lease continued to exist. It was not permissible to look through the leasing arrangements to the college's use of the property under its leaseback to make exempt supplies of education.

Sir Stephen Oliver did not accept these arguments. He considered that the purpose of the CGS was to attribute inputs to their use for making taxable supplies. In this case, the college had initially made taxable supplies, but these had ceased; the ECJ in *Sinclair Collis* had said that "regard must be had to all the circumstances" in determining whether a supply of land was being made, and the circumstances (the property company ceasing to exist, the rent not being enforced) gave the FTT every right to conclude that no taxable supplies were being made. If no taxable supplies were being made, the only supplies of any kind were the exempt educational supplies. The change of behaviour after the initial period was undoubtedly a "change in use" within reg.115, and the appeal was dismissed again.

Upper Tribunal: *Gateshead Talmudical College v HMRC*

5.3.3 The Technical Directive

HMRC have issued an Information Sheet to provide more detail about the changes to the capital goods scheme and *Lennartz* accounting to comply with the EU Technical Directive. It covers the following matters:

- Restricting Input Tax recovery (withdrawal of Lennartz accounting) for certain assets
- Widening the scope of the CGS
- Including non-business use within clawback/payback
- Including non-business use within special methods
- Opting to hold all or part of an asset outside the VAT system
- Dealing with part disposals of CGS items
- Aligning the period of adjustment with the owner's interest
- Updating the definitions for CGS items
- Clarifying ownership of CGS assets in TOGCs and groups
- Defining the start of the CGS by reference to 'first use'
- Legislating for the concession on VAT incurred before registration linked to the option to tax

It is a useful document with numerous examples of how the new rules are intended to work.

Information Sheet 06/2011

5.3.4 Guidance for the insurance sector

HMRC, in cooperation with the Association of British Insurers, have published "Partial Exemption Guidance for the Insurance Sector". It includes sections on: insurance definitions and activities; the attribution of input tax to taxable and exempt supplies; the allocation of residual input tax; pro rata calculations; and run-off. The guidance is intended to help insurers gain approval for a fair and reasonable partial exemption special method (PESM) with the minimum of cost and delay. The guidance is neither mandatory nor binding and HMRC will consider whether to approve any PESM that an insurer declares as being fair and reasonable.

http://www.hmrc.gov.uk/menus/abi-guidance-insurance.pdf

5.3.5 Article

In an article in *Taxation*, Neil Warren examines some of the problems facing partially exempt businesses, and reviews some recent and important case law including *Cirencester RFC* (TC00718) and *Mayflower Theatre Trust Ltd* (CA 2007).

Taxation 26 May 2011

5.4 Cars

5.4.1 Cars, entertainment and subsistence

A trader was assessed for the wrongful recovery of £7,272 of input tax for a single period, relating to the purchase of a Range Rover (£7,421), entertainment (£25), clothing (£19) and "meals/trips" (£207). All the items were disputed before the Tribunal, although HMRC appeared at the hearing unaware that the other items were in dispute – the original notice of appeal had only referred to the Range Rover being exclusively used for business purposes.

It did not take long for the Tribunal to find that the *Upton* decision applied to the Range Rover – there was no physical or legal constraint on private use. It was not necessary for HMRC to cross-examine the witness on the actual use of the car – based on his own evidence, the law would not allow a deduction.

The Tribunal also agreed with HMRC that the £25 relating to entertaining was not deductible; however, it accepted the evidence of the witness that the clothing, subsistence and travel expenses were all used in the trade and were not blocked, and therefore allowed the appeal to that limited extent.

First Tier Tribunal (TC1154): *Hellesdon Leather and Cloth Co Ltd*

5.5 Business entertainment

5.5.1 Foreign customers

The VAT Input Tax (Amendment) Order 2011 has made the necessary change to art.5 of the Input Tax Order to remove the block on entertaining foreign customers in line with the *Danfoss* decision. This is achieved by inserting after the words "for the purposes of business entertainment" the exclusion "unless the entertainment is provided for an overseas customer of the taxable person and is of a kind and on a scale which is reasonable, having regard to all the circumstances".

"Overseas customer" is defined as follows:

a) any person who is not ordinarily resident nor carrying on a business in the United Kingdom or the Isle of Man and avails himself or herself, or may be expected to avail himself or herself, in the course of a business carried on by that person outside the United Kingdom and the Isle of Man, of any goods or services the supply of which forms part of the taxable person's business; and

b) any person who is not ordinarily resident in the United Kingdom or the Isle of Man and is acting, in relation to such goods or services, on behalf of an overseas customer as defined in paragraph (a) above or on behalf of any government or public authority outside the United Kingdom and the Isle of Man.

The Order came into force on 1 May 2011, but is effectively retrospective because it has been made in order to comply with EU law.

SI 2011/1071

5.6 Non-business use of supplies

Nothing to report.

5.7 Bad debt relief

Nothing to report.

5.8 Other input tax problems

5.8.1 TOGC

A company had been registered for VAT since 18 December 2006. On a routine control visit in January and February 2009, an officer found an invoice dated 20 September 2007 for "sale of assets" from a company with a similar name. This was described as £8,000 for furniture, fixtures and fittings and £52,000 for the rights to a portfolio of existing customers, together with £10,500 of VAT. HMRC raised an assessment to disallow the input tax claimed on the basis that the invoice represented the acquisition of a TOGC and was therefore outside the scope of VAT.

A supporting agreement for the transaction included clauses explicitly referring to s.49 VATA 1994 and stated that the parties intended that the Special Provisions Order should apply. Nevertheless, the company appealed against the assessment, claiming that "*Our accountants were involved with this matter and at no point did they advise that the invoice in question should be returned and a new one issued because of TOGC regulations. The vendor company has since gone into liquidation and we will be unable to reclaim the money from them. It is iniquitous and against the laws of natural justice that we should be placed in a position where we are forced to pay the VAT amount twice*." The company informed HMRC that it had ceased to trade and it was not represented at the hearing.

The Tribunal considered that the grounds of appeal amounted to nothing more than "unfairness", and dismissed the appeal.

First-Tier Tribunal (TC01128): *3 Net Media Group*

5.8.2 Invoice problems

A company claimed input tax in relation to supplies allegedly received from a supplier. HMRC raised assessments for a total of £12,870 to claw back the claim because the company did not hold valid VAT invoices. The director claimed to have paid the supplier, a construction industry sub-contractor, without receiving VAT invoices; these were subsequently requested and received but then "destroyed in a fire". Further attempts to obtain copies were unsuccessful. The trader's evidence was vague and inconsistent, and it was clear that invoices complying with the VAT regulations were not held at the time the input tax was claimed. The appeal was dismissed.

First-Tier Tribunal (TC01047): *A1 Construction (Derby) Ltd*

5.8.3 Pre-registration tax

A trader had a rare success with the "legitimate expectation" argument in a dispute about pre-registration input tax. The Tribunal accepted that he had telephoned the Advice Line and had been told that there was a three-year window for claiming pre-registration tax. This created a legitimate expectation of repayment.

In this case, the trader had asked very specific questions about when he should register for VAT in order to recover the input tax on these specific invoices. Although there was no record of the telephone conversation, the Tribunal accepted the trader's evidence of the content of the discussion,

and held that it satisfied the basic conditions for the creation of a legitimate expectation: he had given the relevant information and made it clear that he would rely on the resulting advice. The fact that he had failed to ask for written confirmation did not fatally undermine the argument.

The chairman went on to consider whether he had jurisdiction to allow an appeal on this basis, quoting at length from the *Oxfam* decision in which the point is discussed. He concluded that he did, and allowed the appeal.

First-Tier Tribunal (TC01209): *A Noor*

5.8.4 Fuel advisory rates

Following the unusual step of adjusting the fuel-only advisory mileage rates in March, HMRC have announced the usual 1 June change as follows.

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

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

Note that the banding for diesel cars has changed. Up to the last set of rates (1 March 2011), the same bandings applied for all types of engine. The lower band of diesel cars now runs up to 1600cc.

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

* 1400cc up to 31 May 2011

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

5.8.5 Carousels

HMRC have issued an updated guide to help traders protect themselves from involvement in missing trader fraud. It offers the following advice:

If you do not take due care and HMRC can demonstrate that you knew or should have known that your trading was linked to fraudulent tax losses then you will lose your entitlement to claim the input tax linked to those transactions. Be suspicious if your business or those you are dealing with show any of the following characteristics.

- *Newly established or recently incorporated companies with no financial or trading history.*
- *Contacts have a poor knowledge of the market and products.*
- *Unsolicited approaches from organisations offering an easy profit on high-value/volume deals for no apparent risk.*

- *Repeat deals at the same or lower prices and small or consistent profit.*
- *Instructions to make payments to third parties or offshore.*
- *Individuals with prior history of wholesale trade in 'high value, low volume' goods such as computer parts and mobile phones.*
- *Unsecured loan with unrealistic interest rates and/or terms.*
- *Instructions to pay less than the full price (and often even less than the VAT invoiced) to the supplier.*
- *Established companies that have recently been bought by new owners who have no previous involvement in your sector.*
- *New companies managed by individuals with no prior knowledge of the product, who hire specialists from within the sector.*
- *Entities trading from residential or short-term lease accommodation and serviced offices.*

This list is not exhaustive - use your common sense and be suspicious.

The document gives further advice about the checks that a person should carry out, and what to do if suspicious that someone may be attempting to carry out a fraud.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageExcise_ShowContent&propertyType=document&columns=1&id=HMCE_PROD1_025808

The VAT Tribunal found against a company in a MTIC appeal (VTD 20,883); the High Court dismissed the company's further appeal, and awarded costs to HMRC. The company went into liquidation six days later, and HMRC applied for a costs order against the controlling director. The High Court granted the order, observing that the Tribunal had considered the evidence of this person to be dishonest, and held that he had actual knowledge of the fraudulent transactions. In effect, the appeal had been brought to clear his name, and he could not hide behind the insolvent company to protect himself from the costs of that appeal.

High Court: *Europeans Ltd v HMRC (no.3)*

The FTT decided (TC00380) that a contra-trader "knew and had the means of knowing" that its transactions were connected with fraud. The company claimed to recover £2.1m for the quarter to 05/06. It appeared that other parts of the total claim to nearly £3.1m remained the subject of extended verification.

The company appealed, contending a number of flaws in the FTT's decision. The Upper Tribunal examined each of the criticisms in turn and concluded that the FTT's decision was one it was entitled to arrive at. The appeal was dismissed.

Upper Tribunal: *Regent Commodities Ltd v HMRC*

A company appealed against assessments raised by HMRC to claw back input tax repaid for 02/06 and 03/06, and the refusal of input tax claims for 04/06 and 05/06. After the usual exhaustive examination of 27 lever arch files of evidence, the Tribunal drew the usual conclusion that the

director either knew, or ought to have known, that the transactions were connected with fraud.

First-Tier Tribunal (TC01031): *Mynt Ltd*

A trader claimed £2.87m for the three one-month periods 04/06, 05/06 and 06/06. The Tribunal considered the due diligence that was carried out and concluded that some of it appeared adequate but took place after the deals concerned. One of the witnesses was not entirely truthful in his evidence. The conclusion was that the trader ought to have known that the transactions were connected with fraud, and also did know, even though in this case the company was a contra-trader which was therefore at some distance from the fraud itself. The claim to input tax was rejected.

First-Tier Tribunal (TC01082): *Totel Distribution Ltd*

A company made four deals in mobile phones in its 10/06 quarter and claimed £180,000 of input tax. The trader had registered the previous year with a stated intention of dealing in computer components, and had received a number of warnings from HMRC about the risks of carousel fraud. Although the Tribunal was satisfied that the appellant did not know of the connection with fraud, applying the *Mobilx* test – that there was no other reasonable explanation for the transactions – he ought to have known.

First-Tier Tribunal (TC01114): *3 Deandrake Ltd*

Another trader tried the argument that it had a "legitimate expectation" that HMRC would pay its claims (about £790,000 for the two months 07/06 and 08/06) because it carried out the due diligence exercise that HMRC said in its publications would be adequate. The director of the appellant produced a great deal of evidence and argument, including a strong attack on HMRC's expert witness who described the legitimate grey market in mobile phones for the Tribunal.

In response, the Tribunal listed a number of inconsistencies and discrepancies in his evidence, and found him an unconvincing and unreliable witness. The Tribunal held that he had the means of knowing that his transactions were connected with fraud, and the appeal was dismissed.

First-Tier Tribunal (TC01127): *Sceptre Services*

Another company was denied a total of £8.876m for the four months to 07/06. In a decision which runs to 413 paragraphs, Judge Mosedale dismantles the company and most of its employees, finding that the principals knew, and certainly ought to have known, of the connection to fraud.

First-Tier Tribunal (TC01119): *Network Euro Ltd (in liquidation)*

Another company was denied £125,000 in relation to computer chips purchased in 03/06. The Tribunal concluded that the directors had failed to ask important questions that would have led them to the realisation that something was wrong with the counterparties. That meant that they had the means of knowing within *Kittel* and *Mobilx*, and their appeal was dismissed.

First Tier Tribunal (TC01213): *Flashpoint Technology Ltd*

Yet another company failed to send a representative to argue about £6m of refused input tax in a contra-trading case. The Tribunal was satisfied that the company was a party to the fraud, and the appeal was dismissed. The non-appearance was considered unreasonable behaviour which led to a costs order which might otherwise have been withheld.

First Tier Tribunal (TC01188): *Active Infotech Ltd*

Another company was denied claims totalling about £800,000 for the months 02/06, 03/06 and 04/06. The Tribunal held that the directors had acted in a way that was consistent with protecting their position in relation to a wholly uncommercial trade, which indicated that they either knew or ought to have known that the transactions were fraudulent. Once again, the appeal was dismissed.

First Tier Tribunal (TC01181): *Greystone International Ltd*

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Grouping application to CJEU

The Commission has referred the UK and other countries to the CJEU, applying for a declaration that their grouping rules do not comply with the Directive. The application is simple:

"*For reasons of facility and in order to combat possible abuses, the VAT directive allows Member States to treat two or more taxable persons together as a single taxable person. It is submitted that the directive does not allow them to include non-taxable persons in such a group, thus extending the rights and obligations of taxable persons to non-taxable persons. The United Kingdom legislation which permits the inclusion of non-taxable persons in a VAT group is thus contrary to the directive.*"

The Directive says (at Article 11):

"*After consulting the advisory committee on value added tax (hereafter, the 'VAT Committee'), each Member State may regard as a single taxable person any persons established in the territory of that Member State who, while legally independent, are closely bound to one another by financial, economic and organisational links.*

A Member State exercising the option provided for in the first paragraph, may adopt any measures needed to prevent tax evasion or avoidance through the use of this provision."

The key question for the court therefore appears to be whether the Commission is correct to infer the word "taxable" before "person" in the article.

CJEU (Application) (Case C-86/11): *Commission v UK*

Similar applications have been made in respect of Ireland (Case C-85/11) and the Czech Republic (Case C-109/11).

6.1.2 ESC 3.2.2

HMRC have issued a detailed technical note relating to the replacement of ESC 3.2.2 with a legislative solution, which was announced earlier this year to apply from 2012. It seeks comments on the best way to draft the law in order to give effect to the concession, and any potential further issues or need for transitional arrangements. There is a list of specific questions for respondents to consider. Comments are invited by 3 August 2011.

HMRC Technical Note 11 May 2011

6.2 Other registration rules

6.2.1 Business splitting?

The Tribunal considered a case on business splitting to produce a harsh result by the letter of the law: had they been able to decide on purely compassionate grounds, they would have allowed the appeal.

The trader considered that his two businesses were sufficiently different to be treated entirely separately for VAT – one was a restaurant and the other was an electrical retailer. However, this was a misapprehension – his only hope before the Tribunal was to plead that one of the businesses had been carried on by a partnership and the other as a sole trade (if so, the difference would then have prevented a business splitting direction).

The individual had taken over the restaurant business, which was next door to his main electrical trade, in the hope that he could rapidly do a property deal with the Co-Op which was located across the street. He was supported financially in taking over the premises by an elderly lady with whom he signed a very brief "partnership agreement". This was the basis of the appeal – that the elderly lady was his partner in that trade.

Unfortunately, it appeared unlikely that she was ever intended to participate in trading profits. The restaurant had shut down at the time of the transfer (so HMRC argued and then dropped registration on the basis of a TOGC); it was only started up again by the appellant because the Co-Op deal was delayed and he needed to pay the rent. In the end, the Co-Op deal fell through and the restaurant business was closed; it appeared that substantial losses were made and the appellant probably faced ruin, but he still paid the lady back the £10,000 she had invested with a further £1,000 on top. HMRC argued that this showed it was in reality a loan; the Tribunal considered that it showed the appellant was a man of honour.

The Tribunal also asked what direct tax returns had been filed in respect of the two businesses – the answer, described by the chairman as "unfortunate", was that none had been filed.

Overall, the Tribunal decided that both businesses had been operated as sole trades. The trader was under an honest misapprehension that he did not need to aggregate their turnover, but that did not excuse him under the law, nor did it constitute a reasonable excuse. The assessment and a 15% penalty were both confirmed, but the chairman expressed the hope that HMRC would go about the collection of the tax with as much compassion as they could.

First-Tier Tribunal (TC01117): *James Yarlett t/a Beanies-by-Night and t/a J Y Electricals*

6.2.2 More than one business

A trader carried on three separate businesses, all as a sole trader – interior design, the sale of pianos and the provision of piano lessons. The third is exempt. She registered in 2002 in respect of her interior design business but failed to account for any VAT on the sale of pianos. When this was picked up by HMRC in 2006, they raised an assessment for £10,000.

The trader's accountants protested that the trader had contacted the National Advice Service at the time she registered and was told that she

would not have to account for VAT on the piano business until it reached the registration threshold in its own right. HMRC had records of a number of calls to the NAS, but none of them dealt with this particular matter.

HMRC's counsel argued that in any case the Tribunal did not have jurisdiction to hear an appeal about misdirection (or legitimate expectations). The Tribunal set that point aside, because it concluded that there was in any case insufficient evidence that a misdirection had taken place. The appeal was therefore dismissed without a decision on jurisdiction.

First Tier Tribunal (TC01156): *Ann Hood*

6.2.3 Compulsory registration

A trader ran a takeaway as a sole trader for some years before incorporating on 1 December 2005. An officer made an unannounced visit to the premises on 2 February 2008 and concluded, after enquiries, that the business should have been registered from 1 December 2002 onwards. The company would have been registered immediately under the TOGC provisions. The trader appealed against notices of compulsory registration and the related assessments for underdeclared tax.

The Tribunal considered arguments about the registration issue and concluded that, even if some criticisms of the HMRC calculations were valid (which was not necessarily the case), the registration threshold had been crossed. The appeal against registration was therefore dismissed.

As the trader had not submitted returns, it was not possible to appeal against the assessments.

First-Tier Tribunal (TC01058): *Khan Tandoori II & Khan Tandoori (NW) Ltd*

6.2.4 Voluntary registration

A sole trader ran a property and investment business. She applied to be registered on 28 July 2008 and asked for an EDR of 1 August. She submitted her first VAT return in November 2008, claiming pre-registration input tax on certain supplies which included services received more than six months before the EDR. Some £12,700 was disallowed as a result.

The trader asked for her EDR to be adjusted to an earlier date to enable her to claim the VAT. HMRC refused. The Tribunal did not consider that there were exceptional circumstances which required HMRC to agree to amend the EDR. The trader argued that she had made a "genuine mistake" in choosing 1 August; however, it was really a mistake in failing to appreciate the consequences of that choice, rather than the sort of mistake that might lead to the exercise of HMRC's discretion.

Her argument that there had been a "departmental error" in that her accountants had chosen the wrong date was rejected. In the context of the guidance about changing EDRs, it was clear that the "department" was HMRC, and HMRC had not made an error here.

First-Tier Tribunal (TC01177): *Irene Middleton t/a Freshfields*

6.2.5 Another crackdown

HMRC have announced a new initiative to crack down on traders who have turnover above the registration threshold but who have not registered for VAT. It appears that this is an extension of the long-standing tactic of identifying self-assessment returns which show turnover above the VAT registration threshold and following them up. The HMRC release says:

For each HMRC has used new technology and legislation to gather and analyse data, from internal and external sources, to identify people who should come forward. This has provided thousands more investigations, now being worked through, including a number of criminal investigations.

To join the VAT Initiative discussion, individuals, organisations or businesses should contact Nicky Prys-Jones (Nicola.j.prys-jones@hmrc.gsi.gov.uk).

Previous campaigns for disclosure of unpaid tax have covered offshore investors, healthcare professionals and plumbers. As well as unregistered traders, HMRC are now targeting private tutors (presumably income tax only – they would be exempt from VAT) and e-marketplaces.

HMRC Release 20 May 2011

6.2.6 Reader's Queries

Taxation magazine features a Reader's Query about a pub which does not currently serve food setting up an arrangement with an unconnected trader who will rent the kitchen and supply food independently. The answers consider whether HMRC could issue a business splitting direction, and the steps that could be taken to make sure that the two activities are treated independently for VAT.

Taxation 30 June 2011

Another Reader's Query concerns a gardener who, without taking professional advice, registered for VAT with an EDR backdated to commencement. The answers considered the possibility (remote) that he could revise the EDR and avoid having to pay output tax on turnover that was below the registration threshold.

Taxation 16 June 2011

6.3 Payments and returns

6.3.1 Notice 733

HMRC have issued a new version of *Flat Rate Scheme for Small Businesses*. It reflects the withdrawal of the online "Ready Reckoner". It is notable that the guidance on business turnover does not take into account HMRC's defeat in the Tribunal on the question of bank interest in TC00919 *Fanfield Ltd; Thexton Training Ltd* – the guidance still says, without any explanation, that "interest on a business bank account" is included in flat rate turnover.

Notice 733

In an article in *Taxation*, Neil Warren examines the problems of dealing with fixed assets under the FRS.

Taxation 28 April 2011

6.3.2 Debt management

HMRC have added further guidance to their online manuals on time to pay arrangements, including the interaction with the annual accounting scheme.

www.hmrc.gov.uk/manuals/dmbmanual/dmbm802010.htm

6.4 Repayment claims

6.4.1 Compound interest

The case brought by a number of motor dealers who are claiming compound interest in addition to the simple s.78 interest already paid on their *Italian Republic* and *Elida Gibbs* repayments has been stood over pending the CJEU's ruling in *Littlewoods*. So far:

- the First Tier Tribunal held that any claim for compound interest was out of time;
- as a preliminary issue, the Court of Appeal held that there was no time limit for claiming interest in the law and no bar to making a second claim, so the substantive issues should be heard;
- at the substantive hearing, the judges decided that the issues would be determined by the questions referred in the *Littlewoods* case.

The dealers wanted their own reference to the CJEU because they did not believe that the questions in Littlewoods would be adequate to determine their claims. The Court of Appeal did not follow the line adopted by the Tribunal in the *Grattan* case, and declined to refer its own questions.

Court of Appeal: *John Wilkins (Motor Engineers) Ltd v HMRC (and related appeals)*

Meanwhile, the First-Tier Tribunal has granted HMRC a stay of the previously decided reference of separate questions on interest in the *Grattan* case pending an appeal on that issue to the Upper Tribunal. In the first hearing Judge Berner ruled that there was a separate issue in *Grattan* that was not addressed by the questions in *Littlewoods*; he therefore decided to refer additional questions, and refused leave to appeal his decision to the Upper Tribunal on the basis that he considered HMRC had little prospect of succeeding. He also considered that the reference should be made straight away, even if HMRC were applying to the Upper Tribunal for leave to appeal.

A further hearing was held following the Court of Appeal's decision in *Wilkins*. It appears that Judge Berner has accepted that this indicates more uncertainty about HMRC's chance of success, so (after considering the rules and precedents on references and jurisdiction) he granted a limited

stay of the reference to the CJEU until the Upper Tribunal has considered whether to grant HMRC leave to appeal the reference order.

First-Tier Tribunal (TC01144): *Grattan plc (no.2)*

6.4.2 Direct tax on VAT refunds

HMRC have added a section to the Business Income Manual to cover the corporation tax treatment of VAT refunds. The manual goes through a number of different scenarios, but confirms HMRC's view that such refunds are, in general, chargeable to direct tax, usually as a receipt of the trade that generated the income on which VAT was mistakenly paid and subsequently reclaimed. Interest paid under s.78 VATA 1994 is also regarded as taxable.

www.hmrc.gov.uk/manuals/bimmanual/bim40150.htm

Some of the arguments in relation to this subject are considered in a reply to a Reader's Query in *Taxation*, 29 April 2011. One respondent believes that there is a case that some VAT repayments may be treated as outside the scope of direct tax; the other respondent agrees with HMRC that they are in general taxable.

Taxation, 29 April 2011

6.4.3 Unjust enrichment

HMRC presented a winding-up petition against a football club in respect of outstanding VAT liabilities. The club argued that some of the VAT should not be due because it related to "compensation" in the form of transfer fees, and was therefore outside the scope of VAT. The judge rejected this contention: the club had failed to show that VAT was not due on transfer fees, and even if it was not, the reduction in liability would have to be passed on to the clubs which had paid the transfer fees. There would therefore be no reduction in this club's liability to HMRC.

High Court: *Portsmouth City FC v HMRC*

6.4.4 Academies

HMRC have published an Information Sheet following the introduction of s.33B VATA 1994, which permits schools which have moved out of local authority control to make the claims for VAT refunds on expenditure that the local authority would in the past have made for them. It explains a number of technical issues such as the distinction between business and non-business activities, and goes through the procedural aspects of making a repayment claim.

VAT Information Sheet 09/2011

6.5 Timing issues

Nothing to report.

6.6 Records

Nothing to report.

6.7 Assessments

6.7.1 Delayed assessment

A trader was assessed to tax in respect of underdeclared income of a pub in November 2000. A reconsideration was requested by her accountant and correspondence continued through 2001, but nothing further was heard from taxpayer or representative after August 2001. HMRC sent a statutory demand to her home address in January 2003. She claimed that she did not receive this letter. In September 2003, HMRC commenced enforcement proceedings. The solicitors appointed claimed not to be able to find her, even though she had not moved from the address to which the demand was sent (and still has not). A further demand was sent (and received) in May 2008. The trader replied that the debt was not due, but HMRC issued a further demand and a bankruptcy petition. This was suspended to allow an appeal out of time against the assessment.

The appeal was hindered by a lack of records on both sides. The Tribunal considered what evidence there was and concluded that returns had been made in 1999 and repayments made by HMRC without checking; the assessment had been made and notified in 2000, because it had been the subject of correspondence with the accountant.

The chairman commented that HMRC's conduct in relation to the debt was extraordinary. No effective attempt was made to collect it between 2001 and 2008. Nevertheless, it appeared that the assessment was raised to best judgement at the time, and there was no reason to displace it. It seemed that the accountant had not told the taxpayer about the dispute over the amounts, and he had therefore let her down badly; however, she was responsible for her tax affairs, and her appeal was dismissed.

First Tier Tribunal (TC01060): *Rosanna Jayne Gordon*

6.8 Penalties and appeals

6.8.1 Delayed tax

HMRC used to have a policy that timing errors which reversed in the following period would not be subject to s.63 penalties, even if they were discovered by HMRC rather than the trader. If the trader discovered such an error after it had reversed, it could be "corrected" by netting off under reg.34 and there would be no possibility of an interest effect.

From 1 April 2009, there has been a risk that any error will be looked at in isolation and subject to the potential 30% penalty for a careless error, even if it reverses shortly afterwards. The recent case of *GD & Mrs D Lewis (t/a Russell Francis Interiors)* (TC00983) concerned a partnership which entered input tax on the purchase of a property on the VAT return including the contract date, when the tax point properly arose on completion. Because the input tax was unusually large, HMRC carried out a verification of the return before the trader had any opportunity to reverse the error in the following return, and sought a 15% penalty on the basis of a "prompted disclosure of a careless error". The Tribunal decided that the circumstances were sufficiently exceptional to warrant a further 7.5% mitigation. This halved the penalty from £5,062 to £2,531 (based on tax of £33,750 claimed early).

HMRC have now issued a Brief which changes their policy in this area. They will extend the circumstances in which they will apply para.8 Sch.24 FA 2007: this provides that an error which merely delays tax, rather than risks understating it absolutely, will only suffer penalties based on 5% of the amount delayed over a year. In the recent case, the penalty would have therefore been based on 3/12 x 5% of the full amount, rather than the full amount (i.e. £422, not £33,750); mitigated by their co-operation in the form of a prompted disclosure, a penalty at 15% would amount to just £63.

The Brief explains:

Current position

HMRC's approach to date has been that in order for the penalty to be calculated in this way, the customer had to have submitted both the return containing the initial inaccuracy, and the one containing the automatic reversal of the inaccuracy in a later period. This means that in some cases HMRC has charged a penalty on the full amount because they acted to correct the inaccuracy on the first return before the second return could be submitted, thereby preventing the inaccuracy from being reversed.

Revised position

HMRC is changing its approach for cases where HMRC intervened to correct the inaccuracy before the second return was received, preventing the inaccuracy from being reversed. When HMRC are satisfied that, but for their intervention, the inaccuracy would have been automatically corrected in a subsequent return, customers will receive the reduced penalty based on the rules for delayed tax. HMRC will shortly update our guidance to reflect this.

What you should do

If you have been charged a penalty for an inaccuracy on a return and you believe that, had HMRC not intervened before a subsequent return could be submitted, the inaccuracy would have been automatically reversed in a subsequent period, you should contact HMRC to request that the penalty is reviewed. You should refer to this Revenue and Customs Brief when making your request.

Remember this only applies to timing inaccuracies, those that are automatically reversed in a subsequent period after they are made without you having to do anything more. It does not apply to the VAT Error Correction procedure nor to compensating but unrelated inaccuracies.

R&C Brief 15/2011

6.8.2 Notice

HMRC have issued an updated version of the notice on *Default Surcharge*. This is a reminder that, even though the F(no.3)A 2010 contained provisions to extend the new late filing and payment penalties to VAT, these have not yet been implemented and default surcharge remains in force for the foreseeable future.

Notice 700/50

6.8.3 Defaults

A trader was late three times before the surcharge was triggered (as the 2% and 5% surcharges were below £400). He paid a 10% surcharge without realising what it was, and then appealed against the 15% surcharge for the fifth successive late payment. The excuses offered amounted to "ignorance of the law" and "insufficiency of funds", and these could not be "reasonable". An argument based on proportionality was also rejected.

First Tier Tribunal (TC01072): *Robert Ward t/a WPS Electrics*

Another trader appealed against a 10% surcharge and two 15% surcharges totalling £9,816. It was accepted that the VAT had been paid late. The trader's appeal seemed based largely on dissatisfaction with HMRC's approach to dealing with business, and the assertion that the penalty was "disproportionate". The Tribunal held that the trader had been fully aware of the surcharge system and appeared to have substantial assets; the appeal was dismissed.

First Tier Tribunal (TC01040): *Codicote Quarry Ltd*

A trader attempted to pay a VAT liability of £16,000 by internet, only to find that she could only pay £10,000 on any day. In the event, she was in any case a day late with the first £10,000 (which arrived on 8 October 2009) and two days late with the balance. HMRC levied a 5% surcharge.

The Tribunal could not find any reasonable excuse, nor did it consider the penalty disproportionate.

First Tier Tribunal (TC01045): *Auko Ltd*

The proportionality argument was considered in some detail in a case in which a trader took on a large new contract on which the customer had 45 days to pay. This meant that the VAT liability for the quarter was unusually high, but the customer had not provided the funds to settle it. A time to pay agreement was reached some time later, but not in time to rule out a 10% surcharge.

The Tribunal commented that "proportionality" in this context did not relate to the length of time that the money was outstanding. Surcharge was a penalty for failure to comply with the law, not a substitute for interest for the use of the money. Although the surcharge might be harsh, it could not be said to be manifestly unfair in these circumstances.

First Tier Tribunal (TC01037): *Kaizen Search Ltd*

A firm of solicitors paid five successive VAT liabilities late. They appealed against the 15% surcharge on the fifth, claiming that this was a "genuine mistake" by an employee with 38 years' experience and the penalty was unduly harsh for a small business struggling in a recession. They did not bother to turn up for the hearing, possibly having looked up the law and realising that they could not possibly win.

First Tier Tribunal (TC01104): *Leonards Solicitors Ltd*

A company had been in the surcharge regime since November 2007. A surcharge for November 2009 was levied at 15%. The company claimed that the facts were identical to those in *Enersys Ltd*, and the penalty of £1,365 should therefore be cancelled because it lacked "proportionality".

The Tribunal considered that a 5% surcharge amounting to £130,000 was materially different from the present case. Proportionality had to be considered, but the defence was not helpful here.

First Tier Tribunal (TC01113): *Digitop Ltd*

A company paid £75,000 of its £178,000 liability on 12 November 2008 and the balance by further CHAPS transfers on 18 and 24 November. It was within the surcharge regime and the applicable rate was 5%. The trader's initial appeal was based solely on proportionality, but at the hearing the witness referred to exceptional difficulties in cash flow caused by the finance company which it dealt with. Both parties were invited to make submissions on the issue of reasonable excuse.

Unfortunately, the material provided by the company did not demonstrate that the financial difficulties were exceptional and unavoidable. In the context of a business with a £23m turnover, even one with very small profit margins, a £5,000 surcharge did not appear disproportionate to the Tribunal. The appeal was dismissed.

First Tier Tribunal (TC01137): *Mill Lane Engineering (Aldershot) Ltd*

A company's excuse amounted to little more than the harshness of the surcharge (another trader charged at 15%) and general shortage of funds – although the decision also refers to "the weather and other circumstances". None of this could be a reasonable excuse.

First Tier Tribunal (TC01136): *MTS Recovery & Repairs Ltd*

Yet another company with a 15% surcharge rate pleaded the absence of an administrative assistant on a course relating to dealing with an autistic child, and difficulties with a software upgrade. The Tribunal held that this was "reliance on another" and not a reasonable excuse.

First Tier Tribunal (TC01102): *Digital Solutions Technology Ltd*

A barrister paid his quarterly VAT liability in cash at the Bank of England on 6 October 2009. HMRC did not process the receipt until 9 October, and issued a surcharge. The Tribunal held that the barrister, based on his knowledge of banking law and practice, had a reasonable expectation that the payment would be received on time, and cancelled the surcharge.

Part of the problem was that HMRC changed their banking arrangements on 8 July 2009, so that they no longer used the Bank of England collection account. HMRC had written to the barrister in earlier periods suggesting that his chosen method of settling his VAT liabilities created problems, but the Tribunal concluded that cash payment did give immediate value to HMRC and the "reasonable belief" that the payment would be received in time was a reasonable excuse.

First Tier Tribunal (TC01120): *Dingle Clark*

Yet another trader was subject to the 15% rate of surcharge. The penalty for the return under appeal was £18,500. Its history of defaults showed that it was not always late – after suffering a 5% surcharge it filed and settled three returns on time, but failed to escape the surcharge regime because it missed the deadline for the fourth period. The chairman was troubled by the harshness of the penalty for a single day's delay, and considered the possible application of the Enersys principle of "disproportionality" in detail. He considered that the following factors had to be taken into account:

(1) whether the default was "innocent" or "deliberate";

(2) the number of days of the default;

(3) the absolute amount of the penalty, about which he said "The absence of an upper limit may be justifiable upon the basis that it is a necessary consequence of a tax-geared penalty, though in my view there must come a time, even in the case of a large company, when that justification breaks down";

(4) the "inexact correlation of turnover and penalty"; and

(5) the absence of any power to mitigate.

On balance, he decided that the penalty was harsh but not manifestly unfair in all the circumstances. It was clear that the company could have paid £100,000 of the £123,000 liability by the due date, so avoiding 80% of the penalty. The appeal was dismissed.

The chairman pointed out that HMRC's standard letter imposing a surcharge states that 'you cannot appeal simply on the grounds that you consider a surcharge is too severe'. He pointed out that following *Enersys* this is not true, although the case shows that the circumstances have to be really exceptional for such an appeal to succeed.

First Tier Tribunal (TC01155): *Eastwell Manor Ltd*

A company defaulted five times, but it appealed only against the third (£8,000) and fifth (£27,700). The company claimed to have filed the third return on time – but the chairman pointed out that the receipt of an estimated assessment and a surcharge liability extension should have alerted the directors to the fact that it had not arrived. It was eventually filed six months late.

The excuse for the fifth period was effectively "shortage of funds". It blamed late payments by its largest customer, which accounted for 76% of its turnover. HMRC analysed its income and receipts, and argued that late payment by this customer was not the only cause of its shortages of funds. The Tribunal agreed that the circumstances did not fall within the *Steptoe* principles. There was no reasonable excuse.

First Tier Tribunal (TC01158): *E&P Painting Contractors Ltd*

The UK subsidiary of an Italian company was within the payments on account regime. On transferring its records to SAP it was late filing a return and therefore entered into a surcharge period. It did not argue that it had a reasonable excuse for this period.

For the period to 30 September 2010, the VAT return was submitted on time, showing a liability of £1.135m. An accounts clerk keyed in to the electronic payments system a payment of £11.135m – £10m too much – on 29 October, which would have been in time to make the payment. The error was picked up too late to make a payment in time, so no money was transferred to HMRC by the due date. The 2% surcharge amounted to £22,700.

The company claimed a reasonable excuse on the basis that the bank should have notified it of the error earlier in the day. The Tribunal did not see any evidence that the bank had made an error, but in any case that would be prevented from being a reasonable excuse by s.71 VATA 1994.

The Tribunal considered proportionality in some detail, and compared the situation to *Enersys*. It noted that the liability for the quarter in *Enersys* was unusually high, which was one of the reasons why the penalty was considered exceptionally harsh; in this case, the period had a relatively low liability for this company. The fact that the company left the payment until the last possible date, that two officers failed to pick up the error in spite of knowing that they were within the surcharge regime, and the fact that the penalty was only levied at 2%, all persuaded the Tribunal that *Enersys* did not apply.

First Tier Tribunal (TC01158): *Luxottica (UK) Ltd*

Another 15% penalty was appealed on the basis that the Christmas and New Year holidays had combined with a family bereavement to cause the delay. This was the eighth successive default. However, in respect of six of these periods, no surcharge had been levied because the amount was too small or an exceptional agreement had been reached with HMRC.

It transpired that the bereavement had taken place five days after the late payment. Although one director had visited the sick relative (his wife's aunt) in hospital, it did not appear that the other director should have been so distracted. The VAT return itself was received on 27 December, suggesting that the office was not completely closed over the period. The Tribunal found no excuse.

First Tier Tribunal (TC01166): *North Cooling Ltd*

A company used electronic funds transfer for the first time for its 08/10 quarter. It failed to appreciate that a BACS transfer can take three days to clear, and was issued with a surcharge. After a review, HMRC cancelled the surcharge, but sent a letter explaining the delays inherent in using BACS.

The payment for the following quarter was also late. It was debited from the company's account on 7 January 2011, but was not received by HMRC until 11 January (because of an intervening weekend). The penalty rate was 15%. Not surprisingly, the Tribunal thought that the explicit warning from HMRC ruled out any possible excuse that the company might have had.

First Tier Tribunal (TC01199): *ADM Glass Ltd*

6.8.4 Failure to notify

A trader was issued with a notice of compulsory registration on the basis that a business had been transferred to him as a going concern. He claimed that the business had been transferred to a company and he had never traded. The Tribunal did not accept this contention and confirmed a late registration penalty under s.67 VATA 1994. The agreement which purported to license the business to the company was not referred to in early correspondence about the dispute and appeared likely to have been created at a later date.

First Tier Tribunal (TC01087): *Wai Ho Takeaway*

A company was incorporated in December 2007 and became liable for VAT registration in July 2008. HMRC did not receive a VAT 1 until May 2009 and issued a s.67 penalty. The company appealed, claiming that they had sent a VAT 1 to Wolverhampton in April 2008, and had followed this up with several phone calls before sending in another VAT 1. The Tribunal heard evidence from the company's accountants in which HMRC had acknowledged problems at Wolverhampton in relation to another client, and noted the minutes of the Joint VAT Consultative Committee in October 2008 which commented on delays and processing difficulties in that VAT office.

The company's evidence was accepted and the appeal against the penalty was allowed.

First Tier Tribunal (TC01187): *McMullen Holdings Ltd*

6.8.5 Extensions of time

A builder appealed against an assessment to output tax on building work which he considered eligible for zero-rating as alterations to a listed building. During an extended dispute with HMRC, the company failed to file a Trib 1 form, because it expected HMRC to send one for completion. When it finally formally submitted an appeal, it was three years out of time. It therefore required the leave of the Tribunal to appeal. The chairman was sympathetic to the director's account and decided that the delay in appealing was not wholly the company's fault. The appeal was therefore allowed to proceed.

On the substantive issue, the company failed to provide sufficient evidence to convince the Tribunal that HMRC's apportionment of 25% of the works to standard rated repairs and maintenance was unreasonable.

The Tribunal reserved its decision on whether the appellant might have a legitimate expectation or misdirection defence. This depended on HMRC producing transcripts of a discussion at which the director alleged he had been told that zero-rating would be available. A further hearing would be required to discuss whether the Tribunal had jurisdiction to consider this, and to examine the evidence if it did.

The appellant was also directed to make available one of the listed building consents which was critical to deciding whether some of the works were an "approved alteration".

First Tier Tribunal (TC01159): *TPH Developments Ltd*

A company in liquidation appealed on 29 March 2010 against decisions made on 12 December 2006. The reasons for the delay were, to start with, the company not being aware of the decisions; later, there were insufficient funds for an appeal. Finally, the director of the company was unwilling to spend the time on the appeal.

The Tribunal accepted that there would be a measurable loss to the company if an appeal out of time was not allowed. The decision related to the disallowance of a substantial amount of input tax in a MTIC case. HMRC accepted that the company had produced documents which showed that it had a prima facie case – the goods concerned existed and had been exported.

However, the Tribunal balanced the culpability for the delays against the loss to the company and the need for legal certainty and good administration, and decided to strike the appeal out.

First Tier Tribunal (TC01212): *Corporate Synergy International (in liquidation)*

6.8.6 Costs

In a MTIC case, HMRC applied for a direction that the pre-2009 costs rules would apply. The appellant objected, arguing that the 2009 rules were appropriate (and they would therefore not suffer a costs order, as the case fell in the "standard" category).

The Tribunal agreed with the appellant that it would be wrong to apply the 1986 rules when the application came so long after 1 April 2009. HMRC asked for the transitional direction in October 2010 (that appears to be the

only possible conclusion from the context, although this date is shown as 2009 in para.2 of the decision). The appellant was entitled to expect that the new rules would apply, particularly as most of the costs were incurred after 1 April 2009. In another case in which HMRC had successfully applied for the old rules to apply, *Pars Technology*, the appeal was much further advanced when the rules changed.

It seems that there were a number of administrative mix-ups in the course of the appeal and HMRC did not consider the question of costs at an early enough stage.

First Tier Tribunal (TC01138): *Atlantic Electronics Ltd*

6.8.7 Late evidence, inadmissible evidence

The Tribunal considered the admissibility of a range of evidence in a MTIC appeal. Some of the disputed items were ruled out and some were ruled in, and others could be replaced by revised statements if they were obtained within a set time limit.

First Tier Tribunal (TC01175): *Atlantic Electronics Ltd*

6.8.8 Allocation

The Tribunal had to consider whether to allocate an appeal as a "complex" case under rule 23 of the Tribunal Procedure (First Tier Tribunal) Rules 2009 (SI 2009/273). The appeal had been brought before 1 April 2009, and the Tribunal had to consider the application of the new rules to a transitional case.

After considering precedent and the importance of the case (it concerns the application of the three-year cap to s.33 VATA 1994 bodies, which is the subject of a large number of *Fleming*-type claims), the chairman decided to refer the case to the President to consider transferring the matter to the Upper Tribunal.

First Tier Tribunal (TC01201): *Babergh District Council*

6.8.9 Agent update

HMRC's regular "Agent Update" bulletin for April/May 2011 includes articles on:

- reasonable excuses for late filing of VAT returns;

  www.hmrc.gov.uk/online/excuse-missed-deadline.htm

- related to that, the deadlines for VAT returns and payment dates.

  www.hmrc.gov.uk/vat/managing/returns-accounts/deadlines.htm

6.8.10 Manual update

HMRC have updated their online manual on Civil Penalties to reflect changes in the law on belated notification penalties and incorrect certificates for zero-rating.

www.hmrc.gov.uk/manuals/vcpmanual/vcp10453.htm;
www.hmrc.gov.uk/manuals/vcpmanual/vcp11341.htm

6.8.11 Regulatory penalties

HMRC have published a second discussion document on the possible simplification of regulatory penalties (those that are levied for breaches of regulations, such as failing to keep proper records). Comments are invited by 9 September 2011.

The review comments that there are over 300 regulatory penalties across all the taxes administered by HMRC, of which only 12 appear to relate to VAT.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=HMCE_PROD1_031367

6.8.12 An old complaint

An individual filed a notice of appeal in 2010 against what he claimed was a decision to assess him for £3,600 in 2001. He had been bankrupted by HMRC in 1995 in respect of a debt of over £11,000; he had been protesting this decision to a number of courts for several years, and anticipated a further trip to the ECHR if the Tribunal failed to give satisfaction.

At the hearing, HMRC's counsel could not explain why the individual had received a letter saying that he owed HMRC £3,600. It appeared that this was if anything a mistake, so there was no remaining appealable matter. The individual wanted to argue about the liabilities of the 1990s that had led to his bankruptcy, but the Tribunal could find nothing on which an appeal could be based. HMRC's counsel confirmed that a letter would be sent by HMRC to the appellant confirming that no further debt was due, but in other respects the appeal was struck out.

First Tier Tribunal (TC01070): *Alan Rue (formerly t/a Hermitage Clean Care)*

6.9 Other administration issues

6.9.1 Single compliance process

HMRC have announced trials of a single compliance process for enquiries across a range of different taxes. The single compliance process will focus solely on the risks and behaviours identified in cases and throughout the life of the compliance check, irrespective of the head of duty (VAT, Income Tax, Corporation Tax and PAYE) involved. The process will be capable of addressing lower risk cases at an appropriate level, but will also increase in intensity should the approach be warranted.

By simplifying and standardising the process for compliance checks HMRC intend to "improve customer experience" and reduce costs as the check will only take as long as the risks and behaviours encountered dictate. The Exchequer Secretary, David Gauke, classified this new approach as a way of reducing burdens on business.

The trials of the new process will run for six months from 1 June in 10 different locations across the UK: Reading/Slough, Newcastle, Warrington, York, Exeter, London Euston and Southampton in England; Cardiff in Wales; Belfast and Edinburgh/Dundee.

The new process will be rolled out nationally from January 2012, subject to the results of the trials.

A detailed briefing note for tax agents is available on HMRC's website.

www.hmrc.gov.uk/news/scp-trial.pdf

6.9.2 Compliance centres

HMRC have issued an update on the expanding role and discovery powers of their recently-formed Compliance Centres, which process information received from third-party sources. They operate from three main sites and cover income tax, PAYE, VAT and NIC. They follow up third party information which may indicate omissions from tax returns.

A briefing note explaining their role and work is available on the HMRC website.

www.hmrc.gov.uk/news/compliance-centres.htm

6.9.3 Non-business rulings

HMRC are informally consulting on a draft document which is intended to replace HMRC's Code of Practice 10 and VAT Notice 700/6: *VAT Rulings for non-business customers*. The closing date for comments on the draft is 1 August, and the proposed date for publication of the non-draft version is 30 September 2011.

The draft shows the limitations of what a non-business person can expect by way of a ruling:

When HMRC will give a response under this service

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

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

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

You can ask about a transaction you have already undertaken or one that you plan to undertake, subject to certain exceptions outlined in the section below.

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

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

When HMRC will not give a response under this service

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

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

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

- *You have not provided the necessary information - in which case HMRC will tell you what information they need (see below).*
- *HMRC do not think that there are genuine points of uncertainty - they will explain why they think this and direct you to the relevant online guidance.*
- *You are asking about a future transaction unless HMRC is reasonably satisfied that the transaction, as described, will indeed take place.*
- *You are asking HMRC to give tax planning advice, or to "approve" tax planning products or arrangements.*
- *Your application is about the treatment of transactions, schemes or arrangements which, in HMRC's view, are for the purposes of avoiding tax.*
- *HMRC are checking your tax for the period in question. You will need to contact the officer dealing with the check.*
- *The time limit for HMRC to notify you of their intention to begin an enquiry into the Self Assessment return, to which the transaction you are enquiring about relates, has passed.*

Draft CAP1

6.9.4 New leaflets

HMRC have issued a new leaflet describing the Managing Deliberate Defaulters programme, and have reissued the general guide to compliance checks now that more of the supporting details are in place.

CC/FS14; CC/FS1

6.9.5 Consultation tracker

HMRC's website contains a "consultation tracker" which records the existence and progress of consultations on different tax matters. At the end of June, it included the following entries for VAT:

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

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

6.9.6 Relationship with agents

HMRC are consulting on the implementation of their strategy for engaging with tax agents in the future, in particular those who are paid to represent clients and who have professional qualifications. The closing date for comments is 16 September 2011.

6.9.7 Confiscation order

An individual was arrested and prosecuted following a raid in which contraband cigarettes were discovered at his premises. After he had served his sentence, HMRC issued a confiscation order for £130,000 in respect of VAT not paid on the cigarettes. If he did not pay the order, he would have to go back to jail for two years.

The court of appeal quashed the order on the grounds that it was based on an erroneous assessment of the VAT due. However, the court substituted an alternative order in a lower amount, rather than cancelling the order altogether.

The questions were what value the "VAT evaded" should be based on. The ex-factory price of the packs of cigarettes was only 5p each, on which basis the VAT evaded would be just £939; but HMRC were correct in asserting that the excise duty on the cigarettes was "levied" on importation, even if the defendant had attempted to evade it. That would have been £300,000, and it should be added to the value for VAT purposes. The total VAT evaded was therefore just over £54,000, and this should form the basis of the new order.

Court of Appeal: *R v Redmond*

6.9.8 Agent update

HMRC's regular "Agent Update" bulletin for April/May 2011 includes articles on:

- agent account managers, who help to resolve client issues and offer free learning events;

  www.hmrc.gov.uk/agents/aam.htm

- pre-return toolkits, although no new ones have been issued relating to VAT;

  www.hmrc.gov.uk/agents/prereturn-support-agents.htm

- the "plumbers safe tax plan", which permits plumbers who wish to put their tax affairs in order to come forward against the promise of a reduced penalty (and, because they must be fair to all, this will be extended to others in a comparable position).

www.hmrc.gov.uk/plumberstaxsafeplan

6.9.9 Security

Appeals about security notices have not been as common recently as they used to be. However, when they do arise, they follow a predictable course: the trader argues that the notice will compound an already difficult financial situation, and this helps to prove that HMRC acted reasonably in protecting the revenue by insisting on the security. If the trader has a poor compliance history, or a record of previous business failures owing HMRC money, it will be hard to show that the notice is unreasonable; as the Tribunal's jurisdiction is only supervisory, that is what has to be demonstrated for an appeal to succeed.

First Tier Tribunal (TC01095): *Singh & Singh Ltd*

6.9.10 Equitable liability

The government has introduced a new statutory rule which will allow HMRC to "forgive" tax in circumstances where the taxpayer has no legal basis to cancel a liability – for example, because the time limit for appealing has expired – but HMRC accept that it would be inequitable to collect the tax, usually because it is clear that the assessment is based on a mistake. The statutory rule replaces a concession called "equitable liability" which had the same effect.

However, the new rule does not apply to VAT. HMRC say that the concession did not cover VAT, so it would be an unwarranted extension of the relief to include it.

6.9.11 Prosecutions

HMRC continue to celebrate their successes in court. They achieved a sentence of 7 years in a MTIC fraud case in which a criminal group had stolen £60m. A Berkshire man was ordered to pay another £69,000 in a confiscation order or face a further 21 months in jail. He had failed to account for VAT on a £7.5m sale of commercial land. A Southampton woman was jailed for seven years following a string of false identities, false accounting and false VAT claims totalling £118,000. A man who stole £1.3m in bogus VAT claims were jailed for six years each. His brother also took £330,000 from his 200 employees' debit and credit cards, saying that they were national insurance and tax payments. He received a 12 month sentence, suspended for two years. Another man, who styled himself "Lord Roberts", received a 12 month sentence for attempting to make fraudulent claims for VAT, income tax and corporation tax.

Less successful was the prosecution of two men from Preston, convicted of involvement in a £56m MTIC fraud. They had both fled to Dubai. Extradition proceedings have started, and sentencing will follow in September.

HMRC News Releases