VAT UPDATE
JULY 2013

Covering material from April – June 2013

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VAT Update July 2013

Contents

1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The HMRC website section which reports the progress of appeals reappeared on 21 January 2011 after lying dormant for some time. It says that it will be updated monthly, but it appears to be less frequent or regular than that. The latest update appeared on 20 June 2013 after a gap since 28 February.

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

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

Awaiting the CJEU:

- *Bridport & West Dorset Golf Club Ltd*: the FTT decided that the UK's exemption for sporting services was not in compliance with the Directive; the UT has decided to refer questions to the CJEU (Case C-495/12)
- *GMAC UK plc*: HMRC appealed to the Upper Tribunal after the First Tier Tribunal held that the company was entitled to go back for many years in a bad debt relief claim because the UK rules were too restrictive – in a preliminary decision, the UT decided not to refer questions to the CJEU but to proceed with a substantive hearing; one issue will now be referred to the CJEU, with questions for reference being agreed (and HMRC are considering whether to appeal further on the others, once the CJEU has given its judgment)

UK appeals awaiting hearing (or announcement of decision):

- *Bilta (UK) Ltd (in liquidation) and others v Nazir and others*: the High Court decided that a company was entitled to sue its directors for damages after they had allegedly involved it in a carbon trading fraud; the Court of Appeal heard an appeal by the directors in May 2013, but judgment was reserved
- *HMRC v Atlantic Electronics Ltd*: the Court of Appeal has reserved judgment in a dispute about the admissibility of evidence in a MTIC fraud case
- *Birmingham Hippodrome Theatre Trust Ltd v HMRC*: the Court of Appeal will hear the company's appeal against the decisions of the FTT and Upper Tribunals that HMRC were allowed to offset overclaimed input tax from a different period against its Fleming claim for overpaid output tax (hearing scheduled for December 2013)
- *Colaingrove Ltd*: HMRC intend to appeal the decision of the First-Tier Tribunal that rental of sites for caravans included an element for domestic power that could be lower-rated (the other three appeals by the same company covered in this update are also listed on the website – HMRC appear to regard them all as settled)
- *David Finnamore t/a Hanbridge Storage Services*: HMRC have been granted leave to appeal to Upper Tribunal after First-Tier decided that a trader was supplying a licence to occupy land rather than storage services – hearing date set as 12 – 14 February 2014
- *DCM (Optical Holdings) Ltd*: HMRC have appealed to the Upper Tribunal after the FTT accepted that a floor-area based special method could be appropriate (Upper Tribunal hearing was previously stated as 20 – 23 September 2011, but it now says "date to be confirmed")
- *European Tour Operators Association*: Upper Tribunal has remitted case back to First-Tier Tribunal for further consideration of the facts in relation to the exemption for the association's subscriptions
- *John Wilkins Ltd and others*: Supreme Court refused HMRC permission to appeal one aspect of the case, in which the Court of Appeal decided that motor dealers were entitled in principle to claim compound interest on VAT repayments. Substantive issue stayed pending the *Littlewoods* decision in the CJEU (will presumably now be addressed by the UK courts – website says "stayed until 2013")
- *Lok'n'Store Group plc*: FTT approved a special method which gave the self-storage company 99.98% input tax recovery; HMRC have been granted leave to appeal to the Upper Tribunal (hearing listed for December 2013)
- *Longridge on the Thames*: HMRC have appealed to the UT against the FTT's ruling that a charity was not in business and could receive building services zero-rated
- *Marcus Webb Golf Professional v HMRC*: the taxpayer has applied to the Court of Appeal for leave to appeal against the UT decision that he was not assisted by the concept of fiscal neutrality (hearing commences 3 October 2013)

- *Newey (t/a Ocean Finance)*: HMRC appealed to the Upper Tribunal after the First Tier Tribunal held that a scheme was effective in reducing irrecoverable VAT on advertising costs by moving a loan broking business to the Channel Islands – CJEU judgment in this update; Upper Tribunal to reconsider the case in the light of the judgment
- *Secret Hotels2 Ltd v HMRC*: the Supreme Court has given leave for the taxpayer to appeal against the Court of Appeal's decision that it was buying and selling accommodation as a principal and therefore subject to TOMS in the UK
- *The 'Spotting the Ball' Partnership & Others*: HMRC have appealed to the UT against the FTT's ruling that the company ran a game of chance which would be exempt from VAT (covered in this update)
- *Volkswagen Financial Services (UK) Ltd v HMRC*: CA has given taxpayer leave to appeal against the Upper Tribunal's decision in favour of HMRC, overturning the FTT's decision that the company's suggested partial exemption special method was more fair and reasonable than HMRC's
- *Wrag Barn Golf and Country Club*: dispute about whether a partnership had opted land and later admitted different members, or whether a different partnership disposed of the land and was therefore not bound by the option – FTT found for HMRC (bound); UT referred back for reconsideration; HMRC have been granted permission to appeal to the CA; meanwhile, the FTT re-hearing was scheduled for June 2013

In this update from previous lists:

- *The British Disabled Flying Association*: the Upper Tribunal allowed part of HMRC's appeal against the FTT's decision that supplies of adapted aircraft were eligible for zero-rating – HMRC have confirmed that there will be no further appeal
- *Esporta Ltd*: the Upper Tribunal has agreed that subscriptions payable after early cancellation of gym membership were still subject to VAT
- *Honourable Society of Middle Temple*: the Upper Tribunal has allowed HMRC's appeal against the FTT decision that the Society was making separate zero-rated supplies of water as well as taxable land
- *Simpson & Marwick*: HMRC have won their appeal to the Court of Session against the Upper Tribunal's decision that bad debt relief could be claimed for the full amount of "VAT-only" invoices, rather than only the VAT fraction of them (where the invoice for the net supply had been paid by an insurance company)

It has been confirmed that Abdul Noor will not appeal against the decision of the Upper Tribunal that the First-Tier Tribunal did not have jurisdiction to allow an appeal on the grounds of the protection of legitimate expectations, and that he could not succeed even by bringing an action for judicial review of unreasonable HMRC behaviour in the Upper Tribunal.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Compensation or membership fees?

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

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

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

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

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

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

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

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

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

Upper Tribunal: *HMRC v Esporta Ltd*

2.1.2 Activities incidental to registered business

An individual was registered for VAT as a private bailiff. Unconnected with that work, he occasionally acted as an agent buying properties at auctions for a company. He bought the properties in his own name using the company's finance, and transferred the property to the company afterwards if successful.

The Bulgarian tax authorities ruled that he should have accounted for VAT on the income derived from this occasional activity. He appealed, arguing that it had nothing to do with his VAT-registered business (an argument that would not have succeeded in the UK). The Bulgarian court decided to refer questions to the CJEU.

The Advocate-General gave an opinion which confirmed the basic position for VAT: a taxable person who provides occasional services outside the scope of his normal business activities is nevertheless required to account for output tax on the consideration received for those occasional supplies.

However, the Advocate-General recognised a possible argument in favour of the appellant. Art.12 Principal VAT Directive permits, but does not require, member states to regard those carrying out occasional transactions as taxable persons. Bulgaria has no specific rule on this, so it is possible that someone who carries out only occasional transactions in Bulgaria should not be regarded as a taxable person in respect of those particular transactions. The question was whether, therefore, the individual can separate out the occasional transactions and treat them as something that is not connected with the activities for which he is registered for VAT.

The full court did not agree that this was possible. If a natural person was already registered for VAT, then all economic activities were caught by the registration. The exclusion of occasional transactions in art.12 only applies where someone is not already registered. That is in accordance with the traditional understanding in the UK.

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

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 More pension funds

Advocate-General Sharpston has given an opinion on the operation of pension funds by employers in the Netherlands. A group of companies established a pension fund for all the employees of the group, in accordance with statutory requirements in the country. The fund was established as a separate entity which could not be part of a VAT group with the employers. One of the group companies paid for some fees which were charged by managers to the pension fund, and the Dutch authorities denied a deduction of the input tax.

The Advocate-General agreed with the authorities that the tax could not be deducted by the employer, but only by the fund itself. Also, the pension fund was not a "special investment fund" because it was the employer that bore the risk, not the individual members. This was in line with the decision of the CJEU in *Wheels Common Investment Fund* (Case C-424/11). The employers could only deduct as input tax any VAT charged to them on setting up the fund, enrolling employees and making contributions.

The inputs were proper to the pension fund, but in any case its activities were non-taxable as the mere holding of investments. There was an indirect link to the taxable activities of the employers, who bore the costs of the management supplies, but that link was not as direct and immediate as the link to the pension fund's own activities.

The company argued that this was contrary to the principle of fiscal neutrality. If the group had sub-contracted its obligation to provide pensions to an insurance company, rather than setting up its own fund, it would have been able to deduct VAT on fees charged to it by the insurance company. However, the Advocate-General opined that the situations were different: although employers might choose one or the other, they were not so directly comparable that the principle of fiscal neutrality should overrule the normal consequences of the legal and fiscal separation of the different entities.

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

Meanwhile, HMRC have issued a Brief commenting on services provided by IFAs to employers in relation to the establishment and management of group personal pension schemes. Apparently it has been common in the past for such work to be remunerated by commission and treated as exempt; however, following the Retail Distribution Review, it will have to be remunerated by charging fees.

HMRC point out that these fees will not normally qualify for exemption, because the IFA will not be acting as an intermediary between an individual employee and the pension provider. However, the employer will normally be able to recover the VAT as input tax, if the employer makes taxable supplies.

HMRC recognise that there may be circumstances in which the conditions for exemption are met, but this would have to be borne out by evidence in particular cases.

R&C Brief 9/2013

2.3.2 Portfolio management fees

HMRC have announced that they are changing their policy with regard to periodic fees charged on a flat-fee basis for buying and selling on a client's behalf. Currently, HMRC treat charges for purchases and sales as a separate, exempt, supply. From 1 December 2013, they will be treated as part of a single, standard-rated, supply of portfolio management services. This follows the CJEU judgment in the *Deutsche Bank* case (Case C-44/11).

HMRC state that this will not apply in all circumstances:

As a result of the judgment, it is clear that fees charged by portfolio managers on an annual or other periodic basis for the purchase and sale of securities can no longer be treated as exempt from VAT, regardless of whether or not a separate charge is made.

However, the ECJ in Deutsche Bank only considered the VAT position of periodic fees charged on a flat fee basis where there was no direct link to the transactions being executed. Where, therefore, fees are charged strictly on a transaction by transaction basis (that is, per purchase or sale of investments) exemption will continue to apply. This is conditional upon the portfolio management services being contracted for on that basis and the transaction charges being separately identified in any VAT invoice. This VAT treatment will apply irrespective of whether the portfolio is managed on a full discretionary or on an advisory basis.

Portfolio management services can be distinguished from other financial advisory services because there is an ongoing commitment to monitor and manage an individual client's investment portfolio to formulate investment decisions or recommendations. They should also be distinguished from investment fund management services (that is, the management of pooled investments within a fund structure) where VAT exemption is dependent upon the nature of the fund being managed.

R&C Brief 11/2013

2.3.3 Booking fees

The National Exhibition Centre (NEC) claimed exemption for ticket booking fees for concerts in the period 1 August 1999 to 30 April 2002. HMRC refused repayment by a decision of 27 February 2003. An appeal against that decision reached the FTT in June 2012. Separate disputed decisions were also subject to appeal in relation to different periods – a *Fleming* claim from 1976 to 1996, and separate claims for May 2002 to April 2004, May 2004 to April 2006, May 2006 to October 2007 and November 2007 to October 2009. These other claims were not considered in the current hearing, as it was agreed between the parties that the principles would apply to all the other claims as well. The total VAT at issue was approximately £5m. The Tribunal noted this agreement, but did not support it, being reluctant to make a decision that would extend to periods and matters on which no evidence had been presented to it.

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

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

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

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

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

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

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

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

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

HMRC put forward three arguments in support of its position:

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

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

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

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

HMRC relied on the decisions of the CJEU in *T-Mobile Ltd* (Case C-276/09) and *AXA UK plc* (Case C-175/09) as showing that the law as found by the Court of Appeal in *Bookit Ltd* was not entirely clear. In particular, AXA meant that the fees were taxable as "debt collection". The company countered that AXA had charged dentists – the creditors – for collecting their income. NEC charged the customers – the debtors – for processing their payments. That was a completely different transaction.

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

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

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

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

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

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

First-Tier Tribunal (TC02695): *National Exhibition Centre Ltd*

2.3.4 New investment product

Two Statutory Instruments have amended the law to extend the existing "special investment fund" VAT exemptions (as well as other tax advantages) to the new tax transparent 'authorised contractual schemes'. Details can be found in The Collective Investment Schemes (Tax Transparent Funds, Exchanges, Mergers and Schemes of Reconstruction) Regulations 2013 and The Value Added Tax (Finance) Order 2011.

SI 2013/1400; SI 2013/1402

2.3.5 Chance or skill?

A 'spot the ball' competition (STB) involves entrants paying for a coupon on which they mark where they believe the centre of a football ought to be on a photograph of a football match from which the ball has been removed. The winner is judged by comparison with the views of an 'expert panel' of ex-professional footballers, rather than by comparison with the original photograph. This was intended to circumvent gaming legislation by making the competition a game of skill rather than a game of chance. For this reason, entry fees were regarded as VATable, rather than being exempt under Sch.9 Group 4.

Several companies which run such competitions made a claim for repayment of output tax overpaid from 1979 to 2006, totalling some £72.5m plus interest. They argued that the payments should have been exempt. The FTT was asked to rule on a preliminary issue of principle. This was whether STB was a 'game' and if so whether it was a 'game of chance'. Other issues, such as the effect of capping and the validity of the various claims on administrative grounds, were left for determination later if the matter of principle favoured the appellants.

The Tribunal examined in detail how STB operated during the period. Up to 2002, the entries were judged manually by employees with magnifying glasses. Since then, a digital scanning process identifies the winners. Many entries have multiple crosses, which can be purchased in the form of a sticker which the entrant attaches to the coupon; there has never been an occasion when the companies reckoned that any entrant had marked the exact same spot as the point determined by the panel, even though they were measuring variations of less than 0.1mm (the thickness of a sheet of paper), and there were in the heyday of STB some 1.6m entries per week.

The legislation exempts fees for entering a 'game of chance', which is defined as including 'a game of mixed skill and chance'. The definitions have changed slightly in the law, but either of these would be exempt. HMRC's position was that STB was not a game at all, but if it was, it was a game of skill. This was how it was promoted and described, and how it had been treated for VAT since 1979 (before which it had been treated as exempt).

Counsel for the claimants argued that the way it was promoted was not as relevant as the detail of the way the game was played in practice. Many participants entered large numbers of crosses; even in the promotions, winning was described as 'your lucky day'. Even if there was an element of skill, there was also some chance, and that made it exempt.

The case law relied on by HMRC on the definition of a 'game' was held by the Tribunal to be largely irrelevant – the meanings of words were considered in particular contexts, and general conclusions could not be drawn.

There were some precedents on 'game of skill and chance', which involved prosecutions of STB promoters under gaming legislation. One case in particular was relied on by both parties: the judges commented that they appeared to be 'cherry picking' from the decision, and it could still not be of great assistance because of its different context.

The Tribunal concluded that the word 'game' has a wide meaning that depends upon its context, and it was apt to describe STB as a 'game'.

Further, although there was skill involved, there was also a significant element of chance. Given that there could be several hundred entries within the thickness of a sheet of paper of the winner, and given the imperfections of the process of picking the winner, there had to be enough chance involved to make STB a mixed game of chance and skill. The question of preliminary principle was therefore determined in favour of the claimants.

First-Tier Tribunal (TC02624): *The "Spotting the Ball" Partnership and related appeals*

2.3.6 Closely related to education

The BBC made charges to The Open University in respect of the cost of broadcasting its educational programmes. Following a Tribunal decision in 1982 (VTD 1,196), these supplies were treated as taxable; from August 1994, Customs accepted that they were exempt under Sch.9 Group 6 Item 4 VATA 1994 (the wording was changed, and the exemption extended, on consolidation of the VATA 1983). In 2009, the BBC made a *Fleming* claim in respect of the VAT charged (just under £21m) between 1978 and 1994. When HMRC refused, The Open University appealed to the FTT. It was entitled to do so as it was the recipient of the supplies, and would be entitled to reimbursement if the claim succeeded.

The 1982 Tribunal had decided that supplies of "services closely related to education" had to be made by a person supplying education itself in order to be exempt. As the BBC was not supplying education to the OU's students, it could not qualify. The 2005 CJEU decision in *Horizon College* (Case C-434/05) showed that this was (and always had been) wrong in principle; however, it was binding on the parties in relation to the VAT at issue before the Tribunal, so the *Fleming* claim did not include the quarter to September 1981, because that appeal had determined the tax finally for that exact return period.

The Tribunal judge considered that there were three issues to be determined:

(1) was the BBC a body governed by public law for the purposes of Article 13A(1)(i); and

(2) did the BBC have the educational aim required by Article 13A(1)(i); or

(3) if the BBC was not a body governed by public law with the required educational aim, was it another organisation defined by the United Kingdom as having similar objects?

In respect of the first question, the judge considered himself bound by the ruling of the High Court in the *Cambridge University* case: a body governed by public law must be, for this purpose, part of the public administration of the country. The BBC did not satisfy this condition. The BBC is subject to a range of laws and is a creation of the law, but it does not appear to fall within the type of organisation that the Directive envisages as enjoying this exemption.

The second question was dependent on the first, which meant that it was not strictly relevant, once the judge had decided that the BBC was not a body governed by public law. However, he considered it, in case the point was important to an appeal. Although the BBC has education, in a broad sense, as one of its aims, the judge did not accept that its involvement in educational broadcasting was of the kind envisaged by the CJEU in *Horizon College*.

However, the judge did accept that the BBC was "*another organisation defined by the United Kingdom as having similar objects*." The law had changed in the VATA 1994 to go beyond just state organisations, and Customs had accepted in 1997 that this applied to the OU Production Centre, which was part of the BBC. The judge concluded that the change in the VATA 1994 had correctly implemented a directly effective

Directive provision that applied both before and after 1994, rather than extending an exemption that it was within the power of a member state to restrict. The situation was comparable to that in *JP Morgan Claverhouse*, where the government had argued it was allowed to "define" special investment funds for the purposes of the VAT exemption. The CJEU ruled that such definitions had to be applied in accordance with the concept of fiscal neutrality – it was not permitted to distinguish between organisations or products that were essentially the same.

The appeal was allowed.

First-Tier Tribunal (TC02729): *The Open University*

2.3.7 Commercial education

Meanwhile, Advocate-General Kokott has given an opinion in a case on the permitted scope of the education exemption. A private Polish company wanted to deduct input tax, but the Polish authorities ruled that it was covered by the exemption, which in Poland covers all educational services, regardless of the purpose and nature of the provider. Questions were referred to the CJEU to confirm whether it was permissible to extend exemption to a private entity.

The company argued that educational services were only exempt under PVD art.132 if one or more of the conditions of art.133 were satisfied. In particular, the supplier either had to be a public body or an entity recognised as having a similar purpose. It contended that a company which systematically aimed to make a profit could not satisfy this condition.

The Advocate-General's opinion (which is not available in English) is that Member States must make exemption conditional on recognition of the provider as having similar aims to those public bodies which are referred to in art.132; however, a commercial company would only have the right to deduct input tax by virtue of the direct effect of art.132 if the state's recognition (of that company as having similar aims) was beyond the scope of the discretion given to member states in applying the exemptions. It is not clear whether the opinion implies that the company should be able to treat itself as taxable or not.

CJEU (A-G) (Case C-319/12): *Minister of Finance v MDDP Sp. z o.o., Akademia Biznesu, Sp. komandytowa*

Meanwhile, HMRC has published a summary of responses to its consultation on extending the VAT education exemption. The government has decided not to proceed with its recent proposals for extending exemption to commercial providers of Higher Education. Nevertheless, HMRC will work with BIS on the issues raised and may consult again later this year on the case for change.

It is interesting to note that 20 of the 28 respondents answered 'yes' to the question 'do you agree that extending the exemption will help to contribute to competition and benefit students within the HE sector?' It seems that respondents felt that the proposal did not go far enough, rather than going too far; but it is not going anywhere at all.

www.gov.uk/government/uploads/system/uploads/attachment_data/file/205767/130606HE_CONDOCresponse-Final.pdf

2.3.8 Research bodies

HMRC have issued a Brief about the consequences of the withdrawal of exemption of supplies of research between eligible bodies (which has been accepted as being contrary to EU law). HMRC offer some guidance on the circumstances in which research will instead be treated as outside the scope rather than an exempt (becoming taxable) business activity.

Where research is carried on collaboratively, it is common for one body to act as the 'head', dealing with the funding source and distributing the money to the other entities involved. Where this is the case, the 'head' will not be regarded as buying supplies for consideration; rather, it will be distributing grant income, and if the grant income is outside the scope in principle, the activities of all the collaborators will be as well.

HMRC offer the following generic guidance:

For there to be a supply of services for VAT purposes, there must be a direct and immediate link between consideration paid and a service provided. HMRC do not consider this to happen in the case of research which is funded, either by the public sector or by the charitable sector, for the wider public benefit. This was mentioned in the opinion of the Advocate General in Keeping Newcastle Warm (C-353/00).

Where a subsidy is granted by the donor to the recipient to enable a third party to obtain a specific service (or to obtain it more cheaply) this would, as a general rule, be a taxable transaction.

The main question to answer is whether the funding is the consideration or part of the consideration for any specific supply. If not, then it is outside the scope of VAT.

Situations where the funding will be outside the scope of VAT include:

- *research which is funded for the 'general public good' and there is no direct benefit for the funding body*
- *research which is funded for the general public good and is either not expected to generate any intellectual property (IP), or if it does then any reports or findings will be freely available to others*
- *where there is a 'collaborative' agreement between different research institutions where all parties to the grant are named on the application*
- *where the funding flows through one named party - and they act purely as a conduit passing on the funds to others involved in the research project - the funding remains outside the scope of VAT*

Where funding is provided to a named party for research that will either generate IP to be exploited by the funder and/or is not for the public good and they subsequently decide to sub-contract some of the research to an eligible body (for example a university), the initial funding to the named party (assuming an eligible body) will be taxable consideration for a supply.

R&C Brief 10/2013

2.3.9 Online spectacles

A company sold spectacles online. HMRC accepted that its supplies would have qualified for partial exemption if they had been made from a shop, but ruled that they were wholly taxable because there was no direct contact with the customer. The company accounted for output tax on all its supplies for some time, then claimed a repayment on the basis that it should have had an effective VAT rate of 13.4% of turnover.

The FTT started by reviewing the main precedent case on the supply of dispensing services with spectacles, *Leightons Ltd*. The judge considered that it was still good law: the healthcare service aspect remains a separate supply from the taxable goods. He then examined what the online supplier did and compared it step by step with Leightons' business practices. Although there were differences of detail, he was satisfied that the key element was the same: healthcare services were being supplied under the supervision of a qualified optician, and that qualified for exemption.

The judge was reassured that this was the correct decision by the principles of the *Rank* case: in his view, the aims of a customer in visiting the Glasses Direct website were identical to those of a customer visiting a high street optician's shop, so the VAT treatment of the service provided ought to be the same.

This was a decision in principle on the availability of the exemption. It appears that the apportionment of consideration is still under negotiation; and HMRC may appeal this decision.

First-Tier Tribunal (TC02759): *Prescription Eyewear Ltd*

2.4 Zero-rating

2.4.1 Adapted transport

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

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

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

HMRC appealed to the Upper Tribunal, arguing that the FTT had misconstrued the statutory requirements. In particular, they contended that:

- the aircraft were not “designed” solely for use by a handicapped person as required by item 2(g) Group 12 Sch.8 VATA 1994;
- the aircraft were not “goods of a kind” described in item 2 Group 12, and the BDFA is not a “relevant establishment” for the purposes of Group 15 of Schedule 8.

HMRC did not seek to contest a number of the FTT’s other findings, including that the aircraft were “equipment” for the purposes of Item 2(g) (which the Upper Tribunal had reservations about); that they were “solely” for the use of the handicapped people for the purposes of the relief; and that the adaptations carried out the day after purchase of one of the aircraft had been contemplated at the time of purchase.

HMRC’s principal contention was that an item can only be “designed” for use when it is originally manufactured. Group 12 Item 2(f) and (i) provide explicitly for purchase of cars and boats which have been “adapted” for use by handicapped people, but Item 2(g) only refers to “designed”.

The judges did not accept that this was a reasonable interpretation of the law. Although the law has to be interpreted strictly, as zero-rating is an exception to the normal principles of VAT, nevertheless it has to be interpreted realistically. The judges considered that a sensible interpretation was to consider the condition of the item at the time of supply. HMRC’s version would require investigation of the history of the asset, which would not be practical. “Designed” meant more than “intended”: it related to the physical attributes of the equipment.

Unfortunately for the BDFA, this meant that the aircraft that was adapted on the day after it was purchased could not qualify for zero-rating (and would not qualify for zero-rating in respect of subsequent repairs and maintenance). However, the other aircraft, which had been adapted for handicapped use before purchase, did qualify for zero-rating. The BDFA had leased it for a period before purchasing it.

On the second ground of appeal, the judges considered that the aircraft were “goods of a kind” described in Item 2 of Group 12, which meant that they were capable of zero-rating under Item 5 Group 15. However, that also required BDFA to be a “relevant establishment”, HMRC argued that BDFA did not provide “care” in an “establishment”.

Although the word “institution” was confusingly used in two different senses in Group 15, the Tribunal was satisfied that the requirement was for the charity to provide care – which it accepted BDFA did – in a physical place – which it did not.

BDFA had also argued before the FTT that it had a legitimate expectation of zero-rating under ESC 3.19. The FTT had not been required to consider this, because it had found for the charity on the technical grounds of appeal. The Upper Tribunal only considered it briefly, because it had become relevant in respect of the aircraft which was adapted after the time of supply. The judges did not agree that the charity was within the terms of the concession, because it did not really "provide transport services to handicapped people". It provided "experiences", but not transport.

HMRC's appeal was therefore allowed in respect of one aircraft and dismissed in respect of the other.

Upper Tribunal: *HMRC v The British Disabled Flying Association*

2.4.2 E-books

An interesting question has been referred by the Finnish courts:

Do the first subparagraph of Article 98(2) of and point 6 of Annex III (as that point appears in Council Directive 2009/47/EC) [PVD], when the principle of tax neutrality is taken into account, preclude national legislation under which a reduced rate of value added tax is applied to printed books, but the standard rate of tax is applied to books on other physical means of support such as a CD, CD-ROM or memory stick?

As regards the answer given to the question above, is it of any significance

1. *whether a book is intended to be read or to be listened to (an audiobook),*
2. *whether there exists a printed book with the same content as a book or audiobook on a CD, CD-ROM, memory stick or other equivalent physical means of support,*
3. *that a book on a physical means of support other than paper can exploit technical features provided by that means of support, such as search functions?*

Although this question is asked in the context of the reduced rate of VAT which may be applied in other countries, it is clearly equally relevant to the zero-rating of printed books in the UK, where it has long been established that "soft copy" books are standard rated.

CJEU (Reference) (Case C-219/13): *K Oy*

2.5 Lower rate

2.5.1 Disposable barbecues

A supermarket argued that disposable barbecues partly qualified for the lower rate, because they contained charcoal. This had been the treatment recommended by manufacturers of such barbecues up to October 2006, when HMRC issued Business Brief 17/06 explaining their view that the correct liability was wholly standard rated.

The supermarket complied with the Brief, but made a voluntary disclosure in November 2010, claiming a repayment of £193,000 in respect of sales from October 2006 to October 2010. It claimed that 50% of the value should be lower rated. The FTT dismissed its appeal, holding that *Card*

Protection Plan applied – the barbecues were, in the view of the customer, a single item. Although the company argued that the legislative provisions ought to carve out a separate element with a separate liability, the FTT did not accept that this overrode the principles of *CPP*. The company, supported by two other supermarkets, appealed to the Upper Tribunal.

A significant precedent for this proposition is *Talacre Beach Caravan Sales Ltd v HMRC* (Case C-251/05), in which the CJEU held that the UK's zero-rating rules for caravans did not breach EU law. The supply of caravans was zero-rated, but the law excluded the contents from zero-rating, creating a mixed liability for what the company contended was a "*CPP* single supply". The Tribunal quoted at length from the Advocate-General's opinion and the full court's judgment in that case; it is clear that the UK law was held to comply because it placed a restriction on an exception to the general rules of VAT, and that was permitted.

Several other precedents from the CJEU were considered, including *Commission v France* (Case C-94/09) (the French undertakers case) and *Purple Parking Ltd v HMRC* (Case C-117/11). The parties agreed that the French undertakers case showed that a supply could be divided and given a partially lower-rated treatment (France applied the lower rate only to the transportation of the body, not to some other supplies by undertakers).

The judge concluded that HMRC's main argument was correct: the various cases in which the CJEU had approved a split treatment all arose from situations in which a member state had chosen to restrict the lower rate (or zero-rate, in *Talacre*) to particular elements of a supply. The CJEU had consistently accepted that this was permitted. However, that did not mean that it was required, where no limitation on the application of the lower rate was provided for in the law. In that case, the *CPP* analysis would continue to apply.

The judge considered that the result was sensible and unsurprising. Disposable barbecues are leisure items, not satisfying any particular social need, and there is no particularly strong reason to give them a favourable VAT treatment. They are a single supply from the viewpoint of the customer, and are therefore standard rated. The appeal was dismissed.

Upper Tribunal: *W M Morrison Supermarkets plc v HMRC*

2.5.2 Holiday caravans

HMRC have issued a new document to replace Information Sheet 11/2012, giving more information on sales of second-hand caravans from 6 April 2013, including details of the evidence required to determine whether they were occupied before that date. Legislation in FA 2012 withdraws zero-rating for larger, static holiday caravans with effect from 6 April 2013, replacing it with a 5% reduced rate. Zero-rating remains for caravans complying with the current standard for residential use.

VAT Information Sheet 4/2013

2.6 Computational matters

2.6.1 Apportionment

Following on from its success in the FTT in a case about charges for caravan pitches being partially lower-rated in respect of supplies of power (TC02534), a company has had further partial success in an argument about the way in which the proceeds of sales of caravans should be apportioned between the zero-rated body and the standard rated contents.

The Tribunal considered the relative merits of a list of alternative methods put forward by the parties. These appear to be quite specific to the circumstances of the sale of new and second-hand caravans; the general principle that the Tribunal sought to apply was to reach a fair and reasonable apportionment. It offered conclusions that were hedged around with conditions:

New caravans

73. No method will be completely satisfactory in these circumstances. We find that Methods (3), (6), (7) and (8) are either impracticable or complex or both. Methods 1 1A, 2 and 2A seem to us inherently simpler than Methods 4 or 5.

74. If the relevant fraction for Method 2A can be fairly set, we believe that that method should be used. For the reasons set out above it is inherently simpler and directed more closely at the required objective than methods 4 and 5. If the fraction cannot beset, then in our view Method 1 should be used in preference to Methods 4 or 5.

75. That is because, as a simple rough and ready measure, the inapposite margin of 20% used in Method (1) is roughly compensated for by the over allocation to standard rated items which we believe it is likely that the manufacturer applies, and despite the rough and ready nature of the method it is better directed to the required object than Method 4 or 5 and is theoretically simpler.

Different principles applied to the sale of second-hand caravans. Although the decision said "allowed in part", presumably the parties still have to discuss how these findings are to be applied to the facts.

First-Tier Tribunal (TC02701): *Colaingrove Ltd*

A further decision examines in some detail the different items that may be fitted in a caravan and which might fall to be treated as "removable contents". The judge makes some findings of principle in relation to a list of fittings and invites further submissions from the parties.

First-Tier Tribunal (TC02715): *Colaingrove Ltd*

Yet another decision concerns the supply of caravans with 'verandas' – comprising '*a boarded area abutting at least two sides of the caravan. The level of the veranda deck corresponds to the level of the floor of the caravan*'. The company initially accounted for output tax on the supply of the verandas, but then reclaimed it, arguing that it was an integral part of the caravan, and not 'removable contents.'

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

First-Tier Tribunal (TC02746): *Colaingrove Ltd*

2.6.2 Trade-in values

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

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

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

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

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

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

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

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

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

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

The appeal was dismissed.

First-Tier Tribunal (TC02677): *N & M Walkingshaw Ltd*

2.6.3 Bag levy

A minimum 5p levy has been introduced on single-use carrier bags in Northern Ireland. HMRC have issued a Brief to explain the VAT consequences.

Traders who charge the minimum 5p must hand on the whole amount to the Department of Environment Northern Ireland. No VAT is then due from the retailer.

Traders who charge more than the minimum must account for output tax on the whole amount charged; they are then required to pay 5/6 of 5p (4.17p) to DoENI. That payment will not affect the VAT return.

R&C Brief 7/2013

2.7 Discounts, rebates and gifts

2.7.1 Prizes

In the High Court case of *Customs and Excise Commissioners v Professional Footballers Association (Enterprise) Ltd* (1990), it was held that prizes given at a dinner were not subject to output tax under Sch.5 para.5 VATA 1994: the output tax on the tickets for the events included consideration for the presentation of the prizes, because it was part of the event that people had paid to attend.

Following that case, a ruling was given in relation to medals given for winning Scottish league titles and the Scottish League Cup. The trophies remained the property of the League, but the medals and flags awarded to clubs and players could be subject to Sch.4 para.5. Customs held that the Cup Final was similar to the PFA case: the tickets for the neutral venue were sold by the League, not a club, and the price included seeing the prizes presented. However, the medals for winning the league were different. The games to determine a league would be played at clubs' own grounds, and it would not always be known at which ground the presentation would take place. Accordingly, the gift of medals for winning the league was subject to Sch.4 para.5 if the value was above the limit (then £15) which, in the case of the gold medals for the players, it certainly was. The League then agreed not to claim input tax on the medals and not to account for output tax.

In 2010 the League decided that this was wrong, and made a claim for input tax going back to 2007. Its representative argued that the award of medals for the league championships was more similar to the *PFA* situation (and the League Cup Final) than had been allowed. There were links to taxable sources of revenue including sponsorship and television fees. The membership agreement with the clubs provided that medals would be awarded, which meant that they were not "gifts".

The FTT disagreed. The medals were property of the League, transferred without consideration. They were "voluntary" in the sense that the members of the League agreed to join together and allow the medals to be awarded. Once it had been decided that they were gifts, the VAT consequences had to follow. Either they were subject to output tax to claw back the input tax recovery, or they could be blocked from input tax recovery because no output tax was collected. The appeal was refused.

The League appealed to the Upper Tribunal. It is interesting that the decision notes a further argument, put forward by the League's representative in the hearing but "*not ... emphasised to any great extent in the FTT's findings, either in relation to the facts or the law*." This was that the medals (which cost about £450 each, so a full set for all three divisional champions cost about £27,000) were a cost component of running the leagues, and output tax already accounted for on all the income from taxable sources therefore "covered" the medals. There was no reason for a separate charge on them on their own.

The judges observed that the question which had taken up most of the FTT's time – whether the medals were "business gifts" – was effectively irrelevant, because they cost more than £50. It mattered only whether they were goods forming part of the assets of the business, which were disposed of without consideration. If they were, whether they were business gifts or some other type of disposal, Sch.4 para.5 was engaged.

The judges went on to reject the argument that the rest of the taxable turnover of the League could in any way be linked to the supply of the medals. They were discrete transactions, disposals of goods to particular people, and they were quite separate from the various sources of taxable income. There was an insufficient link.

The judges did not disapprove of the *PFA* decision – they distinguished it. The gala dinner was a self-financing event, so it was clearer that the price of the tickets reflected the cost of the prizes. Similarly, the *Scottish Football Association Ltd* case dealt with the gift of caps to footballers playing in internationals – each match was a specific event, and the cost of the caps was clearly a cost component of the revenue from that particular game.

The appeal was dismissed.

Upper Tribunal: *Scottish Football League v HMRC*

2.7.2 Manufacturers' refunds

HMRC have interpreted the *Elida Gibbs* decision (Case C-317/94) as only applying to promotional discounts and rebates paid by manufacturers to consumers. Where a manufacturer pays a direct refund to a consumer in respect of a faulty product, HMRC have treated it as compensation and outside the scope of VAT.

In the March Budget, it was proposed to change this, and to introduce legislation to widen the scope of VAT adjustments for direct refunds given to people further down the supply chain than the immediate customer. This is being done in the interests of fairness and to make sure that the UK complies with European law.

HMRC have issued a consultation document to find out how common the situation is, and to gather views on the best way of implementing the change.

https://www.gov.uk/government/consultations/vat-treatment-of-refunds-made-by-manufacturers

2.8 Compound and multiple

Nothing to report.

2.9 Agency

2.9.1 TOMS

The Commission has taken infringement proceedings against several member states (Spain, Poland, Italy, Czech Republic, Greece, Finland, France and Portugal) in relation to their implementation of the tour operators' margin scheme. They all require that the scheme is applied not only where the supply is made to the person who will consume the travel services (referred to as 'the traveller'), but also where the supply is made to another business (more generally 'a customer'). Different versions of the VAT Directive use the words 'traveller' and 'customer,' so it is a matter of interpretation arising from translation.

Advocate-General Sharpston has given an opinion in the case against Spain, which also involved some other Commission objections to the Spanish law. On the common issue, the Advocate-General recommended that the Commission's action should be dismissed by the court: the objective of the TOMS was to simplify VAT for those subject to it, and it would be contrary to that objective to impose different VAT treatments which depended on correctly identifying the type of customer.

The Advocate-General recommended that the court should uphold the Commission's other three objections to the Spanish rules, which concerned the exclusion from the margin scheme of situations in which retail travel agents sell travel packages organised by wholesale agents, the statement of the amount of VAT included in the price, and the determination of the taxable amount over a tax period.

CJEU (A-G) (Case C-189/11): *Commission v Spain*

2.9.2 Article

In an article in *Taxation*, Mike Thexton examines the different possible treatments of a transaction involving two businesses which combine together to supply something to a consumer. Four different analyses are considered, together with the way in which they each must be reflected in the VAT return. The implications of the Retail Distribution Review for independent financial advisers are examined.

Taxation, 11 April 2013

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

2.11.1 Updated Notice

HMRC have issued an updated Notice *Clubs and Associations*, replacing the October 2011 version. Section 5 has been amended to clarify the VAT treatment of goods and services provided in return for subscriptions.

Notice 701/5

2.12 Other supply problems

2.12.1 Property subject to agreement for lease

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

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

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

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

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

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

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

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

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

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

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

a. The identity of all the parties

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

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

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

e. The amount of the sale consideration

f. The date of the sale; and

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

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

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

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

First-Tier Tribunal (TC02617): *The Royal College of Paediatricians and Child Health and related appeal*

2.12.2 More TOGC conditions

A company owned 30% of the shares in another company. It was part of the board of management, and supplied management services in return for contractually agreed remuneration. It disposed of its shareholding at the same time as the other members sold their 70%, and received VATable services in relation to the share transaction. As it was a separately registered business in its own right, it deducted the VAT as input tax on its returns. The authorities refused this claim, arguing that it did not relate to any taxable outputs made by the company.

The referring court was unsure whether *AB SKF* (Case C-29/08) might support the appellant's contention that he had made a transfer of a business as a going concern that would count as economic activity and therefore would justify a deduction.

The Commission argued that the Dutch court could have answered the question, so the CJEU should not consider it. The CJEU did not agree: the court's uncertainty related to the treatment of the output transaction (the disposal of the shares), and that depended on the interpretation of EU law.

The court went on to consider the meaning and scope of the *AB SKF* decision. It noted that the decision was limited, in that the court did not have enough knowledge of the facts to rule whether the transaction actually was a TOGC – it only ruled that it might be. The circumstances of the present case were quite different, in that the sale only involved 30% of the company. Someone who owned only 30% had only restricted rights over the assets of the company, and someone who acquired only 30% was not put in a position to carry on an independent economic activity. The fact that several shareholders simultaneously sold 100% of the shares to a single purchaser did not change this analysis.

Accordingly, the sale of the 30% holding had to be an exempt transaction, and the input tax would not be deductible. It also appeared that the sale of the shares would lead to the cessation of the shareholder's economic activities, if that was limited to the provision of management services, and that was a further question for the national court to consider in determining the appropriate deduction of input tax in relation to the transactions.

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

2.12.3 Deregistration charge

A Bulgarian trader was deregistered for VAT following non-compliance and non-payment of VAT due. He retained assets on which VAT had been deducted, and was assessed to a charge based on the open market value of the assets. He claimed that the authorities had failed to take proper account of the depreciation of the assets. His dispute over the amount of the assessment reached the CJEU.

The CJEU confirmed that a deemed supply under PVD art.18(c) could apply on removal from the VAT register, as well as on complete cessation of business. The value should be determined in accordance with art.74, not art.80, because the open market value provisions of art.80 only applied in the specific circumstances listed in that article. Art.74 required the replacement cost of similar items to be used, which should take into account loss in value between purchase and deregistration. Art.74 was sufficiently precise and clear to have direct effect.

It was for the national court to determine whether the precise requirements of Bulgarian law complied with art.74.

CJEU (Case C-142/12): *Hristomir Marinov v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' – grad Varna pri Tsentralno upravlenie na Natsionalna agentsia za prihodite*

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Land and water

The trustees of the Middle Temple leased chambers to barristers and also agreed to supply them with cold water. HMRC ruled that there was a single supply of land, and this would be subject to VAT as the trustees had opted the property. The trustees argued that the supply of water was separate and should be zero-rated.

The premises are held by the trustees under a Royal Charter dating from 1608. The internal network of pipes belongs to the trustees. Water is supplied to the trustees by Thames Water and is subject to a metered charge; this is recharged to the individual barristers on an apportioned basis, but this is not based on usage because the internal pipework is not metered. It is instead based on floor area.

HMRC argued that either the supply of water was so closely related that there was a single supply, or else that the supply of water was for the better enjoyment of the land and was therefore ancillary to it. The appellants argued that fiscal neutrality demanded that the supply should be zero-rated: it was an accident of history (and pipework) that the barristers were supplied their water by the Middle Temple, and if it was practicable for them to receive their supplies directly from Thames Water, that would undoubtedly be zero-rated.

As might be expected, the First-Tier Tribunal was referred to a large number of precedent cases. The chairman preferred the appellants' view: water, as a necessity for life, was clearly "an aim in itself", and the supply was not in any way changed by being packaged with the supply of the land. The appeal was allowed.

HMRC appealed to the Upper Tribunal. The hearing was delayed to take account of two UK references to the CJEU (Case C-117/11 *Purple Parking and Airparks Services v HMRC* and Case C-392/11 *Field Fisher Waterhouse LLP v HMRC*); the Upper Tribunal also took note of a further recent case, Case C-224/11 *BGŻ Leasing sp. z o.o. v Dyrektor Izby Skarbowej w Warszawie*.

The judgment considers the reasoning for the FTT's decision, as set out in paragraphs 47 – 55. The Temple's counsel argued that the most important factor was set out in para.51, being the importance of water to human life, which suggested that the supply was "an aim in itself" for the tenants.

The judges disagreed: the most important reasons for the FTT's decision appeared rather to be those based on fiscal neutrality in para.54 and para.55:

54. The fact that two supplies are provided under one contract is not conclusive of a composite supply being made. It is important to consider all factors objectively. In particular, whether the combining of the supplies into one would breach the principle of fiscal neutrality. A supply may be capable of being supplied outside the contract, separately priced and invoiced and its absence from the contract may not significantly *impact on the packaged contractual price being supplied. Such a supply would clearly be a stand alone supply.*

55. Finally, there is a sui generis category, of a supply being made, which due to a historical accident means the supply has to be made or packaged in a certain way. Such a situation is different to where supplies are commercially required to be combined and this, on its own, should not cause a non-taxable supply to become taxable.

HMRC's counsel relied on *Field Fisher Waterhouse* for support in arguing that supplies by a landlord which are for the better enjoyment of the premises are likely to be part of a single supply. Fiscal neutrality was not engaged because the circumstances of a lease inside the Inn were different from those of a lease outside. There was a single supply of "functioning premises" – it was artificial to regard the water and the premises as separate items. The fact that the packaging of the supplies together arose from a historical accident (the construction of the Inn and the ownership of the ancient pipework) was irrelevant.

The Temple's counsel argued that the FTT had come to a decision which it was entitled to reach on the basis of the evidence, and had made no error of law. The supply of water fell squarely within the zero-rating provisions of the law, and it would be artificial to combine it with the completely different supply of premises.

The judges rehearsed the distinction between *Card Protection Plan* (Case C-349/96) and *Levob Verzekeringen and OV Bank* (Case C-41/04). In *CPP*, a composite supply was made up of two elements, but one was ancillary to the other and as a result took on its liability; in *Levob,* one element was so far subsumed in the other that it had no separate identity, and it would be artificial to separate it out.

The judges referred to Case C-44/11 *Finanzamt Frankfurt am Main v-Höchst v Deutsche Bank AG* for guidance on how to identify different elements which form a single economic supply which it would be artificial to split: "*they must, from the point of view of the typical consumer, be equally inseparable and indispensable*."

The CJEU in *Purple Parking* made it clear that the supply of several things together is not the same as the supply of the same things separately. Fiscal neutrality is therefore not particularly relevant in determining whether supplies are covered by the principles of *CPP* or *Levob*. The judges therefore concluded that the FTT was wrong in taking account of the fiscal neutrality argument in reaching its decision.

The judges then examined the CJEU judgments in *Field Fisher Waterhouse* and *BGZ* in some detail, before listing 12 principles derived from CJEU precedent for determining whether supplies are single or divisible:

(1) Every supply must normally be regarded as distinct and independent, although a supply which comprises a single transaction from an economic point of view should not be artificially split.

(2) The essential features or characteristic elements of the transaction must be examined in order to determine whether, from the point of view of a typical consumer, the supplies constitute several distinct principal supplies or a single economic supply.

(3) There is no absolute rule and all the circumstances must be considered in every transaction.

(4) Formally distinct services, which could be supplied separately, must be considered to be a single transaction if they are not independent.

(5) There is a single supply where two or more elements are so closely linked that they form a single, indivisible economic supply which it would be artificial to split.

(6) In order for different elements to form a single economic supply which it would be artificial to split, they must, from the point of view of a typical consumer, be equally inseparable and indispensable.

(7) The fact that, in other circumstances, the different elements can be or are supplied separately by a third party is irrelevant.

(8) There is also a single supply where one or more elements are to be regarded as constituting the principal services, while one or more elements are to be regarded as ancillary services which share the tax treatment of the principal element.

(9) A service must be regarded as ancillary if it does not constitute for the customer an aim in itself, but is a means of better enjoying the principal service supplied.

(10) The ability of the customer to choose whether or not to be supplied with an element is an important factor in determining whether there is a single supply or several independent supplies, although it is not decisive, and there must be a genuine freedom to choose which reflects the economic reality of the arrangements between the parties.

(11) Separate invoicing and pricing, if it reflects the interests of the parties, support the view that the elements are independent supplies, without being decisive.

(12) A single supply consisting of several elements is not automatically similar to the supply of those elements separately and so different tax treatment does not necessarily offend the principle of fiscal neutrality.

The key difference between *Field Fisher Waterhouse* and *Tellmer/BGZ* was that in FFW the tenants had no choice about who provided the extra services. That meant that it was much more likely that there was a single supply. That was also the case in Middle Temple.

The judges did not interfere with the finding that the supply of water was "an aim in itself". However, they did not consider this to rule out a "*Levob* conclusion". That was the conclusion that the Upper Tribunal drew: "*that the premises and the water are inseparable and indispensable that those elements must be considered to be so closely linked that they form, objectively, a single indivisible economic supply which it would be artificial to split. That supply is a single supply of the leasing of immovable property which is chargeable to VAT by virtue of the Middle Temple's option to tax.*" HMRC's appeal was allowed.

Upper Tribunal: *HMRC v The Honourable Society of Middle Temple*

3.1.2 Manual online

HMRC have added the *VAT Land and Property* (VATLP) Manual to its main online set of guidance manuals.

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

3.1.3 Updated Notice

HMRC have issued an updated Notice *Hotels and holiday accommodation*, replacing the October 2011 version. The main change is in paragraph 4.2 which has been revised to reflect HMRC's current policy regarding accommodation and catering supplied to employees:

If you supply your employees with accommodation or food and drink, in your establishment and they pay for it, the payments are treated as including VAT and you must account for it on your VAT return.

Where employees pay for meals and so on from their pay including under a salary sacrifice arrangement employers must account for VAT from 1 January 2012 on such supplies unless they are zero-rated. Subject to the normal rules, the employer can continue to recover the VAT incurred on related purchases.

Notice 709/3

3.2 Option to tax

3.2.1 Option notified?

A dispute arose between a company and HMRC over the scope of an option to tax made by the company and notified to HMRC. The company was an investment fund set up to acquire some land which was let out to a number of businesses.

In January 2007, the company notified HMRC that it was acquiring a trading business as a going concern. In the event, it acquired the land in June 2007, and at that time applied for registration to be backdated to January. It had also notified HMRC's option to tax unit in January 2007 that it had opted to tax the site it was acquiring, giving the Land Registry title number. This title covered an extensive area, including some open land and 8 buildings.

During the negotiations for the purchase of the site, the company had tried to clarify the scope of the vendor's option to tax. HMRC's OTT unit in Glasgow was unable to confirm this to the vendor. It was the purchaser's intention to opt only those areas that were already opted, in order to preserve TOGC treatment, and so to continue to make exempt supplies where no option was in place. This was believed to apply to some warehouses. Letters were exchanged between the company and the OTT unit in which the company tried to clarify what it wished to opt.

The company made a large repayment claim in its return for March 2011. On a visit to verify this, an officer realised that no partial exemption calculations were being prepared; the company's employees did not appear to understand the difference between exemption and zero-rating. The officer raised an assessment for over £200,000. The company responded with calculations which showed that the de minimis limits applied in all periods.

It appeared that the company's letter, in which it clarified what it thought was covered by the option, had not arrived or had been lost by the OTT unit. The letter from the OTT unit which confirmed that an option was in place had arrived after the company's letter was sent, so the directors assumed that it was a reply; but the two letters did not relate to each other. As far as HMRC were concerned, the whole site had been opted, including the buildings which the company believed were excluded.

Sadly, the employee of the company who had dealt with the matter at the time had died, so evidence had to be gathered from others with less involvement.

HMRC argued that the original letter sent in January 2007 was a valid option over all the land included in the Land Registry title; if it had been sent (which HMRC did not accept), the letter of February 2007 was an attempt to revoke part of the option, and even if it was sent within 30 days of the first letter, it was not valid. The absence of partial exemption calculations suggested to HMRC that the company had treated the whole site as taxable.

The Tribunal was satisfied that the clarifying letter was sent. It had probably been lost either by the Royal Mail or at the OTT unit, which HMRC had accepted was having difficulty coping with its workload at the time. The letters coming back from HMRC in March and April 2007 could reasonably be understood by the company as having taken its clarification by letter and phone call into account, and there was no reason for the company to have questioned these letters or asked for further clarifications.

The Tribunal was further satisfied that the intention of the company was always only to opt the land that it claimed was opted. The original letter was ambiguous, but it was only a notification of the company's decision; it was the decision that mattered in relation to the option to tax.

Even if the February letter was not truly evidence of the original intention in January, it would still constitute a valid revocation of the January option within 30 days, and a replacement of that option with the more restricted version that the company wanted.

The appeal was allowed, and HMRC were directed to give effect to the option in the form the company claimed it had been exercised.

First-Tier Tribunal (TC02632): *Exeter Estates Ltd*

3.2.2 Updated Notice

HMRC have issued an updated Notice *Opting to tax land and buildings*, replacing the June 2010 version and also Information Sheets 06/09, 14/09, 02/10 and 08/10, which are all now incorporated in the Notice. The 'what's changed?' section only lists two very minor corrections, one of which relates to the formatting of bullet points.

Notice 742A

3.3 Developers and builders

3.3.1 Zero-rating conditions

The FTT has disagreed with HMRC's interpretation of the conditions for zero-rating the sale of converting partially-residential property, as set out in Note 9 Group 5 Sch.8 VATA 1994 and considered in the cases of *Jacobs* (CA 2005) and *Calam Vale* (VTD 16,869). Note 9 states:

"*The conversion … of a non-residential part of a building which already contains a residential part is not included within items 1(b) or 3 unless the result of that conversion is to create an additional dwelling or dwellings.*"

The appellant converted a pub into two semi-detached houses. There was previously a flat, occupied by the manager, in the property; parts of that flat were incorporated in each of the new houses. According to HMRC, that meant that the sales could only be exempt. This view had been supported by the Tribunal in *Calam Vale*, although the chairman had expressed his dissatisfaction with the result: it appeared to him that a conversion into upstairs and downstairs flats would be half zero-rated (because the downstairs would have been wholly non-residential before), but a conversion into two-storey semi-detached houses would be wholly exempt, and he thought that was absurd.

The *Jacobs* case concerned a DIY refund claim where an individual converted a building that had previously been a school (with residential parts) into a large dwelling for his own use and three flats. The Court of Appeal held that it was not fatal to a DIY claim that part of the resulting new dwelling was created from a formerly residential part of the building; a DIY claim could not be made unless a new dwelling was created, and a DIY claim could not succeed in relation to the conversion costs of incorporating the previously residential part into the new dwelling, but the claim succeeded in relation to the conversion of the non-residential part into the new dwelling. HMRC changed their policy in relation to DIY claims following that decision. However, as they stated in Business Brief 22/05, they did not believe that it was relevant to the conversion and sale of a property under Group 5 Sch.8.

The Tribunal could not see any obvious reason for drawing a distinction between s.30/Sch.8 and s.35. The conditions, and the underlying reasons for them, were interlinked. The judge concluded that Ward LJ's analysis of Note 9 in *Jacobs* was directly relevant to the current case. This was:

"*In my judgment note (9) has to be construed so that the result of the conversion is to create in the building an additional dwelling or dwellings. One counts the number of dwellings in the building before conversion and again after conversion. If there are more on the recount, note (9) is satisfied. If that is so then Mr Jacobs is entitled to his refund and the commissioners' appeal must be dismissed.*"

The Tribunal also commented on the fact that this overturned HMRC policy in this area:

"We appreciate that this conclusion is contrary to the decision in Calam Vale (which drives HMRC's current policy on this issue) but:

(a) that case, as a decision of the VAT Tribunal, is not strictly binding on this Tribunal;

(b) the VAT Tribunal's views on Note 9 were obiter and on a point expressly not argued by the appellant;

(c) the VAT Tribunal was clearly, and vocally, unhappy at the "absurd" view it felt it was forced to take;

(d) in our opinion, the VAT Tribunal would have reached a different view if it had had the benefit of Ward LJ's analysis of Note 9 (as we have); and

(e) Calam Vale was not cited to the Court of Appeal (nor, so far as we can see, to the VAT Tribunal or the High Court) in Jacobs and so their Lordships did not have an opportunity to comment on the earlier decision."

Lastly, the Tribunal criticised the internal review decision issued by HMRC in this case, which said "I have upheld the Officer's initial decision" without giving any reasons or more detailed explanation. HMRC apologised for the brevity of the letter; the judge stated that "*taxpayer confidence in the statutory system of HMRC internal reviews – most of which, in our experience, are conscientiously and carefully drafted – requires better performance than in the current case*."

First-Tier Tribunal (TC02751): *Alexandra Countryside Investments Ltd*

3.4 Input tax claims on land

3.4.1 No relief for VAT wrongly charged

An individual carried out a DIY construction project on land adjoining his garage business. He submitted a s.35 claim, which included £1,400 of VAT charged for the supply and fitting of four windows and a door. HMRC refused the claim on the basis that these supplies should have been zero-rated by the suppliers.

The Tribunal examined the invoices and concluded that HMRC were right, even if the result was harsh on the appellant. Whether the supply was "mixed labour and goods" or a single indivisible supply of "fitted windows", in either case it was properly zero-rated under Sch.8 Group 5 items 2 and 4.

The claim was made in late 2011, but the invoice was dated 2006. It was therefore unlikely that the building company would agree to repay the VAT wrongly charged, as it was out of time to recover it from HMRC. The length of time between the work and the claim is not commented on in the decision.

First-Tier Tribunal (TC02676): *Paul Charles Hunt*

3.4.2 More planning conditions

In another of a long line of recent cases, a taxpayer has been denied a DIY builders' claim because the planning consent required that the property should only be occupied by the manager or proprietor of a holiday accommodation business to be operated from adjacent barns. The conversion of the other barns was not proceeded with, and HMRC refused the claim on alternative grounds:

- the VAT was incurred in the course of a holiday accommodation business that was to be carried on, ruling out a DIY claim; or
- the planning consent restriction meant that there was a prohibition on separate use or disposal of the property.

The appellant claimed to have only had a vague intention to set up a business and derive income from the other barns. She did not have the resources to develop all the properties at once, and therefore was somewhat surprised by the planning conditions. The Tribunal concluded that she was not carrying on a business.

The Tribunal expressed concerned that the work was effectively in breach of the planning conditions: because without a holiday accommodation business, there could be no lawful occupation of the property. The appellant did not appear to be concerned about this, but the judge noted that enforcement action was a possibility that she should not ignore.

However, he came to his decision ignoring any possible future enforcement action or changes to the conditions which she might persuade the council to make. The relevant time was no later than the completion of the work on which the DIY claim was made; at that time, the condition existed. The judge examined the string of recent cases, including what he called "the successful appeals" (*Phillips*, *Wendels* and *Burton*) and the "unsuccessful appeals". He noted that the Tribunals in the "successful appeals" had held that an occupancy restriction was not in itself a restriction on separate use of the property. He could not agree with that. In his view, occupation and use were essentially the same; if the property could not be occupied except by a person linked with the other buildings, it could not be used at all.

He expressed the hope that the Upper Tribunal will hear an appeal in one of those cases (it is rumoured that *Burton* has been appealed by HMRC) and will settle the law in this area.

First-Tier Tribunal (TC02719): *Lesley Swain*

A project to convert a semi-derelict barn was carried out in two phases. The first planning consent, granted in 1997, referred to the provision of holiday accommodation. The work was not completed and the building remained uninhabitable. A new planning consent was granted in 2007 to permit the change of use to a "live/work unit".

The judge (Colin Bishopp) considered that the basic conditions of s.35 were satisfied: the appellant had started with a non-residential property and had converted it into a dwelling. He did not believe that the condition in relation to the live/work unit was a problem, even though it said "*The residential accommodation of the live-work unit hereby permitted shall not be occupied by any persons other than those occupying the work element of the live-work unit*." In the earlier case of *Kear*, the consent had been much more specific about which parts of the building were to be used for each purpose; here, there were no such clear requirements.

The judge did not consider that note 2(d) (compliance with planning conditions) was engaged: although there might have been some minor breaches of the letter of the consent, he did not believe that it was the role of HMRC or the Tribunal to police the planning laws. In the absence of any evidence that the planning authority was concerned about the breaches, and in the light of the appellant's compliance with what appeared to be the spirit of the consent, the judge was prepared to accept that the development was lawful.

HMRC relied on note 2(c) and the earlier case of *Holden*, in which a live/work unit was held to contravene the requirement for "no prohibition on separate use" because the occupant of the residential part had also to be the person using the work unit. The judge distinguished this case on the grounds that there was no demarcation in the plans or in the resulting building between the two areas. The building was in effect a house in which someone would work from home; it was not possible to separate out two parts of the building and regard one as residential and the other as not so. Accordingly, there could be no "separate use or disposal" – there was only one property – so separate use or disposal could not be prohibited. The appeal was allowed.

First-Tier Tribunal (TC02735): *Henrietta Pearson*

A couple bought a cottage that had been used as part of a care home. It was in a poor condition and had lain empty for 2 years. They renovated it and submitted a DIY claim, which HMRC refused.

The claim could only succeed if the building had been "non-residential" for the preceding 10 years. It had clearly been in use for a relevant residential purpose within that time, and the appeal failed.

The judge went through each of the possible ways in which the claim could succeed and dismissed them one by one, including the possible argument that this cottage included a non-residential part and an additional dwelling was created by the conversion of it and the adjoining property into two cottages (Note 9, as considered in 3.3.1 above); however, there was no non-residential part. Those areas which were only used by the staff of the care home were nevertheless still in relevant residential use.

First-Tier Tribunal (TC02737): *Andrew and Trudy Boakes*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 Exchange rates

HMRC have published the usual table of exchange rates for those registered under the special scheme for e-traders for the quarter to March 2013.

VAT Information Sheet 5/2013

4.2 Where is a supply of services?

4.2.1 Cross-border storage facilities

The CJEU has upheld the opinion of the Advocate-General in the case about storage facilities referred by the Polish courts.

The appellant company provides services for the storage of goods to undertakings established in other Member States of the European Union and in non-member States. Those services include admitting the goods to the warehouse, placing the goods on storage shelves, storing the goods, packaging the goods for the customer, issuing the goods, unloading and loading. The service may also include repackaging materials supplied in collective packaging into individual sets.

The Polish authorities took the view that this was a supply connected with immovable property and would therefore be taxable in Poland. The company appealed, contending that it was a standard business-to-business supply which would be subject to VAT where the customer belonged. Questions were referred by the Polish courts to the CJEU.

Advocate-General Kokott considered first whether there was a single supply or a series of independent individual supplies. She considered that this was primarily a question for the referring court; however, it seemed compelling that the warehousing of goods was a principal supply to which the various other aspects would be ancillary, with the possible exception of repackaging goods if that was not simply to achieve a better storage solution. The full court has agreed with this conclusion: the principal supply is storage, and all the other aspects (apart from repackaging) are ancillary to that.

The Advocate-General went on to discuss whether there was a "sufficiently direct link" between the immovable property and the services to satisfy the requirements of art.9(2)(a) 6th Directive/art.47 PVD. It would not be enough for there to be a requirement that the services were supplied in a particular place – that would be common for supplies of services which would be carried out in the business premises of the supplier. Rather, "specifically determined immovable property must also be the subject-matter of the service, that is to say, the immovable property is the object of the supply."

Again, the full court agreed with this opinion. The principles of determining what constitutes a land supply are explained as follows:

35 However, in so far as a large number of services are connected in one way or another with immovable property, it is, in addition, necessary that the supply of services should relate to the immovable property itself. That is the case, inter alia, where expressly specific immovable property must be considered to be a constituent element of a supply of services, in that it constitutes a central and essential element thereof (see, to that effect, Heger, paragraph 25).

36 It is clear that the supplies of services listed in Article 47 of the VAT Directive, which concern the use or the development of immovable property, or the management, including the operation and evaluation, of such property, are characterised by the fact that the immovable property itself constitutes the subject matter of the service.

The court's answer to the question referred is:

Article 47 [PVD] must be interpreted as meaning that the supply of a complex storage service, comprising admission of goods to a warehouse, placing them on the appropriate storage shelves, storing them, packaging them, issuing them, unloading and loading them, comes within the scope of that article only if the storage constitutes the principal service of a single transaction and only if the recipients of that service are given a right to use all or part of expressly specific immovable property.

CJEU (Case C-155/12): *Minister Finansów v RR Donnelley Global Turnkey Solutions Poland Sp. z o.o.*

4.3 International supplies of goods

4.3.1 Replacement cardigan

An individual purchased a cardigan for his wife while on a business trip to Hong Kong. It was below the threshold at which import duty and VAT is payable on goods imported in hand luggage. However, it proved to be the wrong size, so the individual mailed it back to the supplier and received a replacement by post. This was intercepted by the UK Border Agency, which ruled that import duty of £28.01 and VAT of £52.29 were due. The individual paid the tax but asked for repayment, appealing against the refusal.

Although he said he was content to have the matter determined by a "paper hearing", HMRC insisted on an oral hearing and instructed counsel. The Tribunal judge agreed that this involved the appellant in disproportionate expense and trouble, but the rules were clear: a paper hearing was only possible if both parties agreed.

The judge examined the facts and the law and agreed with HMRC that there was no relief which assisted the appellant. He had imported two different items under two different regimes; had the original cardigan been faulty he might have qualified for replacement goods relief, but it was not. The duty and tax were properly due.

First-Tier Tribunal (TC02647): *William Abraham*

4.3.2 Indirect exports

The March Budget included an announcement that the UK will amend its law to permit zero-rating of indirect exports, where goods are supplied to a customer established outside the UK for onward export outside the EU, and the customer is registered for VAT in the UK. The UK currently does not permit zero-rating in this circumstance, in contravention of EU law, which allows zero-rating for such indirect exports, whether or not the customer is registered in the supplier's country for VAT, provided that customer has no business establishment there.

The changes will take effect from 1 October 2013, although businesses may zero-rate affected supplies in the meantime. A consultation document was published in May, requiring responses by 5 July. The consultation includes draft legislation in the form of a statutory instrument.

www.gov.uk/government/consultations/changes-to-vat-zero-rating-of-exports-from-the-uk

4.3.3 Updated Notice

HMRC have issued an updated version of their Notice *The Single Market*, replacing the October 2012 version. The main changes are the inclusion of Croatian VAT registration numbers with effect from 1 July 2013, and changes to Irish registration numbers.

Notice 725

4.3.4 Isle of Man

HMRC have added the VAT Isle of Man (VIOM) Manual to the online guidance manuals.

UK VAT law does not apply in the Isle of Man, but VAT is instead collected under the Value Added Tax Act 1996 (of Tynwald). The Customs and Excise Agreement 1979 between the UK and IOM governments maintains a customs union and common indirect tax area and is implemented in the UK by the Isle of Man Act 1979.

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

4.3.5 Notification of vehicle arrivals

HMRC have issued an Information Sheet to give guidance on the online Notification of Vehicle Arrivals (NOVA) system. It has been updated to include transitional arrangements for imported vehicles bought from a UK supplier before 15 April 2013, and information on vehicles brought to the UK in parts.

The system was introduced on 15 April 2013 to tackle VAT evasion on vehicles brought to the UK. It is explained as follows in the Information Sheet:

Before the introduction of NOVA, as part of its licence and registration procedures, the DVLA requested evidence to show that the VAT had been paid or would be accounted for. Without such evidence, the DVLA was entitled to refuse an application. However, the absence of real-time information about vehicles brought into the UK, especially in respect of *vehicles arriving from other EU Member States, has been exploited by fraudsters, who were able to present the paper forms to the DVLA before the VAT had been secured by HMRC. This resulted in significant amounts of revenue due to the Exchequer being lost, as well as undercutting legitimate trade.*

VAT Information Sheet 6/2013

4.3.6 Consultation

HMRC are carrying on a consultation on the VAT Retail Export Scheme ("tax-free shopping") under which non-EU visitors to the UK can reclaim the VAT they have paid on goods they take with them when they leave. The document outlines a number of areas in which the government believes that the scheme might be improved, and seeks comments which will improve the experience of users while protecting the revenue.

www.gov.uk/government/consultations/vat-retail-export-scheme

4.4 European rules

4.4.1 ECOFIN: tax avoidance and evasion

At the meeting of ECOFIN on 14 May, the European Council adopted a number of recommendations on a multilateral approach to tax evasion and aggressive avoidance, whilst qualifying these with a note about their non-binding nature and the EU principle of subsidiarity in relation to tax matters. VAT is only mentioned in passing, with a reference to efforts made by Council preparatory bodies and the Irish presidency to clamp down on VAT fraud. Much of the document is concerned with aggressive direct tax planning.

Meanwhile, a House of Lords committee has issued a report on fraud on the EU's finances, concluding that not enough is being done by the government to stem the losses. VAT fraud in the UK was still estimated to be running at £1bn in the last year, with smaller losses to fraud against EU agricultural and cohesion policy programmes.

www.parliament.uk/documents/lords-committees/eu-sub-com-e/combatingfraud/FRAUDVoloralandwrittenevidence%28FINAL%29.pdf

4.4.2 International rulings

A group of 13 EU member states, including the UK, are to participate in a pilot for private VAT ruling requests involving complex cross-border cases, between 1 June and 31 December 2013. The other states are Belgium, Estonia, Spain, France, Cyprus, Lithuania, Latvia, Malta, Hungary, Netherlands, Portugal, and Slovenia.

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

Such requests should generally be accompanied by a translation into the official language of the other Member State(s) concerned (although English is accepted in all 13 states).

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

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

4.4.3 Correction of errors

A Bulgarian company sold a property. It regarded most of the transaction as exempt, but charged VAT on the cost of renovations, purchase tax and stamp duty. The tax authority refused the purchaser a VAT deduction, ruling that the whole transaction was exempt. The vendor therefore applied for a refund, but this was also refused, on the grounds that the company had entered the VAT on an invoice and was therefore liable to pay it. It seems that the vendor had failed to follow the correct procedure in Bulgarian law for correcting an error (which required cancellation and replacement of the original invoices), and now sought to rely on EU legal principles to insist that it was entitled to a refund just on the basis that the authority had denied a deduction to its customer.

The CJEU affirmed the right of a member state to collect VAT which a vendor showed on an invoice, regardless of whether there was an underlying VATable transaction. That was provided for by art.203 PVD. However, where the tax authority had definitively refused a deduction to the customer on the grounds that the transaction was exempt from VAT, it could not also refuse a refund to the company which had erroneously charged VAT. That would offend against the principles of fiscal neutrality.

The company was able to rely on the Directive to enforce its right to a repayment.

CJEU (Case C-138/12): *Rusedespred OOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' - gr. Varna pri Tsentralno Upravlenie na Natsionalnata Agentsia za Prihodite*

4.4.4 Intra-group charges

A group of companies in Belgium was refused a deduction of input tax on intra-group charges on the basis that the invoices were incomplete. They were supposed to represent supplies of staff, but the details of the hours worked and unit prices were not shown. Further information was provided by the group to show that the supplies had taken place, but the authorities refused to accept this information. Questions were referred to the CJEU to establish whether the principle of fiscal neutrality required that the VAT should be deductible, or whether the refusal of deduction to one company required the authorities to refund output tax to the corresponding supplier.

The court ruled that the exercise of the right of deduction should not be made excessively difficult or impossible by imposing overly stringent conditions on invoices, but the Belgian rules were not contrary to the Directive.

The charge to output tax arose on the supply of goods or services for consideration. Where it was established that there had been a taxable supply, output tax was due. The principle of fiscal neutrality did not prevent a member state from refusing to refund VAT that had been properly charged, simply because deduction had been refused to the purchaser of the services.

CJEU (Case C-271/12): *Petroma Transport SA and others v Belgium*

4.4.5 Tax point rules in Poland

The CJEU had to consider the rules for fixing tax points in Polish law. These provided for liability to pay output tax to be fixed on receipt of payment, but not later than 30 days after the supply of the service. A company sought a ruling that it was entitled to account for VAT in the period in which it raised invoices, regardless of the 30 day rule.

The court considered the options available to member states under art.66 PVD, and decided that Polish law had wrongly combined two of them. It was possible to set the tax point no later than the time at which the invoice is issued or the payment is received (as the UK does); it is also possible to have rules which fix the tax point within a specified period from the date of the chargeable event, where an invoice is not issued, or is issued late. However, it is not possible to fix the tax point within a specified period (the 30 day rule) where an invoice is issued, as was the case in the present dispute.

CJEU (Case C-169/12): *TNT Express Worldwide (Poland) Sp. z o.o. v Minister Finansów*

4.4.6 Subsidised expenditure

A Hungarian company received grant aid in respect of a project. Under Hungarian rules, it was not allowed to deduct all of its input tax in relation to such a subsidised activity; accordingly, it restricted its claims, but later applied for a refund of the tax (which it said it would hand on to the grant-paying organisation which had provided the money in the first place). The authorities refused to refund the VAT on the grounds that the project had been financed by the state. Questions were referred to the CJEU.

The court ruled that, in accordance with precedent, input tax should be deductible on subsidised expenditure – it was only exempt income that restricted the right to deduct. In principle, therefore, the refusal of repayment represented tax levied in breach of EU law, which normally would give the taxpayer a right to a refund. However, the court ruled that the state was not precluded from refusing repayment, provided that the economic burden relating to the refusal to deduct VAT had been completely neutralised, which was for the national court to determine. This is an unusual application of the principle of unjust enrichment to input tax.

CJEU (Case C-191/12): *Alakor Gabonatermelő és Forgalmazó Kft. v Nemzeti Adó- és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága*

4.4.7 Fine for error

A Bulgarian taxpayer claimed input tax on an invoice that should not have been raised. This was corrected by the issue of a 'memorandum' (apparently equivalent to a credit note) a year later, and the VAT was paid with interest. The authorities then levied a fine for an "administrative offence", which appears to have consisted in failing to make the appropriate correction within 12 return periods of the original claim (the input tax was reversed in December 2010, after the original deduction was made in October 2009). The amount was 100% of the VAT. The company appealed, and questions were referred to the CJEU.

The court ruled that the levying of penalties for failing to follow the rules did not contravene the Directive. The PVD has no rules about penalties; it is then settled case law that member states have discretion to impose such measures as seem appropriate to them to enforce compliance with the law, subject to the overall principles of EU law.

A penalty of 100% of the VAT was not in itself excessive; however, it would be for the national court to determine whether it was excessive in the circumstances. It could be disproportionate to the offence if it went beyond what was necessary to attain the objectives of ensuring the correct collection of tax and preventing evasion, having regard to the period within which the irregularity had been rectified, the seriousness of that irregularity, and the presence of any evasion or any circumvention of the applicable legislation that was attributable to the taxable person. Late payment of VAT could not, in itself, be equated to VAT evasion.

CJEU (Case C-259/12): *Teritorialna direktsia na Natsionalnata agentsia za prihodite – Plovdiv v Rodopi-M 91 OOD*

4.4.8 Reverse charges

The PVD allows member states to make the recipient of a supply liable for the VAT on that supply in certain circumstances. Spanish law provides that this applies where immoveable property is sold as a result of insolvency proceedings.

In the instant case, a Spanish company was placed into insolvency, and two properties were sold. The winding-up was still in a "voluntary" phase; the PVD refers to the reverse charge applying to "*the supply of immovable property sold by a judgment debtor in a compulsory sale procedure*" (art.199), which did not appear to describe the present arrangements. Questions were referred to determine whether the Spanish law, which imposed a reverse charge on the recipient in these circumstances, was in compliance with the Directive.

The court considered that the purpose of the reverse charge mechanism here was to provide for the collection of VAT in a circumstance where the supplier's ability to pay that VAT was in question. Accordingly, it was in accordance with the purpose of the provision to apply it to all sales made in the course of insolvency proceedings, not just to judgment debts.

CJEU (Case C-125/12): *Promociones y Construcciones BJ 200, S.L. y otros*

4.4.9 Disbursements?

In Portugal, television advertising is subject to a 'screening tax' which is charged to advertisers but paid to the state by television producers. The question is then whether it is included in the taxable amount for the services that the producers provide to the advertisers, or is a disbursement 'paid in the name and on behalf of' the purchaser, and excluded under art.78 PVD.

Advocate-General Cruz Villalon has given an opinion that the question depends on whether the taxpayer is the advertiser or the producer. This is expressed as depending on whether the fiscal relationship of a public law character is between the fiscal substitute (the producer) and the state, or whether it is between the advertiser and the state. This might depend, for example, on whether the state can claim the tax directly from the advertiser in certain circumstances.

It was not possible to determine categorically what the correct relationship was on the basis of the information provided. However, it appeared more likely that the producer was liable for the tax. It was charged on the dissemination of the advertisement, which was something the producer did for consideration paid by the advertiser. The A-G recommended that the court should give general guidance on the interpretation of the expression 'in the name and on behalf of' in the Directive.

CJEU (A-G) (Case C-618/11): *TVI Televisão Independente SA v Fazenda Pública*

4.4.10 Fraudulent supplies

The Polish court has referred questions about whether the use of another trader's identity, to conceal the real supplier's economic activity, meant that the supplies concerned were not properly regarded as supplies of goods, and the consequences of such an arrangement for output tax and input tax.

CJEU (Reference) (Case C-33/13): *Marcin Jagiełło v Dyrektor Izby Skarbowej w Łodzi*

4.4.11 Building for local authority

The Netherlands court has referred a question about the treatment of a building which a local authority has had constructed on its own land and taken first occupation of, where it will be used 94% for its purposes as a public authority, 5% for taxable business activities and 1% for exempt business activities without the right of deduction.

CJEU (Reference) (Case C-92/13): *Gemeente's-Hertogenbosch v Staatssecretaris van Financiën*

4.4.12 Transfers of land by public authorities

The Polish court has referred questions about the VAT consequences of transfers of immovable and movable property by municipalities to commercial companies, where the property was acquired by operation of law or without consideration, in particular by inheritance or gift.

CJEU (Reference) (Case C-72/13): *Gmina Wrocław v Minister Finansów*

4.4.13 Payments in advance

The Bulgarian court has referred questions about the consequences of the failure to make a supply for which a payment on account has been made, and on which payment input tax was properly deducted at the time. In the UK, the answer is clear: the purchaser has no right to deduct input tax unless a supply is received, so the deduction must be reversed.

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

4.4.14 Fraud – laws or principles?

The Dutch court has referred questions on whether the tax authorities can refuse deductions of input tax on general EU principles concerning VAT fraud (presumably the *Kittel* decision) if the member state has not imposed specific rules implementing those principles.

CJEU (Reference) (Case C-131/13): *Staatssecretaris van Financiën, other party: Schoenimport 'Italmoda' Mariano Previti*; (Case C-163/13): *Turbo.com BV*; (Case C-164/13): *Turbo.com Mobile Phones BV*

4.4.15 Dentists

Dutch law exempted supplies of dental prostheses by anyone, not just dentists and dental technicians, until 2008. Questions have been referred by the Dutch court to establish whether someone who should not have qualified for exemption under the Directive, but was treated as exempt under Dutch law, can rely on the Directive and claim input tax deduction. Further questions deal with the treatment of cross-border supplies in dental prostheses, which presumably were treated as not subject to acquisition tax in the Netherlands during the period concerned.

Similar questions have been referred in two other cases.

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

4.4.16 Acquisition of client base

The German court has referred questions about the ability of a tax adviser to deduct input tax charged on the acquisition of a proportion of the client base of a dissolved partnership. The court may consider whether such an acquisition might in any case constitute a TOGC.

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

4.5 Eighth Directive reclaims

Nothing to report.

5. INPUTS

5.1 Economic activity

5.1.1 Abuse of rights?

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

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

The effect of this was that the advertising was treated as supplied outside the EU and was therefore outside the scope of UK VAT. The sub-contracted work was also a financial service supplied to a person belonging outside the EU, so it would have been outside the scope with recovery of input tax. The licensing of the trading name (for commissions of 50% and later 60% of the gross revenue on loan business written) was supplied where received under Sch.5 VATA 1994, and therefore outside the scope of VAT.

HMRC argued that the loan broking business was in reality still carried on by the UK individual, and therefore the advertising services were received by him. According to the CJEU judgment, "*In practice, potential borrowers contacted directly Mr Newey's employees in the United Kingdom who processed each file and sent the applications which satisfied the credit eligibility criteria to Jersey to Alabaster's directors for authorisation. The approval process generally took around one hour to complete and, in fact, no request for authorisation was refused.*" As a result, there should be a reverse charge, which would be irrecoverable because it was being used for exempt supplies (the assessment was for more than £10m).

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

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

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

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

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

paragraphs 74 to 86 of the Judgment in Case C-255/02 Halifax Plc and others v CCE?

6. *If the answer to question 5 is yes, how should arrangements such as those in the present case be recharacterised?*

The CJEU referred to Cases C-53/09 and C-55/09, *Loyalty Management UK* and *Baxi Group*, as authority for the importance of considering the economic and commercial realities in applying the common system of VAT. "*Given that the contractual position normally reflects the economic and commercial reality of the transactions, and in order to satisfy the requirements of legal certainty, the relevant contractual terms constitute a factor to be taken into consideration when the supplier and the recipient in a 'supply of services' ... have to be identified.*"

However, the contractual terms should not be followed if they constitute a "purely artificial arrangement" which does not correspond with the economic and commercial reality of the transactions. It is for the referring court to decide whether this is the case, but the CJEU implies that the decision could depend on whether the relationship between the owner, the Jersey company, the lenders and the advertising agency, suggested that the advertising services were in reality "used and enjoyed" by the owner in the UK, rather than by the Jersey company outside the EU.

The CJEU does not spell out who should win. It is interesting that its comment on the fifth and sixth questions is:

"*In view of the answer given to the first to fourth questions, there is no need to reply to the fifth and sixth questions referred by the referring court.*"

That suggests that the answer to question 4 is "yes", but no method of recharacterisation is spelled out. It may be necessary to wait for the Upper Tribunal's reconsideration of the matter to see exactly what this judgment means.

CJEU (Case C-653/11): *HMRC v Paul Newey t/a Ocean Finance*

5.1.2 Article

In an article in *Taxation*, Neil Warren examines the scope for reclaiming input tax where costs are incurred in relation to activities which generate income which is outside the scope of VAT, for example for selling services abroad.

Taxation, 2 May 2013

5.1.3 Home electricity production

Questions were referred by the Austrian court about the possible VAT liability of a householder who installs solar panels on his house. The Advocate-General gave an opinion that this is economic activity – and therefore capable of input tax deduction and a liability to output tax, subject to local rules on registration – where the electricity generated is sold to the national grid for consideration. It did not matter that over the period in question the individual had consumed 44,000 kWh and only produced 19,000 kWh.

The Advocate-General suggested that there is an important difference between a situation in which a householder installs solar panels which only reduce electricity bills (not an economic activity) and one who does so in order to generate income by selling surplus electricity to the grid, whether that is achieved by selling all the electricity and buying back what is needed, or by selling only the surplus at any particular time, and topping up a shortfall by buying electricity from the grid. The second situation is subject to all the rights and obligations of a taxable person in the member state concerned.

The opinion went on to consider the effect of the private consumption on the right to deduct input tax – the Advocate-General points out that the expenditure was incurred in 2005, before the introduction of art.168a which allows member states to make adjustments to input tax on capital goods dependent on the extent of business and private use. It seems that the *Lennartz* approach would have been appropriate in 2005 – full deduction followed by output tax charges to reflect private consumption.

Lastly, the opinion considered the relevance of a substantial grant which was paid to the individual. Precedent case law on grants suggested that this should be ignored in determining the right to deduct input tax.

The full court has come down even more strongly in favour of the householder's right to deduct input tax. It noted that the householder was entitled to receive income from the sale of electricity to the grid, regardless of the profitability of the operation, and the contract was of indefinite duration. This had all the hallmarks of economic activity. The only condition was that the purpose of the activity was to generate income on a continuing basis. The generation of electricity in return for consideration, and the consumption of electricity in return for payment, were separate and independent activities.

The court's judgment does not refer to the issue about the grant, but only makes it clear that input tax is deductible on the cost of the installation.

CJEU (Case C-219/12): *Finanzamt Freistadt Rohrbach Urfahr v Unabhangiger Finanzsenat Außenstelle Linz*

5.2 Who receives the supply?

5.2.1 Avoidance scheme fails

The Supreme Court has finally determined the outcome of the "offshore loop" scheme in the *WHA* case. The essential purpose of the scheme was to increase VAT recovery in relation to repairs carried out by UK garages for UK customers under insured warranties. Without the planning, the supply of the repairs would be made to a UK insurer who would not be able to recover any of it (in spite of usually having to charge 17.5% IPT on the warranty itself).

The scheme worked in outline as follows:

- the UK insurer reinsured its risk 100% with a Gibraltar insurer;
- that Gibraltar insurer reinsured most of its risk with another Gibraltar insurer;
- a UK company, connected with the two Gibraltar insurers but not with the UK insurer, then acted to meet the Gibraltar insurers' obligations under the insurance contracts, paying for the supplies of repairs by the garages;
- the first way in which the scheme might succeed was that the UK company could claim input tax on the repairs because the supply it made to the first Gibraltar insurer was an insurance-related supply and was therefore exempt as an output but giving rise to input tax recovery under the Specified Supplies Order (SI 1999/3121);
- the second way in which the scheme might succeed was that the UK company would have to charge VAT on its supplies to the first Gibraltar insurer, but that company could make a 13th Directive reclaim in respect of its onward supplies to the second Gibraltar insurer.

The Court of Appeal held in 2004 that the "first way" did not succeed – the supply by the UK company to the first Gibraltar insurer was not an "exempt with credit" supply. However, the 13th Directive claim would succeed unless it turned out – once the CJEU had heard the *Halifax* case – that it was an abuse of rights.

The Court of Appeal considered that question in 2007 and decided it briefly in favour of HMRC. It was clear that in the "normal" situation, there would be no recovery of input tax by an insurer paying for warranty repairs. That had to be taken to be the "purpose" of the VAT Directive in this area. Further, it was clear that the sole purpose of the arrangements was to circumvent that purpose: the chain of companies and supplies were involved for no other reason. The arrangements were artificial and abusive, and the claim to input tax would therefore be disallowed.

The Supreme Court has heard an appeal by the UK company and the first Gibraltar insurer. It concluded that, on the true construction of the contractual relationships, the garages made supplies of repair services to the insured persons, not to either the insurer or its handling agent. The handling agent was not providing repair services to anyone, but meeting the insurance company's obligation to fund the repairs up to the agreed amount of the claim. Lord Reed considered each of the decisions below, and concluded that, in accordance with the principles set out in *Redrow* and most recently in *Aimia*, WHA did not "receive" the supply.

The Supreme Court therefore did not have to consider the question of abuse of rights – the scheme was ineffective on technical grounds, so there could be no abuse.

Supreme Court: *WHA Ltd and another v HMRC; http://www.supremecourt.gov.uk/decided-cases/docs/UKSC_2009_0074_Judgment.pdf*

5.2.2 HMRC try again on loyalty points

Following the Supreme Court's slightly surprising ruling in the *Loyalty Management* case reported in the last update, HMRC applied for a further reference to the CJEU. They argued that a national court was obliged under EU law to make a further reference if it regarded a CJEU answer as incomplete or unsatisfactory, which appeared to be the case here; and the fact that the Supreme Court was split 3-2 on the issue suggested that the matter required further clarification from Luxembourg.

This time the five Law Lords were unanimous: there was no need for a further reference. The decision had not questioned or criticised the CJEU judgment: rather, it had decided that, with the benefit of hindsight, the original reference had been unnecessary, as the case did not raise any new point of law. That had been confirmed by the CJEU's dispensing with an Advocate-General's opinion in the case. No further reference was required.

Supreme Court: *HMRC v Aimia Coalition Loyalty UK Ltd (formerly known as Loyalty Management UK Ltd)*

5.3 Partial exemption

5.3.1 Capital goods and ineffective options

A Dutch dispute about the operation of the capital goods scheme has reached the stage of an Advocate-General's opinion. That opinion has not been made available in English, so it is to be hoped that the full judgment will be translated.

It appears that a building was successively transferred between four owners. The first and second transferors opted to tax, but the third did not. The third owner rented and sold the building without charging output tax, even though it had declared that it would make fully taxable use of the building when it acquired it. This declaration was required by Dutch law to validate the second transferor's option to tax.

The authorities took the view that the failure to comply with the declaration meant that the transaction between owners 2 and 3 was properly exempt, not taxable. Owner 3 was assessed to recover the input tax which had been claimed by it, apparently not because of the exempt outputs but because VAT should not have been charged on the input.

The Advocate-General has given an opinion that the 6th Directive, in force at the time, did not allow an adjustment of input tax under the CGS to be required from a person other than the person who had originally claimed that input tax. However, it is not clear how that opinion relates to the facts as described.

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

5.3.2 Proportion for lessor's deduction

The Portuguese court has referred the following question to the CJEU:

In a financial leasing contract under which the customer pays rent, the latter comprising financial payback, interest and other charges, does or does not the rent paid fall to be taken into account, in its entirety, in the denominator of the deductible proportion or, conversely, must only interest be taken into account, since it constitutes the remuneration, the profit, accruing to the bank from the leasing contract?

CJEU (Reference) (Case C-183/13): *Fazenda Pública v Banco Mais SA*

5.3.3 Higher Education special methods

HMRC has agreed with the British Universities Finance Directors' Group and the Higher Education Funding Council for England the latest version (May 2013) of its guidance on partial exemption special methods for higher education institutions. The guidance includes comprehensive discussion of appropriate methods and examples of how they work.

http://www.hmrc.gov.uk/menus/frame-hei.pdf

5.4 Cars

Nothing to report.

5.5 Business entertainment

Nothing to report.

5.6 Non-business use of supplies

5.6.1 Helicopter

A helicopter was purchased by a company in 2007. Input tax was claimed in relation to the purchase and running costs. The company's main business was the supply of specialised parts for 4x4 cars; the helicopter was also rented to the owner, his son, and an unconnected flying instructor who had rented a previous aircraft from the owner.

An officer visiting the company in March 2009 took the view that there was no connection to the business of the company, that the *Lennartz* approach was not valid, and accounting for output tax on the hires to the three fliers was an attempt to disguise tax avoidance. Assessments were raised to disallow all the input tax.

Following correspondence and review, another officer accepted that there had been an intention for mixed private and business use, and in June 2010 he opened discussions about the *Lennartz* choices – claiming a percentage of the input tax on purchase, or claiming it all and then accounting for output tax on private use.

Correspondence followed in which the company's advisers insisted that the invoicing by the company, and accounting for output tax, meant that there was no non-business or private use. The helicopter was either used for the purposes of the spare parts business, or else it was generating revenue. HMRC did not accept this. They insisted that the *Lennartz* adjustments (which would be higher than the output tax on the actual revenue) were required.

On appeal, the taxpayer's representative argued that the only way in which HMRC could levy a higher amount than the output tax on actual consideration was by making a direction under Sch.6 para.1. They had not done so; and, in any case, the amounts paid by the director and his son were in line with market rates for the use of a helicopter, and in line with what the company charged to the unconnected instructor. They were therefore "open market value". She also argued that the assessment was out of time in relation to all but one of the periods concerned.

The Tribunal allowed the appeal, although not for exactly the reason that the representative put forward. The company had not operated *Lennartz* accounting, as she asserted; but it had also not had any non-business use at any point. It was therefore correct in deducting the input tax in full and making no further adjustments. The helicopter hiring activity was a valid business of the company, in spite of HMRC's suspicions that it was "private use".

The time-bar issue was therefore not important; for completeness, the Tribunal examined it, and concluded that HMRC did not have sufficient information to raise the assessment 12 months before they did so. If they successfully appeal on the operation of *Lennartz*, therefore, the assessment would be valid.

First-Tier Tribunal (TC02635): *JNK 2000 Ltd*

5.7 Bad debt relief

5.7.1 Normal understanding restored

The Court of Session has reversed the decision of the Upper Tribunal and restored the decision of the First-Tier Tribunal in the *Simpson & Marwick* case on bad debt relief.

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

In 1985 the Law Society of Scotland publicised an agreement between the British Insurance Association and HM Customs & Excise (without publishing the actual wording of any formal agreement with the tax authority) that VAT-registered insurance claimants could claim as input tax the VAT incurred on legal fees in relation to claims, whether the instructions were given by the policyholder or by the insurer on his behalf. As a result, the insurer usually indemnifies a VAT-registered policyholder for a net-of-VAT amount, because that is the measure of the policyholder's loss. If the policyholder is partially or fully exempt, the loss will be greater and the insurer will have to pay more. The insurance company will not in any case be entitled to recover any of the input tax.

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

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

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

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

The Upper Tribunal overturned this decision and allowed the taxpayer's appeal. The judge's application of "fairness and common sense" over the apparently clear wording of the legislation was surprising, and HMRC immediately announced an intention to appeal further.

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

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

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

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

Both parties appealed to the Court of Session: HMRC against the interpretation of s.36 VATA 1994, and the firm on the refusal to allow the human rights argument.

The Court examined the Upper Tribunal decision and the reasons for it. In particular, the UT judge had approved the decision of the VAT Tribunal in *Palmer t/a R & K Engineering* (MAN/92/724), in which a trader had been allowed a similar claim to bad debt relief on "VAT-only" invoices. In that case, Customs had created a problem by taking a long time to process a registration application. As a result, the trader could not issue proper VAT invoices until some time after the event, by which time several customers had become insolvent. The Court concluded that the Tribunal had been minded to right an administrative wrong, whether or not the decision was strictly in accordance with the law.

The Court also noted the reliance on *Elida Gibbs*, but decided that this was misplaced. Even though bad debt relief is based on the same VAT Directive provisions as the rules on discounts, the circumstances were entirely different, and there was no support in that decision for the proposition that a particular part of the consideration could be identified as “the VAT and only the VAT”.

Rather, s.19 VATA 1994 treated “the consideration” as a single sum that represented the net price and the VAT together. S.36 referred to any part of “the consideration” being unpaid. The UT judge had accepted that, in the normal situation (as confirmed by several VAT Tribunal decisions with which he agreed), it was not permissible to divide up the single consideration into different elements. If that were allowed, it would be too easy to increase bad debt relief by simply making an agreement between the supplier and the customer.

The UT judge had erred in believing that this general rule was changed by the existence of the agreement between the BIA and Customs, as publicised by the Law Society of Scotland. The judge had also apparently not clearly understood or correctly interpreted the nature of the invoices issued by the solicitors – it was not true that separate invoices were or could be issued for the single supply. Instead, the VAT invoice was issued to the customer – the insured person – as it should be, with a note that only an amount equal to the VAT needed to be paid; a copy was sent to the insurer, with a note that only the net amount needed to be paid. This did not change the legal position: the supply was made to the insured person, and the insurer paid 40/47 of the consideration for it.

The Court’s judgment is summed up in the following sentences:

For the reasons which we have already given, and indeed for the reasons which the Upper Tribunal itself recognised in paragraph [17] of its judgment, we do not consider that it is open to the taxable person to demonstrate that the amount written off by him is “demonstrably all VAT”. But beyond that, we have difficulty in seeing the existence of some consideration of “elementary fairness” to which the judge in the Upper Tribunal refers and which the Upper Tribunal Judge regards as dictating a “purposive approach”. Put shortly, S&M provided a taxable service for which they received partial payment of the consideration and we have to say that we cannot see any real basis whereon it is inequitable, or contrary to elementary fairness, that they should not be responsible, in the normal way, for the proportionate amount of VAT on the part-consideration which they received.

The cross-appeal was dismissed quite briefly. It seems that the firm’s representative was unable to put a very strong argument for it: he did not contend that HMRC had given a positive direction to the firm to account for VAT in a particular way, so the only remaining reason that its human rights might have been infringed was the possible disproportionality of the VAT burden. The court concluded: “*we are unable to see that there can be said to be any disproportionate burden placed upon S&M in requiring that, as a taxable person, they pay the proportionate amount of VAT on the substantial part of the consideration which they have unquestionably received in respect of their taxable supply to the client.*”

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

Court of Session: *Simpson & Marwick v HMRC*

5.8 Other input tax problems

5.8.1 Supply of machinery a TOGC

A company transferred machinery to another company and later was wound up. The transferee claimed input tax deduction, which HMRC disputed on the grounds that the transaction was a TOGC.

The Tribunal examined all the circumstances surrounding the transaction. There was substantial common ownership; one business stopped and the other started shortly afterwards; most of the employees were taken on by the new company, which operated from the same premises. There was no transfer of goodwill, but overall it appeared that the business had been supplied as a going concern. HMRC were justified in disallowing the £13,000 of input tax included in the gross cost of £78,000 for the purchase of machinery.

The taxpayer's representative argued that the vendor had "properly accounted for" the output tax; although it had not settled the whole of its VAT liability, it was still negotiating its corporation tax position, and it appeared that the overall loss to HMRC would be less than £13,000. It was therefore unjust to deny the whole deduction. The Tribunal did not think this assisted the appellant. There was certainly no evidence that the vendor had paid the output tax by the date of the hearing, and even if it had, allowing the input tax to the purchaser in such a case was by concession only.

Presumably the vendor will now adjust its final VAT return, so its debt to HMRC – which will probably still end up unpaid – will be smaller.

First-Tier Tribunal (TC02640): *H Q Graphics Ltd*

5.8.2 Missing traders: mixed results

A company failed in its appeal against HMRC refusals, given in 2007/08, to repay input tax of £5.8m in relation to purchases of various electronic devices between 03/06 and 08/06. The director of the appellant decided not to attend the hearings, even though he was a witness whose presence was required; the company had no money left to pay for representation, so it relied on its representative's opening submissions. In spite of this, there was plenty of evidence of what had gone on, and the Tribunal concluded that the pattern of trading was such that the director must have known that his company was taking part in a fraudulent scheme to obtain VAT refunds.

First-Tier Tribunal (TC02687): *Asylum Distributions Ltd*

Another case featured just four transactions in June and July 2006, with input tax refused of just under £400,000. The director claimed to have become involved in the trade through working with and for an old friend, whose word he did not question. However, the Tribunal was satisfied that he must have known that he was facilitating a VAT fraud.

First-Tier Tribunal (TC02694): *Digit Three Ltd*

Another case revisited a dispute first heard by the Tribunal in 2009 (TC00076). The decision (for HMRC) was based on the Tribunal's understanding of the *Kittel* tests:

In deciding whether S&I should have known of the connection we applied the following test, namely whether a reasonable man with ordinary *competence in the position of S & I, and knowing what S & I knew (a) would have taken any additional steps, and (b) would have come to the conclusion, on the basis of what he knew and had found out, that it was more likely than not that the transaction was connected to fraud.*

The Upper Tribunal decided in 2012 that this was not the correct test, following the *Mobilx* decision, and remitted the case to the FTT. The UT directed the FTT to consider whether "*[S & I] knew or should have known that [its] the transactions were connected with fraud or that there was no reasonable possibility other than they were connected with fraud?*"

The taxpayer's representative made submissions on the significance of the CJEU decisions in *Mahageben* (Case C-80/11), *Peter David* (Case C-142/11) and *Gabor Toth* (Case C-324/11), arguing that these imposed a higher test of knowledge: "would have had to have known" rather than "should have known". The Tribunal rejected this analysis, holding that the *Kittel* test remains unchanged, and it applied in this case. The Tribunal concluded that the only reasonable explanation of the circumstances of the company's deals was that they were connected with fraud; it had not been persuaded that the director actually reached that conclusion, but the judges commented that "*had we been S&I's shoes we would have concluded that the only explanation was fraud*." The appeal was dismissed again.

First-Tier Tribunal (TC02702): *S & I Electronics Ltd*

A trader in contact lenses was denied input tax of £50,000 in relation to its 01/07 return. Unusually, the decision was based not on knowledge of fraud, but on a failure to prove that the consideration for the supply had been paid – the input tax was therefore disallowed under s.26A VATA 1994.

First-Tier Tribunal (TC02674): *Opticare Ltd*

A rare success for the taxpayer in a missing trader case featured input tax of £53,000 claimed on the purchase of CD and DVD players in the period 11/06. The decision starts with the comment that problems – including a 17-month gap between two hearings – were caused by an apparent division between the civil and criminal investigations arms of HMRC. An officer revealed during the first hearing that certain criminal matters were under investigation, and referred to documents and evidence which the company had not seen. This led to an adjournment in the interests of fairness, and a considerable delay because of the difficulty of rescheduling the hearing.

The Tribunal examined the evidence, and commented that it was hard to make inferences – particularly in relation to fraud and to "means of knowledge" – where there was only a single deal chain, rather than a pattern of trading. The Tribunal summarised the question as follows: "*the issue here is not whether DCL took every precaution but whether the only reasonable explanation for DCL's transaction was that it was connected to DCL did not meet the standard in what DCL did*." On that basis, the Tribunal allowed the appeal – fraud was not the only reasonable explanation for the transaction under dispute. Costs were awarded to the taxpayer.

First-Tier Tribunal (TC02679): *Dynamic Corner Ltd*

The more normal result followed in a case concerning £2.5m of input tax for the periods 04/06 and 07/06. The trader claimed to have concentrated his due diligence efforts on the suppliers rather than the customers, because "he thought that if there was a tax loss it would be on the UK supply side." However, the Tribunal concluded from the wholly inadequate due diligence carried out that the director ought to have known that there was no reasonable explanation for the transactions other than fraud.

First-Tier Tribunal (TC02678): *Rigcharm Ltd*

Another success for the appellant concerned claims for £6.3m in periods 04/06 and 05/06, and £3.5m in relation to 06/06. The initial hearing of the appeal took place in early 2012, but the release of a decision was stayed pending criminal proceedings which took place in the summer of that year.

The company clearly had a genuine trade which had been going on for some years and had been closely monitored by HMRC. The control officer was apparently unaware, when arranging an annual inspection in June 2006, that other HMRC officers were about to raid the premises with a search warrant and remove all the records – some of which appeared then to disappear altogether.

The Tribunal was split: the judge found the director a convincing witness, an honest businessman whose trading had many of the indications of carousel frauds (including rapid growth and banking with FCIB), but who had co-operated with HMRC throughout and had carried out genuine due diligence. His side member concluded that the *Kittel* tests were satisfied, and that on the balance of probability the company was a willing participant in a fraudulent scheme. The appeal was allowed on the casting vote of the chairman.

First-Tier Tribunal (TC02667): *CCA Distribution Ltd (in administration)*

Another trader was denied £400,000 of input tax in relation to purchases and exports (not despatches) of CPUs in 07/06 and 08/06. After exhaustive examination of the circumstances, the Tribunal concluded that the trader knew of the connection to fraud; if, instead, it had been 'innocently' duped into entering into the disputed transactions, it was because it had chosen to disregard the circumstances which would have indicated that connection. Its appeal was dismissed.

First-Tier Tribunal (TC02728): *JMC Electronics Ltd*

Yet another successful appeal followed in a case concerning two companies which had claimed in total nearly £2.4m of VAT in relation to the periods 04/06 and 05/06. Once again, this was an established trade which had been subject to HMRC inspections over an extended period. There were features that were unusual in a MTIC case – the company had insisted that all payments were made from UK bank accounts, and it appeared that it was dealing at arm's length with the counterparties in a way that was not indicative of complicity in a fraud. Although some of the evidence was unsatisfactory, taken in the round, the Tribunal was not satisfied that HMRC had made their case on the balance of probabilities.

First-Tier Tribunal (TC02747): *Unistar Group Ltd and related appeal*

HMRC were more successful in a case concerning claims for nearly £2.4m in relation to mobile phone deals in 06/06 and 12/06. The company had been incorporated in 2004 and made modest sales; nevertheless, it was sent a copy of Notice 726 in late 2005 to warn of the risks of MTIC fraud. The turnover in the 06/06 return jumped to nearly £8m. Turnover in 09/06 fell back to £28,000, before going up to £17.6m in 12/06.

The judge makes an interesting comment on the credibility of the director:

He claimed to have 15 years experience in dealing in mobile phones giving the impression that he was an experience trader in this sector. However, it transpired that other than a Saturday job, which he had for about two years when at school, in a mobile phone shop he had no such experience and he did not have any full time job until FOS was established.

The trading was clearly not commercial, and the only reasonable explanation was connection to fraud. The appeal was dismissed.

First-Tier Tribunal (TC02760): *Face Off South Ltd*

5.8.3 Crime of the century?

A specialist journal has identified the organised VAT fraud in the carbon emissions markets, which appears to have been rife in 2009, as the ‘financial crime of the century’. It seems a little early to award this title.

Journal of Financial Crime

5.8.4 Missing invoices

In an article in *Taxation*, Neil Warren examines the basic conditions for claiming input tax, and considers the circumstances in which a claim can be made out without a tax invoice.

Taxation, 16 May 2013

5.8.5 Company car advisory fuel rates

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

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

Engine size	Petrol	LPG
1400cc or less	15p (15p)	10p (10p)
1401cc – 2000cc	17p (18p)	12p (12p)
Over 2000cc	25p (26p)	18p (18p)

Engine size	Diesel
1600cc or less	12p (13p)
1601cc – 2000cc	14p (15p)
Over 2000cc	18p (18p)

Although the rates now change quarterly, the actual adjustments are very small – in this case, 1p reductions on smaller diesel engines and larger petrol engines.

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

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Commission loses

The CJEU has agreed with the Advocate-General's opinion in the cases brought by the Commission against those member states which allow non-taxable persons to join VAT groups. The Commission believed that only companies which were taxable persons in their own right should be allowed to join groups.

The court pointed out that this appeared to be based on the wording of the Second VAT Directive, which referred to 'taxable persons' in this context. The words were removed in drafting the 6th Directive, and the Principal VAT Directive is broader still, referring to 'any persons'. Although in some parts of the Directive 'person' is used to denote 'taxable person', that depends on the context and is for the avoidance of repetition. There was no reason to infer the word into the provisions about grouping.

The court ruled that the only relevant conditions were that the persons should be legally independent but closely bound by economic, financial and organisational links; and they should be established in the territory.

The result, which the Commission objected to, was not in fact contrary to the objectives of the Directive, but helped to achieve them, "*either in the interests of simplifying administration or with a view to combating abuses such as, for example, the splitting-up of one undertaking among several taxable persons so that each might benefit from a special scheme, to ensure that Member States would not be obliged to treat as taxable persons those whose 'independence' is purely a legal technicality.*"

If there was scope for abuse, art.11 allowed member states to introduce rules to counter it.

CJEU (Case C-85/11): *Commission v Ireland*

Similar decisions were handed down in a series of other cases. There was a slight difference in the Czech Republic's case – the court noted that no such grouping had been registered in the Republic, so there was no infringement in practice in any case.

CJEU (Case C-86/11): *Commission v United Kingdom;* CJEU (Case C-65/11): *Commission v Netherlands;* CJEU (Case C-109/11): *Commission v Czech Republic;* CJEU (Case C-95/11): *Commission v Denmark*

In the case involving Finland, the Commission attempted to introduce a further argument about fiscal neutrality, but this was not included in the reasoned opinion sent to the member state, so it was inadmissible. The basic cause of action was the same as in the cases above, and it was dismissed.

CJEU (Case C-74/11): *Commission v Finland*

The case against Sweden was different, in that the Commission's objection to the Swedish rules was that they only allowed grouping to companies in the financial sector. The Advocate-General agreed that such a restriction was not permitted by the Directive.

The full court observed that member states were permitted to impose restrictions on grouping to prevent abuse. The Swedish authorities argued that the restriction achieved that objective, because it meant that only companies that were subject to supervision by the Finance Inspectorate could enjoy grouping. The Commission had failed to argue that this was not a valid application of the permission in art.11, so its action was dismissed in this case as well.

CJEU (Case C-622/11): *Commission v Sweden*

6.2 Other registration rules

6.2.1 Threshold tests

A self-employed plumber was registered for VAT in 2002 with retrospective effect to 1997. By 2008, medical problems meant that his turnover had fallen, and he successfully applied for deregistration. For the next three years, he gave his business records to his accountant each month, and relied on the accountant to tell him if the VAT registration threshold had been breached: he knew how damaging it would be to undergo retrospective registration again.

The plumber's son worked for him between March 2009 and February 2011, allowing him to take on heavier jobs and therefore increase his turnover again. In May 2011, the accountant told the plumber that he had exceeded the threshold in July 2010. The plumber attempted to apply for exemption from registration online, but found that this was not possible; he experienced further difficulty in trying to contact HMRC to explain that his online registration application was in fact an application for exemption.

HMRC asked for further information, and concluded that he had exceeded the threshold earlier, and had to be registered from 1 May 2009. The accountant, who had failed to notice this, disappeared, so there was no redress against him. A new accountant, who appeared for the plumber at the hearing, agreed that HMRC were correct.

The plumber argued that he should be excused from registration because he had relied on his accountant and had acted reasonably. The Tribunal judge had some sympathy for him, but ruled that she had no discretion in the matter; nor did HMRC. The agreed figures showed that he was liable for registration at the end of March 2009; the precedent cases showed that exemption from registration could not in practice be applied for retrospectively.

The plumber had, after contacting HMRC in May 2011, asked to be deregistered. As the son had left the business, HMRC accepted that he was no longer required to be registered, and cancelled his registration from August 2011. However, they refused to backdate the effect of this, applying the normal rule that an application for deregistration can only be given effect on the date it is received or on a later agreed date.

The judge said that it was not as simple as that. The application to register had given HMRC information to suggest that the plumber was eligible for exemption from registration in July 2010, and this was confirmed by the facts. It seemed that HMRC had accepted the information as reliable, and had not applied their minds to the possibility that they should:

- give effect to the registration application from when the threshold was breached, which they concluded was an earlier date than that given by the trader; but then
- consider whether registration was required at the end of each later month.

If they had done so, the judge held that they would have inevitably have concluded that the plumber was no longer required to be registered after October 2010. To that extent, the trader's appeal was allowed: registration was confirmed to run from 1 May 2009 to 30 September 2010.

First-Tier Tribunal (TC02683): *Andrew Quentin Merrell*

6.2.2 TOGC and registration

An individual took over a fish and chip shop that had been operated by her parents in partnership. The parents cancelled their VAT registration. HMRC attempted to find out about the daughter's operations, but received no replies to letters; in due course they issued a notice of compulsory registration to take effect from the date of transfer, followed by assessments for estimated tax.

When the daughter finally submitted tax returns, they showed turnover above the deregistration threshold. In spite of that, she still appealed to the Tribunal against the decision to register her with effect from the transfer. The Tribunal had no hesitation in finding that she had acquired a business as a going concern from a taxable person, and had as a result inherited the turnover record. She was therefore correctly registered with effect from the transfer.

First-Tier Tribunal (TC02673): *Kate Salisbury*

6.2.3 Deregistration problem

An individual operated a shop from 2000 to December 2008, when she closed it due to ill-health. According to her, she sent a VAT7 deregistration form with a covering letter, but HMRC did not acknowledge it. They sent estimated assessments and surcharges. In February 2012 the trader wrote to them again, explaining that she had asked for cancellation of registration in December 2008. HMRC refused to backdate the deregistration, ruling that it only applied from the date they received this second request.

This mattered because she did not cease business in December 2008: she moved her stock from the shop to a warehouse and sold it off over the next two years. Her turnover dropped from £67,600 in 2008 to £26,500 in 2009 and £12,800 in 2010.

Several VAT returns and payments were outstanding from before December 2008. It was only after submitting some of the outstanding returns that the trader claimed to have already submitted a request for deregistration. She said that she had not been aware that her application had been refused.

The Tribunal distinguished the present case from several previous decisions on which HMRC relied. It found, on the balance of probabilities, that the trader had indeed sent in the VAT 7 form in December 2008, and that HMRC had probably lost it. Even though a decision to allow retrospective deregistration was within HMRC's discretion, and therefore only subject to the supervisory jurisdiction of the Tribunal, the judge held that it was unreasonable for HMRC not to allow it. On receiving the second application, and in view of the probability that the first had been received and mislaid, and also the fact that the shop was closed on 20 December 2008, the date on which deregistration was sought, HMRC could not reasonably have concluded that the trader continued to be liable for registration after that date.

The appeal was allowed. The judge noted an assurance from HMRC's representative that any VAT already paid for periods after 20 December 2008 would be refunded.

First-Tier Tribunal (TC02758): *Deborah Lisbth La Roche*

6.2.4 Closing a business

HMRC have gathered together on their website the information self-employed taxpayers and business owner-managers need to settle their tax affairs when closing or selling a business, whether unincorporated or incorporated. The guide covers self-assessment and NIC; corporation tax considerations and capital gains tax on disposal of business assets; VAT; the construction industry scheme; PAYE for employers; and authorising an agent to act on behalf of the business.

www.hmrc.gov.uk/dealingwith/changes/close-sell-business.htm

On a related subject, HMRC have issued a new version of their notice *Cancelling your registration*. The main changes are the inclusion of the online system for deregistration, and the removal of the registration threshold for non-established businesses.

Notice 700/11

6.3 Payments and returns

6.3.1 Exceptional circumstances for the FRS

A management consultant left his employer at the end of 2006 and registered for VAT as a sole trader in January 2007. He did not apply for the Flat Rate Scheme, although he was aware of it, because he expected his turnover to exceed £150,000. In the event, over the next five years his turnover never even approached the registration threshold, and he eventually applied to deregister in December 2011. At the same time, he asked for his VAT liability to be recalculated in line with the FRS, which would reduce his total VAT payments for his five years from £23,997 to £21,846. HMRC refused, ruling as usual that it was not permissible to join the FRS retrospectively unless there were exceptional circumstances.

The Tribunal decided that these circumstances were exceptional. The trader had never needed to register for VAT at all. However, the appeal could only be allowed on a supervisory basis: it would be necessary for HMRC's decision to be "unreasonable". The review decision did not appear to consider or respond to any of the grounds put forward by the trader. The following is an interesting comment on what ought to be covered in a review decision:

On its reading of those decision letters, the Tribunal is satisfied that they did not consider those specific circumstances at all. Mr Bingham suggested that it could be inferred that the decision maker considered everything advanced by the Appellant, and that the decision did not need to refer to every consideration individually. However, the Tribunal considers that the decision needs to show at least that the core elements of the Appellant's case were considered...

The HMRC decisions do not consider whether this peculiar combination of circumstances amounts to exceptional circumstances that would justify granting retrospective application of the FRS. The guidance makes clear that "Each case should be considered on its own merits" and that "all relevant facts" must be considered. The guidance is expressed in non-mandatory language. In referring to exceptional circumstances that might justify retrospectivity, the policy states, in an open-ended way, what "in principle" such circumstances are "likely" to involve. The guidance does not lay down any hard and fast rules. In contrast, the 4 April 2012 HMRC review decision states for instance that "there would need to be firm evidence that a trader would be put out of business as a direct result of a decision to refuse retrospection". Not only does the decision suggest that this is a hard and fast rule, but the language used here does not itself even appear in the guidance.

Having concluded that the decision was not made in accordance with the guidance, and did not take into account all relevant information, the Tribunal made its own decision. The circumstances were not those of a business which was unaware of the FRS, or that waited to see whether it would benefit from it. The trader had registered for VAT, and deliberately chosen not to use the FRS, on the basis of expectations that turned out to be catastrophically wrong, largely because of the unforeseeable financial crisis which started in 2008. In such an unusual situation, the Tribunal considered that retrospective admission to the FRS was justified.

Given that HMRC argue that the FRS is intended to be for simplification, and the trader had already submitted VAT returns on the standard basis which could not be retrospectively simplified, they may appeal.

First-Tier Tribunal (TC02738): *Geoffrey Seeff t/a TPL Associates*

6.3.2 FRS Notice

HMRC have issued an updated version of the notice on the *Flat rate scheme for small businesses*. The changes are minor, although there is additional information on ceasing to use the cash-based turnover method, and on leaving the scheme.

Notice 733

6.4 Repayment claims

6.4.1 Repayment arrangements

A company designed, supplied and installed aluminium windows. Between 2006 and February 2009, it supplied a construction company customer with windows under five contracts on which VAT was charged in error – the supplies should have been zero-rated, because the supplies were made in the course of construction of dwellings.

The customer fell into financial difficulties and went into administration, owing the company £763,000. In reviewing its bad debt, the company became aware of the VAT error. In May 2009, it made a voluntary disclosure to HMRC, claiming repayment of £683,000. The correctness of this amount was not in dispute. HMRC did not initially respond, but in September 2009 they sent various forms, including the declaration that normally accompanies a claim to repay output tax: an undertaking to reimburse the customer, in order to prevent unjust enrichment of the claimant.

A director of the company told HMRC that the reimbursement would not be made by cash or cheque, as stated in the standard declaration, but by crediting the ledger account, which would remain in debit (but without specifying that the customer was in administration). HMRC accepted that this was a reasonable approach. The amended undertaking was submitted in October 2009, and HMRC sent a cheque for the amount claimed.

A year later, HMRC decided that the repayment had been incorrectly made, and raised an assessment. The officer reviewed information relating to the customer and concluded that there was no reason to suppose it had not claimed input tax credit for the amounts wrongly charged to it by the company. In those circumstances, unjust enrichment would apply.

The Tribunal agreed that the modification of the reimbursement arrangements was not in accordance with the law; although HMRC had consented to it, they had no discretion or power to do so. The law required payment by cheque or cash, and offsetting in a ledger account was not the same thing. The effect of the arrangements that the company had put in place was that it had simply retained the funds repaid to it by HMRC.

The company argued that the approval by HMRC constituted a binding agreement, or at least created a legitimate expectation. The Tribunal did not agree. The consent was far short of a contract: it was probably entered into on the understanding that the building company would receive a credit note and adjust its input tax claims. The company could not have a legitimate expectation that HMRC would act ultra vires, as in agreeing to the amendment they surely did; and the company had failed to "put all its cards face upwards on the table", in that it had not informed HMRC of the insolvency of the customer.

A claim under s.80(3B), that the company was not unjustly enriched because it had suffered detriment, was not accepted. There was no quantifiable loss arising from the original mistake in charging VAT on zero-rated supplies. The detriment claimed arose instead from relying on HMRC's consent to the repayment. The offset in the ledger reduced the indebtedness of the customer so that the company was no longer a 10% creditor, and therefore had less influence over the administrator. That detriment, even if true, was too far removed from what the VATA provision envisaged.

A further decision, following on the first, revealed that the company has gone into liquidation itself. Attempts to continue the action failed, because they raised no new issues that had not already been considered and dismissed.

First-Tier Tribunal (TC02616A and TC02616): *Systems Aluminium Ltd*

6.4.2 Fleming evidence

On 27 March 2009 two companies in the same group submitted *Fleming* claims for VAT on subsistence expenses incurred by employees between May 1988 and April 1997. HMRC rejected the claims for lack of supporting evidence. The companies appealed, arguing that the amount of evidence they produced was reasonable in the context of a *Fleming* claim.

In effect, there was no evidence at all. The companies could not even provide clear evidence of their VAT registration at the beginning of the periods covered by the claims. The amounts were arrived at by extrapolating from later periods. The judge held that the burden of proof lay on the claimant; while some allowance might be made for the difficulties arising from the delays involved in *Fleming* claims, “it is simply not good enough” to expect HMRC to accept their word on the basis of no evidence at all and to repay substantial amounts of tax without question.

First-Tier Tribunal (TC02629): *WMG Acquisition Co UK Ltd*

A similar decision was reached in a case which concerned share issue expenses and staff entertainment costs. The Tribunal could not be satisfied that the input tax at issue had not already been claimed at the time.

The company had made several share issues between 1987 and 1991, for which little evidence was still available beyond the figures debited for “costs of issue”. It claimed that these were VAT-inclusive and that the VAT would not have been recovered, because it had been advised that share issue costs did not give rise to credit. However, in relation to a share issue in 1996, the amount debited for share issue costs was the VAT-exclusive amount. This suggested that the VAT had been recovered, because otherwise the gross amount would have been shown as a cost (in accordance with SSAP 5 and FRS 4). The Tribunal inferred that the same conclusion might apply to the earlier share issues: at the very least, the company would have to show some evidence that it had not claimed the VAT.

In respect of the staff entertainment, the company claimed that it had only deducted 50% of the input tax on the annual Christmas party, in line with HMRC’s guidance at the time. It now sought to increase this to the whole of the input tax, as the *Ernst & Young* case showed that full deduction was available where only staff were present. HMRC argued that the 50% policy only applied to parties where non-employees were entertained, and there was no reason for the company not to have deducted 100% at the time. Once again, the Tribunal held that the company had not made out that, on the balance of probabilities, it had not already claimed the VAT.

The claim was described as "opportunistic and made without careful regard to what, on the balance of probabilities, the appellant actually did." The appeal was dismissed.

First-Tier Tribunal (TC02718): *KDM International Ltd*

6.4.3 Date of claim

In a variation on the arguments about appealing out of time in connection with *Rank* reclaims, the Tribunal had to consider when a claim had been made, and when, if at all, HMRC had refused it. A company operating amusement arcades wrote to HMRC in September 2006, stating that it wanted to make a claim based on *Linneweber*. HMRC wrote back asking for more information, but nothing further was heard from the company until July 2010. The company provided details of amounts in September 2010, at which point HMRC accepted that it had made a claim; but that claim was now time-barred in relation to the periods for which the VAT was claimed.

The Tribunal concluded that the letter of September 2006 did not constitute a "claim" for the purposes of reg.37 and therefore could not engage the time limits for repayment of three years' worth of VAT leading up to that date.

As it was not a claim, it could not be refused. However, for completeness, the judge considered two further arguments:

- whether HMRC had refused the claim, if the September 2006 letter had been one: they had not done so in clear terms, but had instead asked for further information, in a letter which the Tribunal was satisfied that the company had not received;
- whether the company had abandoned the claim, given that it had taken no action for nearly four years: the Tribunal decided that a reasonable observer would not come to this conclusion, but would think that the company was waiting for the outcome of the *Rank* litigation.

If the September 2006 letter was a claim, the correct analysis was that HMRC had not refused it but asked for further information; the company had not abandoned its claim, but had provided that further information four years later.

First-Tier Tribunal (TC02643): *Websons (8) Ltd*

6.4.4 Direct tax on VAT repayments

Early in 2012, the First Tier Tribunal rejected appeals by four companies which were each representative member of a group of retailers which had received large VAT repayments (running in total into hundreds of millions of pounds) together with statutory interest under s.78 VATA 1994. The companies had all treated the receipts as outside the scope of corporation tax, and HMRC had raised assessments on the repayments as trading receipts and the interest as a "credit on a loan relationship".

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

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

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

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

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

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

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

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

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

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

The fourth proposition was accepted.

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

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

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

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

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

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

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

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

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

and lastly,

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

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

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

Upper Tribunal: *Shop Direct Group and Others v HMRC*

6.5 Timing issues

Nothing to report.

6.6 Records

6.6.1 Self-billing

A company operated a business of road transport, warehousing and container hire. From 2004 it used a system of self-billing to deal with a large number of small suppliers of local haulage businesses which it used for sub-contracted work.

HMRC issued assessments to disallow £214,000 of input tax claimed on self-billed invoices in the period 09/05 to 06/08. The invoices related to supplies by 18 other businesses which were not registered for VAT at the time.

The company argued alternatively that:

- the requirements of reg.13 SI 1995/2518 in respect of self-billing were in fact fulfilled;
- the supplies were made in the first 12 months of their self-billing arrangement, when the rules should have been more lenient;
- the payments included VAT, and the company was therefore entitled to input tax deduction;

- HMRC should have exercised its discretion to accept alternative evidence in support of an input tax claim.

The Tribunal examined the legal requirements for self-billing agreements in reg.13 and the HMRC guidance in Notice 700/62. It concluded that a self-billing agreement can only be valid if the supplier is registered for VAT at the time. Self-billing arrangements are supposed to be renewed at no longer than 12 month intervals, at which point the customer should re-check the VAT status of the suppliers.

It appeared that the company's director, who gave evidence, had made an honest mistake in interpreting the conditions of Notice 700/62. He believed that the self-billing agreement could be given an end-date that was consistent with the renewal of commercial contracts, if that was longer than the 12 month period – in effect, the 12 month period was not a maximum duration for self-billing.

The Tribunal also noted HMRC's policy on "Input Tax Deduction without a Valid VAT Invoice", set out in a statement of practice in March 2007. This sets out the conditions under which HMRC will exercise discretion under reg.29:

- *The supply as stated on the invoice did take place*
- *There is other evidence to show that the supply/transaction occurred*
- *The supply made is in furtherance of the trader's business*
- *The trader has undertaken normal commercial checks to establish the bona fide of the supply and supplier*
- *Normal commercial arrangements are in place – this can include payment arrangements and how the relationship between the supplier/buyer was established.*

Although the self-billing agreements were not in accordance with the law and the guidance, HMRC had exercised their discretion when other evidence showed that the supplier was in fact registered for VAT. They refused to do so in other cases, even where it was clear that the supplier should have been registered – based on the amount of supplies paid for by the appellant, or the assumption made by the appellant that anyone operating an articulated lorry would have to have turnover above the threshold in order to cover the costs.

The company's first two arguments had no merit. The arrangements that were entered into clearly were not in accordance with the regulations or the Notice, and there was no "12-month period of grace" as suggested by the appellant.

The European law argument was rejected on the grounds that member states had the right to impose proportionate conditions on the deduction of input tax. The holding of a VAT invoice was a requirement under the Directive, and none of the cases cited by the appellant suggested that an invalid self-billing invoice should be accepted as a matter of EU law.

Contrary to HMRC's argument, the Tribunal decided that it did have jurisdiction to consider the exercise of discretion under reg.29, but only on a supervisory basis. It could find no fault with the reasonableness of the decision that was made. It appeared that the company had not taken sufficient care: not all VAT numbers were checked, and some supplies were made before VAT numbers were obtained. The company's reliance on the assumption that all its suppliers must be large enough to be VAT registered was unreasonable; it should have sought more specific evidence, and should have done so on a regular basis.

The appeal was rejected on all four grounds.

First-Tier Tribunal (TC02739): *Taygroup Ltd*

6.7 Assessments

6.7.1 Time limits

A solicitor acted as an intermediary in respect of transactions in capital redemption bonds. He treated his services as exempt from VAT. HMRC decided that they were not, and issued an assessment for £499,000 on 8 December 2008. He appealed, and the Tribunal first considered the preliminary issue of whether the assessment was issued in time; if it was, it would be necessary to examine whether exemption was properly due.

The decision is strange, in that it proceeds on the basis that the issue is, as stated by the parties, "*What amount of [the Assessment] is time barred by operation of the three year time limit set out in VATA 1994 s 80(4) in force as at 8 December 2008?*" S.80(4) is a time limit on repayment claims, not on assessments. However, it appears that the decision can be read in relation to the equivalent cap on assessments in s.77(1).

The judge comments that the accounting for transactions between several related companies was opaque and confusing, but concluded that the time that payments were made fell after 31 March 2006. From this, it is concluded that reg.94B SI 1995/2518 applied: these were services which were supplied continuously, and if they were not paid within 6 months of the period to which they related, a tax point would be fixed 6 months after the end of the period. As the commissions had not been paid by 31 March 2006 in respect of accounting periods up to then, reg.94B fixed a tax point; the assessment was raised too long after that, and so it was out of time.

First-Tier Tribunal (TC02655): *Mark Reid (practising as Reid & Co. Solicitors)*

6.8 Penalties and appeals

6.8.1 Default surcharges

A partnership of lawyers had a long history of problems with HMRC. In 2001, a Tribunal allowed a reasonable excuse defence to a string of default surcharges, which were in the first place triggered by a burglary at the business premises, followed by a catalogue of incompetence by HMRC. Following that decision, it was still not possible for the parties to agree the state of the VAT account, but the difference was reduced to only £2,000, and the partnership paid its VAT on time for some years.

A further series of defaults arose from 2008, leading to the imposition of default surcharges totalling £6,760 for periods from 02/08 to 11/10. This was partly blamed on the incompetence of HMRC in failing to agree the VAT balance, which meant they could not produce audited accounts that would have freed up bank facilities.

The Tribunal did not accept that this was a reasonable excuse. The new chain of defaults started too long after 2001. It should have been possible to draw up accounts in the meantime, even with a provision for the disagreement. The appeal was dismissed.

First-Tier Tribunal (TC02627): *Prime & Co (a partnership comprising Andrew Stevenson and Elizabeth Stevenson)*

A trader appealed against the imposition of a surcharge levied at 15% for the period 03/12. The Tribunal reports the difficulties he experienced in trying to get anyone at HMRC to talk to him about it; he received letters demanding payment and threatening distraint, but when he rang to try to resolve the matter, he could not find anyone who would discuss the matter. Eventually, HMRC accepted that payment had been made on time for two of the previous periods in the default surcharge period, which reduced the level of penalty from 15% to 5%.

The Tribunal had sympathy for the trader, who had made an honest attempt to deal with the situation in difficult circumstances; however, he had admitted that the reason for the late payment was his own decision to prioritise operational concerns in his short-staffed factory, rather than submitting the VAT return. He did not have a reasonable excuse, and his appeal against the reduced penalty was dismissed.

First-Tier Tribunal (TC02669): *Levantine (UK) Ltd*

A trader was late four times in a row. The fourth default led to a surcharge at 10% of £204. The trader claimed that the penalty was excessive for one day's delay (although the Tribunal found that the payment was four days late, while the return was only one day late). HMRC's case was well-founded, and the Tribunal could only conclude that the surcharge was properly due.

First-Tier Tribunal (TC02685): *Gilmours Off Sales*

A company argued that it had a reasonable excuse for late payment, and also that it should not be charged at 15% – it had had a time to pay agreement in place for an earlier quarter, which meant that it should have been removed from the surcharge regime at that time.

The Tribunal found that it had not complied with the TTP agreement, so it could not rely on it to cancel the surcharge liability notices. The reasonable excuse was that the money had arrived with HMRC on the first banking day after the Easter holiday, when it was due on Easter Saturday; the Tribunal agreed with HMRC that a reasonable person would have consulted and followed HMRC's publicly available guidance.

The Tribunal judge, Anne Redston, had earlier heard (and been overruled by the Upper Tribunal) in the case of *Total Technology*. She must have therefore treated the appellant's argument about the disproportionality and unfairness of the penalty with some care. It was clear from the earlier case that she could not allow an appeal on the grounds of disproportionality; and it appeared from *Noor* that she could not exercise a judicial review function either.

She did, however, comment that she did not accept that HMRC had acted unreasonably. The basis of the "unfairness" argument was that those paying by direct debit were given an extra three days to pay, so they made their payments on the same day as this company were not penalised. Judge Redston considered that setting up a DD in advance was a different situation to making individual BACS transfers, and so HMRC were entitled to treat them differently; there were also good reasons for HMRC to encourage traders to pay by DD, so giving an incentive was not an unreasonable action.

The appeal was dismissed.

First-Tier Tribunal (TC02732): *Sygma Security Systems*

Another trader made a bank transfer after 3:30pm on the due date, without realising that this would only clear on the following day. The Tribunal was satisfied that the warnings given to traders about checking payment terms were reasonable, and this was the sixth default (leading to a surcharge at 15%). There was no reasonable excuse.

First-Tier Tribunal (TC02670): *J and P Windows Ltd*

6.8.2 Late notification of liability to register

A solicitor set up a sole practice in October 2009 after being made redundant. He believed that he had to consider the VAT registration threshold on an accounting year basis, and was not told otherwise by his accountant. A Law Society inspection in June 2011 revealed that he had exceeded the threshold in September 2010, so he should have registered from 1 November 2010. He immediately instructed his accountant to calculate the VAT due, which was £25,000. He understood that the Legal Services Commission would pay the majority of this – as it funded his clients under Legal Aid – but it would take some time to meet the claim. Until he received their payment, he could not afford to pay HMRC: he had no working capital and his bank would not extend his overdraft. As soon as the solicitor received a payment of £18,000, he registered for VAT and paid the money to HMRC. The notification was made online on 1 December 2011.

HMRC issued a penalty at 19% of the potential lost revenue, later reduced to 10%. It stated that this was the minimum penalty for a late notification over 12 months after the correct time.

The Tribunal considered the Hansard record of discussions of the penalty provisions in Sch.41 FA 2008. It concluded that the intention of the law was to encourage traders to put their affairs in order, rather than to punish those who did so. The special circumstances of this case were enough to justify cancelling the penalty altogether.

First-Tier Tribunal (TC02611): *James Hillis*

A restaurant was late registering for VAT. It made an unprompted disclosure, and HMRC accepted that the quality of that disclosure was such that any penalty should be mitigated by the maximum amount allowed. However, they considered that it was over 12 months late, so they could not mitigate the penalty to nil – 10% was the minimum.

The Tribunal had to consider what the start date of the 12 month period is: the law refers to "when tax first becomes unpaid by reason of the failure." HMRC argued that this was the date from which the taxpayer was obliged to be registered; however, the Tribunal concluded that it more naturally referred to the time when VAT would have been payable in respect of the registration period, had the registration liability been notified at the right time.

The restaurant's accountant had received the accounting records for the year to 31 March 2011 in April 2011, but had not started work on them until October. When he did so, he became concerned that it had exceeded the threshold, and asked for a breakdown of weekly turnover. He disclosed his conclusion to HMRC (required EDR of 1 May 2011) in November 2011. HMRC asked for further information, and decided that the correct EDR was 1 November 2010. Notification was therefore too late, in HMRC's view, to benefit from full mitigation, and a 10% penalty of just over £900 was imposed.

It appears that it was the Tribunal itself which raised the question of the meaning of "when tax first becomes unpaid", and asked for written submissions from the parties. HMRC set out reasons for treating it as the EDR, but the Tribunal did not accept them. There were sound reasons for using the date on which tax actually became due and payable – for example, a trader who was in a repayment position to start with should not be deprived of the opportunity to make a disclosure without being penalised. The trader did not have a reasonable excuse; however, at the very earliest, it would have had to pay VAT for its first return period in early 2011, and it had made its disclosure within 12 months of that. The appeal was allowed.

First-Tier Tribunal (TC02721): *Taste of Thai Ltd*

6.8.3 Penalty rules

A Swiss-registered non-profit making association (equivalent to a UK charity), with its main establishment in Austria, organised a congress in the UK in November 2009. It engaged a company to act as its agent in organising the UK event. It registered for VAT in the UK in March 2009, with an expected turnover for the coming year of up to £7m, mainly comprising fees from the 17,500 delegates at the congress. It received various amounts from the organisers, but failed to consider whether these were taxable receipts, and did not enter them as outputs on its VAT returns for 06/09, 09/09 or 12/09. By the time it came to consider the matter, and realised that it needed to account for a considerable amount of output tax (£693,897, plus incorrectly claimed input tax £5,925), HMRC had arranged for a control visit to take place.

Before HMRC had arranged to make the visit, the charity's Austrian accountants had reviewed the results for the 2009 congress, and had concluded that something must have gone wrong. On further investigation, it transpired that the organisers had issued invoices in the name of the charity, so it should have accounted for output tax on all the receipts. The accountants were instructed to make a disclosure.

HMRC argued that this disclosure was "prompted", because a control visit had been booked. The charity argued that it was unprompted, because the disclosure would have been made anyway. HMRC accepted that the quality of the disclosure made was such that the maximum mitigation should be given, but this was only 15% for a prompted disclosure. The resulting penalty was nearly £105,000.

The Tribunal accepted that the disclosure was not "prompted" in the colloquial sense – it did not result from anything done by HMRC. It would have happened anyway. However, that was not what the legislation meant by an unprompted disclosure. It must be made at a time when the taxpayer had no reason to believe that HMRC were about to discover the error. In view of the impending visit, and the fact that the output tax liability was likely to be discussed at that visit, this could not be said to apply.

As the charity had no immediate plans for another UK congress, and had deregistered for VAT in the UK, it was not possible to suspend the penalty. Although there were some flaws in the way the HMRC officers had refused suspension and upheld that decision on review, the Tribunal decided that the decision was undoubtedly correct – the charity had not made any taxable supplies since the 2009 congress and had no plans to do so, so it could not comply with suspension conditions.

First-Tier Tribunal (TC02698): *United European Gastroenterology Federation*

A mosque registered for VAT in October 2007, backdating the EDR to 2 March 2006. In its first return, to April 2008, it claimed an input tax repayment of £36,700 in relation to the costs of building the mosque. HMRC refused the claim on the grounds that it did not relate to a taxable business. The officer who visited to verify the claim entered into some correspondence about the possibility of the mosque deregistering and claiming under the DIY builders' scheme, or remaining registered and restricting its claim to 65% of the VAT on the basis of an option to tax.

In November 2008 HMRC received a notification of an option to tax, purporting to take effect from 1 January 2003. HMRC responded, pointing out that notification should have been made within 30 days and asking for further information. There was no response from the management committee of the mosque, in spite of repeated attempts by the officer to clarify their intentions.

The appellant made a further return for its period to April 2010, claiming £42,200, which included the same VAT that had already been refused for the earlier period. HMRC ruled that it was not deductible at all, and an officer decided that the return contained a deliberate inaccuracy. A penalty of £20,700 was imposed. The management committee of the mosque appealed.

The Tribunal judge observed that churches are often allowed 25% input tax recovery, even though any taxable activity is incidental to the main function of the building as a place of worship. It appeared that, in negotiations over the first claim, the committee had arrived at the genuine belief that the mosque would be entitled to 65% of the input tax back; the Tribunal accepted that the return was submitted, claiming 100%, honestly believing that this was the opening of a negotiation – that the return would again be subject to verification and bargaining would follow. However, that was not how the system should operate. The claim for the extra 35% was known to be excessive, so it was a "deliberate error", and the Tribunal set the penalty at 35% of that. The claim for the 65% was held to be "careless", and the penalty was set at 15%. HMRC were directed to consider whether the "careless" part could be suspended.

First-Tier Tribunal (TC02727): *Bilal Jamia Mosque*

6.8.4 Dishonesty penalty

An accountant registered for VAT in 1977 and deregistered in 1997, although he continued to practise. His self-assessment returns for the years from 2003/04 (based on the accounting year to 31 July 2003) to 2008/09 all showed turnover above the VAT registration threshold. HMRC started an investigation under Public Notice 160; the accountant refused to attend an interview, even though the consequences of doing so were explained to him. He entered into correspondence with HMRC and provided various documents, but by the time he came to appeal against an assessment to tax and a 100% penalty, he appeared to be confused and unwilling to take any further part. The Tribunal judge noted that he was in his mid-80s.

This was the only ground on which the judge appeared to consider that mitigation of the penalty was appropriate: she gave him 20% mitigation for being old, but confirmed that the penalty and the assessment were both due. As this is a matter involving dishonesty, the accountant will presumably be struck off by ICAEW.

One curious point about the matter is touched on but not fully explained by the decision. HMRC based their assessment on the self-assessment returns as if the turnover was VAT-exclusive. The accountant argued that it was VAT-inclusive, because he would not be able to charge the VAT to his clients. This seems unarguably correct, but the assessment was confirmed; perhaps the accountant should have taken a more active part in the hearing, rather than attempting to withdraw his appeal at the start. Because the penalty was 80% of the assessment, the difference this makes is over £60,000.

First-Tier Tribunal (TC02680): *I Argent*

6.8.5 Sales list penalty

HMRC imposed the rare s.66 VATA penalty for failure to submit EC Sales Lists by the due date – £500 for the 6/11 period and £1,000 for the 12/11 period. The company's director was certain that no penalty liability notice had been received. The Tribunal accepted this statement and cancelled the penalties.

First-Tier Tribunal (TC02657): *ETP Card Processing Ltd*

6.8.6 Late appeals

A social club has succeeded in persuading the Tribunal to allow a gaming machine appeal to be made out of time. It made the original claim by voluntary disclosure in January 2007, and HMRC refused it within a week. The club's representative, a firm of accountants, wrote in 2011 stating that one of its employees discussed the 2007 refusal with a named officer, who said that the claim would be allowed if Rank succeeded in their appeal, and that no formal written appeal was necessary. HMRC refused to accept that this extended the time to appeal.

The Tribunal accepted that the appellant's witnesses were credible. There was evidence to support the assertion that the representative had contacted the officer two days after the original decision, even though the officer could not recall the conversation; and it was logical to suppose that, had the officer said a formal appeal was necessary, one would have been made at the time. The Tribunal distinguished this case from a number of others where leave to appeal out of time has been refused. On the facts, it seemed fair to give permission.

First-Tier Tribunal (TC02623): *Heald Green Social Club and Institute Ltd*

A routine dispute about a *Linneweber* claim involved a decision made by HMRC in November 2006. The company claimed never to have received this decision, but later correspondence implied that it had in fact been received. Leave to appeal out of time was refused. When attempting to re-open the claim in May 2011, a director of the company referred to a "refund [claim] received by you on 21.09.06". The only place where HMRC had said when this letter arrived was in the refusal decision of November 2006; the director had no other explanation for quoting the precise date.

First-Tier Tribunal (TC02659): *DL Leisure Ltd*

Another *Linneweber* application followed a different path. A claim was submitted in August 2006 and received no response. A follow-up was sent in January 2007, eliciting a refusal dated 30 January 2007. On 5 February 2007 the appellants sent a letter asking for their case to be stood over behind *Rank*. HMRC claimed never to have received this letter, but the Tribunal found as a fact that they did. The company wrote again on 15 October 2009, following the High Court decision in *Rank*. HMRC refused again, this time giving full details of the rights of appeal. The company's accountants wrote in July 2011 to ask about progress, and this appears to have led to yet another rejection, which again referred to a time limit of 30 days for appealing, and this happened again in October/November 2011.

On 5 March 2012, the company finally submitted a formal notice of appeal. HMRC now relied on the time limit and asked for the appeal to be struck out.

The Tribunal considered the recent decisions of the Upper Tribunal in *O'Flaherty* and *Data Select*. A number of questions were suggested by those decisions; there was no limit on the discretion to extend time, but it was for the appellant to show why time should be extended, and an extension should be the exception rather than the rule. It was clear from the correspondence that there had been some misunderstandings, but the bare fact was that the company had been refused at least three times and given a time limit in which to take action, and had not done so. It had not shown proper attention to its affairs, and could not justify the exceptional extension of its rights to appeal.

First-Tier Tribunal (TC02724): *Chisholm Bookmakers Ltd*

A property development company was involved in a long-running dispute with HMRC. The Tribunal picked its way through the history, identifying a number of decisions and assessments and trying to identify which the company could reasonably appeal against. It refused leave to appeal against some, but gave permission in principle to appeal against others, provided the company now complied with certain directions about submitting a proper notice of appeal with all the supporting information required by the Tribunals rules.

First-Tier Tribunal (TC02675): *Romasave Property Services Ltd*

In a case about assessments to corporation tax and penalties for failing to deliver returns on time, a company argued that the 30-day time limit for making appeals was an infringement of its human rights. The Tribunal considered the question in detail and concluded that there was no such infringement. The discretion of the Tribunal to accept late appeals in appropriate circumstances (and HMRC's practice of not raising objections for short delays) adequately dealt with any possible unfairness in setting a tight statutory deadline. The application for a late appeal was dismissed again.

First-Tier Tribunal (TC02743): *Aqua Products Ltd*

6.9 Other administration issues

6.9.1 40 years on

In an article in *Taxation*, Neil Warren celebrates the 40th anniversary of the introduction of VAT in the UK by reviewing some of the key developments in the tax over that period. In his view, these include:

- Jaffa cakes (1991) – *United Biscuits* (VTD 6,344)
- the option to tax (1989)
- Card Protection Plan (CJEU 1999)
- arguments about land or services
- the flat rate scheme (2002)
- changes in the rate – in 1979, the standard rate of VAT was 8% and the basic rate of income tax was 33%; now both are 20%.

Taxation, 4 April 2013

6.9.2 HMRC suing for fraud

HMRC sued a number of companies for damages in connection with carousel fraud. It opened proceedings in the UK High Court, and also in the Danish courts. EU law provides that certain decisions of the High Court would be binding in Denmark; if this was covered by what is called the 'Brussels I Regulation', the Danish proceedings would be stayed while the UK case was heard. The Danish court referred questions to the CJEU to determine whether it ought to stay its proceedings.

Advocate-General Kokott has given an opinion that HMRC are acting in the capacity of a private person, as the victim of a fraud, rather than in the exercise of sovereign power. The case is therefore in the context of infringements of legally-protected rights, a civil and commercial matter, and that is within the Brussels I Regulation. Tax was the context of the dispute, but it was not really about tax but about fraud. In the A-G's opinion, therefore, the Danish proceedings should wait for the UK decision.

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

Meanwhile, the High Court has found in HMRC's favour in relation to the great majority of the claims it made – 23 out of 26 sample supply chains were shown to be fraudulent and led to a VAT loss. The company was a party to a conspiracy and was liable in damages. HMRC's claim was for £40m.

High Court: *HMRC v Sunico A/S*

6.9.3 NHS trusts accused of tax avoidance

It has been reported that HMRC are investigating a number of NHS trusts over the alleged use of VAT avoidance schemes. The scheme described involves hiring locum doctors as if they were staff, rather than through an agency. This certainly would avoid VAT, but would possibly create a number of other problems instead; the question is whether the trusts have pretended that the VAT advantage is due while still actually using the agency to avoid all the problems of payroll and employment rights.

Some trusts apparently used locums who had set up their own personal service companies. These might be below the VAT registration threshold and therefore able to avoid VAT.

Financial Times, 28 June 2013

6.9.4 Ringing the changes

HMRC are introducing new cheaper helpline numbers for VAT, National Insurance, Income Tax and Self Assessment. The 0300 prefix is cheaper for the caller than an 0845 number.

From 12 June 2013, the VAT numbers will change as follows:

Line	Old Number	New Number
VAT Enquiries	0845 010 9000	0300 200 3700
VAT Online Services Helpdesk	0845 010 8500	0300 200 3701
VAT, Customs & Excise Welsh Language Line	0845 010 0300	0300 200 3705

The old numbers will continue to work for about 18 months.

search2.hmrc.gov.uk/kb5/hmrc/contactus/home.page

6.9.5 Criminal investigation procedures

HM Inspectorate of Constabulary (HMIC) has published a report following an enquiry into the extent to which HM Revenue and Customs (HMRC) is meeting its statutory disclosure obligations under the Criminal Procedure and Investigations Act 1996. Overall, it finds HMRC has invested in processes to reduce the risk of unsuccessful prosecutions, but still needs to improve governance and leadership. Failures in following disclosure procedures have led to the collapse of some high-profile MTIC prosecutions, but changes in law and rigorous challenges to VAT claims has led to a significant reduction in offences.

The targets for prosecution are interesting:

2011/12 – target 365, achieved 302;

2012/13 – target 565, achieved by November 2012, 349;

2013/14 – target 765;

2014/15 – target 1,165.

200 new investigators and 40 intelligences officers have been recruited to manage the expanding workload.

www.hmic.gov.uk/media/hmrcs-disclosure-compliance-with-criminal-investigations-20130610.pdf

6.9.6 Search warrants

The High Court has considered the issue of search warrants, approved by magistrates and executed by HMRC, in connection with an investigation into alleged VAT fraud at a restaurant. The application for judicial review of the warrants was allowed, as they were too widely drawn – they did not identify the items sought, as required by the law. However, the remedy sought – the return of all original and copy documents – was not granted. A remedy of damages might be appropriate, but some of those documents that had been seized would have been lawfully taken if the warrants had been properly drawn up, and they were appropriate for consideration by a Crown Court judge.

R (on the application of Hoque) v City of London Magistrates Court and another

6.9.7 The fight on fraud

HMRC have announced a new "taskforce" to target people in London who are claiming VAT repayments they are not entitled to. The press release contains some interestingly contradictory statistics:

- HMRC has brought in more than £70 million since the initial taskforces were launched in 2011-12. They expect to bring in over £90 million from taskforces this year.
- Taskforces are a result of the Government's £917 million spending review investment to tackle tax evasion, avoidance and fraud from 2011-12, which aims to raise an additional £7 billion each year by 2014-15.
- Last year HMRC brought in £20.667 billion of additional revenues from tackling avoidance, evasion and criminal attack.

These numbers do not all appear to relate to each other.

HMRC Press Release 13 May 2013

HMRC issued a briefing paper describing a range of measures being employed against tax evasion among traders in the "hidden economy". The briefing states that "*Our aim is to change the behaviour of those who are part of the hidden economy, or are tempted to join it, to ensure everybody pays the tax they owe.*" These "carrot" measures include:

- *supporting business start-ups with educational guidance and tools so they know what they needto do and are steered away from joining thehidden economy*
- *making compliance easier, so people come forward and pay the tax they owe*

These positive measures are balanced by "sticks":

- *improving how we identify those outside the tax system, including the use of more data held by third parties*
- *taking a tougher approach to those businesses who refuse to come forward.*

There is a longer list of more detailed measures being taken, and yet another statistic describing their success – "*in 2012-13 we investigated more than 19,300 potential hidden economy participants, securing more than £160 million in taxes*."

HMRC Briefing 19 April 2013; www.gov.uk/government/organisations/hm-revenue-customs/series/briefings

The government continues to "name and shame" those convicted of tax offences, including a former magistrate and a company director who faked documents in a £1m VAT fraud linked to the house building trade in Lancashire, who were jailed on 13 May 2013. One pleaded guilty, the other not guilty, but both were convicted: the pleas appear to have made little differences to the sentences (3.5 years and 40 months).

rnn.cabinetoffice.gov.uk/Press-Releases/Magistrate-jailed-for-1m-VAT-fraud-68c71.aspx

The director of a timber merchant which went bust owing over £700,000, with poor accounting records and having apparently traded over the registration threshold after deregistering for VAT in October 2003, was barred from acting as a company director for 10 years after an Insolvency Service investigation.

rnn.cabinetoffice.gov.uk/Press-Releases/TIMBER-Tax-dodging-wood-merchant-gets-ten-year-ban-68bad.aspx

The managing director of a clothing firm was jailed for 18 months for failing to pay over his company's VAT and PAYE deductions. The tax returns showed turnover of £1.2m for an 18 month period, but HMRC's investigation suggested it was over £7m. The VAT understatement was between £300,000 and £500,000.

rnn.cabinetoffice.gov.uk/Press-Releases/Clothing-chain-boss-jailed-for-VAT-fraud-68cd1.aspx

A "missing trader" fled the UK shortly before his trial for setting up one of the earliest carousel frauds in CPUs during the 1990s. He was re-arrested in Ireland and extradited to the UK, where he pleaded guilty and was sentenced to four and a half years in jail.

http://www.cps.gov.uk/news/latest_news/most_wanted_fugitive_jailed_for_11m_tax_fraud/

6.9.8 Updated Notice

HMRC have issued a new version of their Notice *Insolvency*, replacing the March 2013 edition. Section 17 dealing with Law of Property Act (LPA) receivership has been reworded, with inclusion of details to facilitate electronic payment of VAT by LPA receivers.

Notice 700/56