VAT UPDATE
JULY 2015

Covering material from April – June 2015

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1. INTRODUCTION

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

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

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

1.1 Appeals pending

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

The HMRC website section says that it will be updated "on a monthly basis", but it appears to be less frequent or regular than that. The latest update appeared on 18 May 2015 after a gap since 19 January.

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

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

1.1.1 UK appeals awaiting hearing or decision

- *Associated Newspapers Ltd*: HMRC are appealing to the UT against the FTT's interpretation of SI 1993/1507 on gifts of business services (hearing listed for 5 – 7 October 2015).
- *Bridport & West Dorset Golf Club*: the HMRC list notes that three follower cases are going to the FTT on the question of unjust enrichment, hearings listed for 22 – 26 June 2015.
- *British Film Institute*: HMRC have been granted leave to appeal to the Court of Appeal against the UT's confirmation of the FTT's decision that the Institute was entitled to rely on the cultural services exemption in the period 1990 – 1996 in support of a *Fleming* claim.
- *Brockenhurst College*: HMRC have been granted leave to appeal to the Court of Appeal against the UT's confirmation of the FTT's decision that supplies of meals to outsiders were an essential part of the education of the students who prepared and served the meals (appeal scheduled for November 2015).

- *CCA Distribution Ltd*: HMRC have been granted leave to appeal in relation to 4 of 8 stated grounds against FTT's finding that fraud was not the only explanation of transactions in a MTIC case (hearing date set at 29 June – 1 July 2015).
- *Colaingrove Ltd*: HMRC's list includes separate entries for
  - TC02715 (removable contents/definition – UT allowed HMRC's appeal in part; taxpayer was granted leave to appeal to the CA, but has dropped the appeal).
  - TC02701 (removable contents/apportionment – appeal stayed pending decision in TC02715, neither party now pursuing the matter).
  - TC02534 (fuel – UT decision in favour of HMRC in last update; in April the CA started to hear the company's appeal against the UT's recent decision that it was not entitled to apply the lower rate to electricity supplied as part of a compound supply of "caravan with electricity"). This therefore appears to be the only remaining "live" issue.
  - TC02701 (verandas – UT decision in favour of taxpayer in last update – HMRC will not appeal, and will shortly issue a R&C Brief).
- *Davis & Dann Ltd and Precis (1080) Ltd*: HMRC have received leave to appeal to the Court of Appeal against the Upper Tribunal's decision that the companies did not have the means of knowing that their transactions were connected with fraud (hearing listed for 24 November 2015).
- *DPAS Ltd*: Upper Tribunal heard HMRC's appeal against the FTT's acceptance that a VAT planning arrangement to circumvent the *AXA* judgment was effective and not abusive (hearing 6/8 May 2015, decision awaited).
- *Finance and Business Training Ltd v HMRC*: taxpayer is applying for leave to Court of Appeal against UT's upholding of FTT's decision that it was not an "eligible body" by being so closely connected with the University of Wales that it became a "college of the university" – oddly, the list says that "HMRC is appealing", even though the decisions below went against the taxpayer (hearing listed for October 2015).
- *Finmeccanica Group Services Spa*: HMRC have been granted permission to appeal to the UT against the FTT's decision that services were not subject to UK VAT (hearing listed for 3 June 2015).
- *GMAC UK plc v HMRC*: last update reported the reaffirmation of the UT decision in favour of the taxpayer on the basis of the CJEU decision (Case C-589/12). HMRC has been granted permission to appeal to the CA.
- *Investment Trust Companies (in Liquidation) v HMRC*: after the CA effectively reversed the High Court's decision in relation to the companies' direct claims for overpaid VAT, both parties are applying for leave to appeal to the Supreme Court.

- *Iveco Ltd*: HMRC have been granted leave to appeal to the Upper Tribunal against the FTT's ruling that a claim for repayment was not subject to the cap (hearing listed for 24 – 25 November 2015).
- *Longridge on the Thames*: HMRC have been granted leave to appeal against the UT's dismissal of their HMRC appeal against the FTT's ruling that a charity was not in business and could receive building services zero-rated (appeal scheduled to start in the Court of Appeal 19/20 April 2016).
- *Mercedes-Benz Financial Services UK Ltd v HMRC*: HMRC have been granted leave to appeal to the Court of Appeal against the decision that the Agility product involved a supply of services rather than goods (hearing commences 21/22 October 2015).
- *MG Rover Group Ltd*: HMRC have been granted leave to appeal against the FTT's decision about who is entitled to claim a refund where an overpayment was made on a group VAT return – case management decisions on this case and *Standard Chartered/Lloyds Banking Group* were issued in March 2015, hearing listed for July 2016.
- *Pacific Computers Ltd*: the FTT found in favour of a MTIC appellant. HMRC are seeking leave to appeal to the UT.
- *Privin Corporation Ltd*: the FTT found in favour of a MTIC appellant. HMRC are seeking leave to appeal to the UT.
- *The "Spotting the Ball" Partnership & Others*: the taxpayers have been granted leave to appeal to the CA against the UT's overruling of the FTT decision in their favour in relation to the exemption of "spot the ball" competitions (hearing listed for November 2015).
- *Vodafone Group Services Ltd*: HMRC have been granted leave to appeal against the FTT's decision that the trader could replace the reasons for an in-time but disputed claim with the grounds for an accepted but out-of-time claim (UT hearing listed for December 2015).
- *Wakefield College*: HMRC have been granted leave to appeal against the FTT's decision (itself a finding on remittal from the UT) that the college's buildings were used for non-business purposes (hearing listed for 27 – 28 July 2015).

1.1.2 Cases going no further

HMRC's list suggests that the following cases will go no further:

- *Colaingrove Ltd*: as stated above, HMRC's list suggests that three of these cases have been abandoned.
- *Earthshine Ltd v HMRC*: Court of Appeal refused leave to appeal against UT's upholding of FTT's decision that it should have known of connection to MTIC fraud and was therefore not entitled to input tax credit.
- *Royal College of Paediatrics and Child Healthcare & Coleridge Ltd*: UT overturned the FTT's decision that a transfer of property

constituted a VAT-free TOGC, but the assessment was out of time. HMRC are not appealing on the time limit point.

1.1.3 Unresolved cases not on the list

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

- *AN Checker Heating & Service Engineers*: it was reported that the taxpayer will appeal to the UT against the FTT's decision that none of its supplies of boiler installation qualified for the lower rate as the installation of energy-saving materials. The hearing has apparently been stood over pending the UT's decision in the *Colaingrove* (fuel) case.
- *HMRC v Atlantic Electronics Ltd*: the Court of Appeal has reserved judgment in a dispute about the admissibility of evidence in a MTIC fraud case.
- *John Wilkins Ltd and others*: Supreme Court refused HMRC permission to appeal one aspect of the case, in which the Court of Appeal decided that motor dealers were entitled in principle to claim compound interest on VAT repayments. Substantive issue stayed pending the *Littlewoods* decision in the Court of Appeal (High Court applied the CJEU's judgment in Case C-591/10 in favour of the taxpayer, but HMRC have appealed).
- *Leeds City Council v HMRC*: taxpayer council's appeal to the Court of Appeal against the UT's decision that the three-year cap validly blocked a number of claims for repayment was heard in December 2014.
- *R (on the application of Rouse) v HMRC*: HMRC appealing against Upper Tribunal's decision that they were not entitled to set off a credit against money owing from the taxpayer under s.130 FA 2008.
- *Volkswagen Financial Services (UK) Ltd v HMRC*: CA has given taxpayer leave to appeal against the Upper Tribunal's decision in favour of HMRC, overturning the FTT's decision that the company's suggested partial exemption special method was more fair and reasonable than HMRC's.

1.1.4 Cases in the current update

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

- *Littlewoods Retail Ltd*: Court of Appeal decision on compound interest in this update, refusing HMRC's appeal against HC decision to award £1bn to the taxpayer; HMRC are considering applying for leave to appeal to the Supreme Court.
- *National Exhibition Centre Ltd*: HMRC appealed to the UT against the FTT's ruling that services were exempt payment processing; UT decided to refer questions to CJEU, details in this update.
- *Newey (t/a Ocean Finance)*: HMRC appealed to the Upper Tribunal after the FTT held that a scheme was effective in reducing irrecoverable VAT on advertising costs by moving a loan broking

business to the Channel Islands – HMRC regard the CJEU judgment (Case C-653/11) as being ‘in their favour’; however, UT dismissed HMRC’s appeal.

- *Pendragon plc v HMRC*: Supreme Court allowed HMRC’s appeal against the Court of Appeal’s ruling that the Upper Tribunal had incorrectly overturned the FTT’s decision that the company’s arrangements were not abusive.
- *The Chancellor, Masters & Scholars of the University of Cambridge*: the UT dismissed HMRC’s appeal against the FTT’s decision that the costs of managing the endowment fund were residual and partially recoverable.
- *The Open University*: the UT dismissed HMRC’s appeal against the FTT’s ruling that the OU was entitled to exemption in respect of supplies by the BBC.

1.1.5 Other known developments on appeals

Other developments on appeals that have been reported include:

- *Airtours Holiday Transport Ltd v HMRC*: the Supreme Court has given the taxpayer leave to appeal against the UT’s decision, upheld by the Court of Appeal, that it could not deduct input tax in relation to fees charged by professional advisers in relation to debt refinancing – the UT held that, in spite of the tripartite nature of the contract, the supply was made to the creditors rather than to the claimant.
- *Changtel Solutions UK Ltd (formerly Enta Technologies Ltd) v HMRC*: Supreme Court has refused the company leave to appeal against the CA’s decision that the Companies Court could hear a winding up petition even though the company had an appeal pending against the liability in the FTT.
- *Fonecomp Ltd v HMRC*: Supreme Court has refused leave to the taxpayer to appeal against the CA’s decision that it was not entitled to input tax credit in a MTIC case. The CA ruled that the Mobilx test was appropriate and was satisfied, and it was not necessary for the company to have detailed knowledge of the fraud or of the connection between its transaction and the evasion of VAT.
- *Shop Direct Group v HMRC*: Supreme Court has granted leave to the taxpayer to appeal against some aspects of the CA’s decision that it was chargeable to corporation tax on VAT repayments and interest on VAT repayments.

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

Nothing to report.

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Financial service?

The questions for reference in the *NEC* case have been published:

1. With regard to the exemption from VAT in Art.13B(d)(3) 6th Directive as interpreted by the CJEU in Case C-2/95 *Sparekassernes Datacenter v Skatteministeriet*, what are the relevant principles to be applied for determining whether or not a service has "the effect of transferring funds and entail[s] changes in the legal and financial situation" within the meaning of paragraph 66 of that judgment? In particular:

1.1. Is the exemption applicable to a service, such as that performed by the taxpayer in the present case, which does not involve the taxpayer debiting or crediting any accounts over which it has control, but which is, where a transfer of funds results, the cause of a transfer of funds made by an independent financial institution?

1.2. In a case where payment is made by credit or debit card, does the answer to Question 1.1 depend on whether the service provider itself obtains authorisation codes directly from the cardholder's bank, or alternatively obtains those codes via its merchant acquirer bank?

1.3. What factors distinguish (a) a service which consists in the provision of financial information without which a payment would not be made but which does not fall within the exemption (such as in Case C-350/10 *Nordea Pankki Suomi*, from (b) a data handling service which functionally has the effect of transferring funds and which the Court of Justice has identified as therefore being capable of falling within the exemption (such as in SDC at paragraph 66)?

2. What are the relevant principles to be applied for determining whether or not a service such as that performed by the taxpayer in the present case falls within the scope of the "debt collection" exclusion from the exemption in Art.13B(d)(3) 6th Directive? In particular, if a service of processing payment by a particular method (e.g. debit or credit card) would, pursuant to the principles in Case C-175/09 *HMRC v AXA UK plc*, constitute "debt collection" in circumstances where the supply of that service was to the person to whom that payment was due (i.e. the person receiving the payment), will that service also constitute "debt collection"

in circumstances where the supply of that service is to the person from whom the payment is due (i.e. the person making the payment)? Further, in the circumstances of this case, does a "debt" even exist to be "collected"?

These questions appear likely to provide clarification on a number of matters of current uncertainty, provided the CJEU answers them directly. The *AXA* judgment remains an anomaly, in that the court applied the rules on debt collection to circumstances that no one else considered appropriate. The second question appears to encourage the court to reconsider the effect of that decision.

CJEU (Reference) (Case C-130/15): *HMRC v National Exhibition Centre Ltd*

2.3.2 SIF?

Questions have been referred by the Belgian court to determine whether a real estate investment fund could qualify as a special investment fund for the purposes of VAT exemption of its management fees, and if so, whether ordinary property management costs would constitute "management" for this purpose.

Advocate-General Kokott has given an opinion that the nature of the underlying investment is irrelevant: if a fund is governed by the UCITS Directive, or by national regulations that are equivalent to it, then it is a special investment fund. What constitutes "management of investments" will differ according to the nature of the assets, so in principle property management expenses could fall within the exemption.

CJEU (A-G) (Case C-595/13): *Staatssecretaris van Financiën, other party: Fiscale Eenheid X NV cs*

2.3.3 Status of vouchers

A group of companies operated licensed lap dancing or table dancing clubs in London under the trading name 'Secrets'. A dispute arose as to the correct VAT treatment of vouchers called 'Secrets money'. A patron who had run out of cash could buy a voucher using a debit or credit card. The company charged a 20% commission on top of the face value (so £100 in 'Secrets money' cost £120); if the voucher was given to a dancer in consideration of her services, she could cash it in at the end of the evening, and would be charged another 20% by the club – so she would receive only £80.

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

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

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

The FTT (TC03255) examined the way in which the business operated, including the contracts between the companies and the dancers, the terms and conditions attaching to Secrets money, and the extent to which customers disputed that they had bought it (the company suffered chargebacks of only £16,000 on £22.5m over a 3 year period – less than 0.1%).

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

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

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

HMRC argued that there was a composite supply of services by the company to the dancers for a composite consideration, and the discount on the vouchers was part of that consideration. It could not be looked on in isolation, but must be examined in the wider context. The entry fee was consideration for the opportunity to dance, and the discount was consideration for access to a wider 'market' – customers who did not have enough cash, but had Secrets money to spend.

The FTT accepted this contention. The discounts were not consideration for a separate financial supply. The appeals were dismissed, and the companies appealed further to the Upper Tribunal.

The Upper Tribunal rehearsed the facts of the case, then examined the decisions of both Sir Stephen Oliver and Neuberger J in the *Kingfisher* case. HMRC argued again that the vouchers were not 'a security for money', but the UT judge agreed entirely with the reasoning and conclusion of the FTT. Even though the vouchers did not expressly include a promise to pay money on their face, there was an implication

that the dancers would be able to encash them – if that did not happen, the scheme would rapidly collapse.

In relation to the nature of the supply, the appellants' counsel argued that the FTT had been wrong to "throw all the factual background into the mix" in determining that the commission was part of the consideration for the composite supply of "access to customers" by the club to the dancers. He argued that the FTT should have started with the contractual position and should have considered the background facts only as a "sense check" of the result. Alternatively, the nature of the supply by the club to the dancers was much more limited: any other benefits to the dancer, beyond the ability to encash the vouchers, were more akin to the benefit to Woolworths in relation to the voucher scheme considered to be exempt in *Kingfisher*.

The judge examined the "contractual position" argument, for which counsel relied on the Supreme Court's decision in *SecretHotels2*. He did not agree that the facts were sufficiently similar for that precedent to be of assistance. There were no written contracts purporting to set out comprehensively the rights and duties of the club and the dancer. In the absence of such documents, the rights and duties have to be drawn from such documents as do exist together with the way the clubs conduct their business.

The judge went on to distinguish the Secrets voucher scheme from that operated in *Kingfisher* or by credit card companies. A retailer is solely responsible for providing the infrastructure and ambience to attract customers to come and spend their money in its stores – the credit card company or voucher provider has no role in that. In this case, the dancers are in the position of "retailer", and the club is "the credit card company". The dancer can only make money out of the vouchers if the rest of the club's facilities are also provided to her.

The judge considered that the encashment of the vouchers could not be separated out as part of a multiple supply from club to dancer. There was a composite supply of which the vouchers formed part. That composite supply went well beyond the scope of item 1 Group 5 Sch.9 VATA 1994. The commission was consideration for a taxable supply, and the appeal was dismissed again.

Upper Tribunal: *Wilton Park Ltd and others v HMRC*

2.3.4 Education

A private college offered "Education Development International" qualifications in English for Speakers of Other Languages (ESOL), painting and plumbing. It treated its supplies as exempt. HMRC ruled that it was not an "eligible body" within VATA 1994 Sch.9 Group 6, and charged VAT of £207,750 plus penalties for £47,744 for the periods 02/11 and 05/11 (the penalties had initially been charged at 50% but were later reduced to 23%).

The FTT agreed with HMRC that the college was not a "school" within the definitions of s.4(1) Education Act 1996. The courses offered were either part-time or highly specialised: they did not constitute "education". School students under the age of 16 did work placements at the college to gain outside experience, but that was not enough to make the college itself

into a school. The teaching of students under 19 was also not enough if it was not carried out in a place where under 16s were taught.

The college was also not a university nor integrated with a university, so it could not qualify under that heading as an eligible body. It had arrangements with several universities which allowed credit for completion of its courses, and it provided a pathway to entry onto degree courses, but that was not enough to make it a college of any particular university.

HMRC were therefore correct to refuse the general exemption available to eligible bodies providing education. However, the ESOL courses qualified for exemption under Group 6 Note 1(f), even if some of those attending the college already had a basic command of English. The appeal was allowed in principle, but the parties were directed to go away and agree the proportion of the income that qualified for exemption. This would presumably not remove the bulk of the assessment or penalty.

First-Tier Tribunal (TC04369): *Bell's College Ltd*

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 FTT decided for the taxpayer, and HMRC's appeal to the Upper Tribunal has recently been heard.

First-Tier Tribunal

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 FTT 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 OU's appeal was allowed.

Upper Tribunal

The judge set out the background and identified the same issues as those considered by the FTT. HMRC were appealing on the third point (organisation having similar objects); as part of its objection to that appeal, the OU argued that the first two issues should have been decided in its favour. The judge therefore reconsidered all three issues.

On the question of whether the BBC is a body governed by public law, the judge examined the precedents and further arguments put forward by the OU's counsel. He rejected the OU's reliance on the UK domestic legislation: according to CJEU precedent, "body governed by public law" has an autonomous EU law meaning.

He went on to consider the CJEU decision in *MDDP* (Case C-319/12), in which the court set out the purpose of the education exemption in clear terms. This post-dated the FTT hearing, and the OU's counsel argued that it supported his case – he contended that the CJEU had drawn a clear distinction between public sector bodies and private sector enterprises. However, the judge did not accept that this point had been relevant in the case: it was rather about whether a profit motive was fatal to a claim for exemption.

Counsel further sought to rely on a definition of "body governed by public law" in the Procurement Directive – that would certainly apply to the BBC. However, the judge concluded that the purposes of the VAT and

Procurement Directives are different, and the roles of the concept of public law bodies in each of them are likewise different.

The judge noted that his first impression had been that the FTT had asked the right questions and had come to the right answer on this point; his more detailed consideration had not changed that.

On the second issue, the judge considered the problems of applying the *Horizon College* decision to distance learning. He drew a distinction between a mere provider of materials (who would be in the same position as Horizon College, which provided only teaching staff), and a provider of materials in the context of a self-contained course. In his view, the BBC did more than provide support to others who supplied education; the BBC had an educational aim.

He decided that this was one of the rare cases in which an appellate Tribunal should overturn a decision below in relation to the facts. His conclusion on the second issue was as follows:

I think that the FTT took too narrow a view of what Horizon College requires, in the context of distance learning provided by a public sector broadcaster. Secondly, I think the FTT's analysis failed to do justice to the scale and variety of the forms of distance learning provided by the BBC throughout the Appeal Period, as reflected in the annual reports from which I have quoted. Thirdly, this led the FTT to state, wrongly in my view, that the BBC always provided "only a part of the package". Finally, the question is not one which turns in any way on the oral evidence, or on the FTT's assessment of the witnesses. In the light of these considerations, I am satisfied that the FTT's conclusion on this issue is erroneous in law; that there would be no point in my remitting it to the FTT for reconsideration; and that I should re-determine the issue myself, under section 12 of the Tribunals, Courts and Enforcement Act 2007, so as to hold that the BBC did at all material times have the requisite educational aim.

This meant that the conclusion on the third issue was simple: if the BBC had the requisite educational aim, it clearly had "similar objects". The judge was satisfied that the conclusion of the FTT – that the definition of such bodies was a matter of EU law rather than relying on specific domestic "definition" – was correct, and was in accordance with the purpose of the exemption as set out by the CJEU in *MDDP*.

HMRC's appeal was dismissed.

Upper Tribunal: *HMRC v The Open University*

2.4 *Zero-rating*

2.4.1 Caravans

A company treated rental of caravans as zero-rated. HMRC raised an assessment for £481,068, covering periods from 12/09 and 04/13, disallowing input tax claimed on that basis; HMRC ruled that the supplies should have been treated as exempt.

The taxpayer supplies caravans, used as mobile homes, to members of what is known as the "travelling community" eligible for housing benefit for use as their homes and to be sited on pitches provided, in general, by local authorities.

The judge noted that one of the taxpayer's complaints was that HMRC had carried out three visits on which they had effectively approved the practice, before raising the issue only on the fourth visit. The judge pointed out that the FTT could not give a remedy on the basis of this argument: that could only be taken to the Revenue Adjudicator, or by applying for judicial review.

The technical argument was also based on Notice 710/20, which gives the following explanations:

You are supplying a caravan if you do any of the following:

- *sell it*
- *lease it under a long term leasing agreement under which the lessee is free to transport it to a park or other place of their own choosing*
- *loan it without making a charge*
- *divert it to your own personal use*

If you provide accommodation in a caravan that is:

- *on a site designated by the local authority as for permanent residential use, and*
- *let to a person as residential accommodation*

your supply will be exempt.

It was common ground that the caravans exceeded the size limits in Sch.8 Group 9 and were capable of being zero-rated if they were supplied in accordance with the conditions of that legislation. The tenants paid the local authority for the right to place a caravan on the site, and rented the caravan itself from the taxpayer.

The taxpayer's counsel characterised the transactions as follows:

(i) the supply of a sited mobile home is a composite supply of both a home and a pitch, whereas the taxpayer's only supply is that of the mobile home;

(ii) the mobile home cannot be an exempt supply in the absence of the supply of the pitch or some other right over land, since the supply of the pitch itself is not by the taxpayer but by a third party site owner, usually a local authority;

(iii) the mobile home lessees are free to move their home to a park or other place of their own choosing.

HMRC responded that Note (b) of Group 9 Sch.8 excludes from zero-rating “the supply of accommodation in a caravan or house boat”. In spite of attempts by the taxpayer’s representative to differentiate that provision from the situation in which travellers were using a caravan as their residence, HMRC argued that it applied. The supply of land was indeed exempt, and was also separate from the supply of the caravan because they were made by different people; but the only possible conclusion was that the supply of the caravan ought to be standard rated.

This possibility had not been raised before the hearing, in correspondence, in the review of the decision or in HMRC’s skeleton argument. The judge adjourned the hearing for the taxpayer’s representative to consider whether he needed to prepare a response; after taking instructions, he decided to carry on without a further delay.

This led to a bizarre result. The judge concluded that HMRC’s arguments at the hearing were correct – the taxpayer’s supplies could not be exempt and they could not be zero-rated, so they must be standard rated. However, that was not the basis for the assessments: they had been raised on the basis that the input tax was not deductible. That was incorrect, so the appeal had to be allowed.

The taxpayer had applied for costs on the basis that HMRC had acted unreasonably in bringing the proceedings. As HMRC’s representative had not prepared a response to this point, the judge gave the parties 30 days to make further submissions about costs. The taxpayer may decide that winning the appeal on these unusual grounds may be enough, and pressing for costs could be a step too far.

First-Tier Tribunal (TC04434): *C Jenkin & Son Ltd*

A company accounted for output tax on supplies of motor homes. It then claimed a repayment of nearly £1.2m on the basis that the supplies should have qualified for the zero-rating traditionally allowed to caravans above a certain size.

The word “caravan” is not defined in the VATA. However, it is defined in one statute, the Caravan Sites and Control of Development Act 1960: “‘caravan’ means any structure designed or adapted for human habitation which is capable of being moved from one place to another (whether by being towed, or by being transported on a motor vehicle or trailer) and any motor vehicle so designed or adapted”. The taxpayer argued that the motor homes it sold clearly fell within this definition. Although exceptions to the general rules of VAT should be narrowly construed, they also should be given their proper effect where they applied.

The Tribunal did not consider the definition in the 1960 Act to be relevant. It was of limited application even in its own context, and was not applicable to the present dispute. The decision referred to an analogy from the 1995 *Colour Offset* case on the zero-rating of printed matter: “a cheque book is plainly not a book”. Similarly, the fact that the vehicles might be called “motor caravans” did not mean that they were, in normal English usage, “caravans”. The judge considered that the context made it clear that the legislation was intended to refer to towed vehicles, not to motorised vehicles.

This was a significant distinction. The judge saw nothing in either UK or EU law to justify disregarding the distinction, just because both types of

vehicle could be used for residential purposes. The taxpayer's appeal was refused.

First-Tier Tribunal (TC04445): *Oak Tree Motor Homes Ltd*

2.4.2 Updated Notices

HMRC have issued a revised version of their Notice *Zero rating young children's clothing and footwear*.

Notice 714

HMRC have also issued a revised version of their Notice *Zero-rating of books and other forms of printed matter*. The treatment of direct mailing/marketing businesses delivering items of printed matter has been added.

Notice 701/10

2.5 Lower rate

2.5.1 Infringement

The Commission took infringement proceedings against the UK in relation to the application of a reduced rate of VAT to the installation of energy-saving materials in dwellings. The dispute started as long ago as September 2011, following which the UK changed the law to withdraw the lower rate for energy-saving materials installed in property used for relevant charitable purposes. The UK continued to argue that installation in houses was in compliance with the Directive.

The reduced rate is permitted by the Directive only for supplies listed in Annex III. These include "the provision, construction, renovation and alteration of housing, as part of a social policy" and "the renovation and repairing of private dwellings".

The Commission argued that the installation of energy-saving materials did not fall within either of these categories. Even if it could be argued to fall within the second, the lower rate was supposed to be applied to the service of installation; item 10a Annex III excludes the materials themselves if they form a significant part of the value of the supply.

The Court agreed. To extend the lower rate to all housing, without regard to the people occupying the property (in particular with no regard to levels of income, age or other criteria designed to give an advantage to those who have more difficulty in meeting the energy needs of their accommodation), could not be regarded as relating either exclusively or principally to reasons of social interest.

The UK tried an alternative argument in relation to the "significant materials" point, suggesting that in some way the zero-rating provisions (still allowed under PVD art.110) applied. The Court rejected this argument and upheld the Commission's complaint on this point as well.

CJEU (Case C-161/14): *European Commission v United Kingdom of Great Britain and Northern Ireland*

2.6 Computational matters

Nothing to report.

2.7 Discounts, rebates and gifts

2.7.1 Clothing allowance

A company provided employees with a clothing allowance in respect of each new "season" which they could use to buy items from the company's stock. They were required to wear the company's products while working in its stores. If they left within 3 months, a deduction was made from their final salary to reflect the value of clothes supplied in that time. HMRC ruled that the stock had been provided to the employees as a taxable supply within Sch.4 para.5, and raised an assessment to output tax. By the time of the hearing, this had been set at £35,724.

The company relied on the exemption from the self-supply charge in art.16 PVD that applies to goods provided for the purposes of the business. The FTT rejected an argument that the clothes were a "uniform" – they did not identify the staff (who had to wear a separate badge for that purpose), and they were not sufficiently alike to constitute "uniform". Even if it had been a uniform, this would not change the VAT treatment – there was no separate or total exemption for gifts of goods for the purposes of the business. The "business gifts" exemption would only apply where the total amount was less than £50 in a year.

The value of the goods was "replacement cost at the time of supply" (Sch.6 para.6). Given that this figure would have been taxed at the time of supply, there could be no further VAT on a charge deducted from an employee's pay on leaving within 3 months of receiving clothes. The company had treated these payments as VATable, so the assessment had been reduced (before the hearing) to take account of this. The taxpayer's counsel tried to argue that "replacement cost after use" – that is, the second-hand value to the employee – was somehow relevant, and it was unascertainable. The FTT agreed with HMRC that it was not relevant to VAT: the value was the cost price to the shop at the time the goods were supplied to the employee, and the conditions of use were not relevant.

The FTT also rejected an argument that the possibility of an employee leaving – and therefore the possibility that there would be actual consideration at some future point – changed the VAT position at the time the goods were supplied to the employee. The VAT treatment had to be determined at the time of supply, and that was the point at which the goods ceased to be part of the assets of the business – the uncertainty about a possible future payment could not prevent there being a supply. It could only be right to cancel a potential double charge if the contingency came to pass, not to cancel the initial supply.

The appeal was dismissed.

First-Tier Tribunal (TC04367): *French Connection Ltd*

2.8 Compound and multiple

2.8.1 Printed matter and service

HMRC assessed a marketing company to £395,157 of output tax in relation to supplies made in its periods 01/09 to 10/12. The company designed sales incentive schemes involving "rewards" for customers of its client businesses. It had treated its supplies of sales promotion activities as partly zero-rated printed matter (e.g. guidebooks listing hotels) and partly standard rated "fulfilment services", including distributing the printed matter, administering offers and benefits, and providing assistance to customers qualifying for those benefits. The promotions had been carried out for various financial companies, and involved offering incentives to existing and new customers.

The company's counsel invited the FTT to consider whether the whole supply might be zero-rated (the printed matter being the principal supply), but concentrated on the question of whether there were separate supplies.

The FTT considered the facts, hearing evidence from the controlling director of the business. Although the company emphasised that the printed matter involved editorial work in its preparation and was not artificially separated from the fulfilment side, the judge had no doubt that the proper characterisation of the business was as a supplier of marketing and promotional services, to which the printed matter was incidental. The guides were not truly bespoke, and they were not sold separately. The assessment was well founded, and the appeal was dismissed.

First-Tier Tribunal (TC04411): *The Marketing Lounge Partnership Ltd*

2.8.2 Updated Notice

HMRC have issued a revised version of their Notice *Postage, delivery charges and direct marketing*. It has been revised to contain more information on when printed matter may be treated as a supply of either delivered goods or direct marketing. Several illustrative examples have been added.

Notice 700/24

2.8.3 Concessionary split

Normally where the principal benefit arising from the payment of a membership subscription is standard rated, any ancillary benefits will also be standard rated. However, HMRC applies ESC 3.35 to non-profit-making organisations:

Bodies that are non-profit making and supply a mixture of zero rated, exempt and/or standard rated benefits to their members in return for their subscriptions, may apportion such subscriptions to reflect the value and VAT liability of those individual benefits, without regard to whether there is one principal benefit. This concession may not be used for the purpose of tax avoidance.

The Reform Club is a non-profit members' club in London. It had benefited from the concession in the past, but a dispute had arisen about how the apportionment between the different elements of the supply should be carried out. Since 1998 the club had used a floor-area based

method that was agreed with HMRC; however, that did not mean that it was the only method that would produce a fair result, nor that it could be regarded as set in stone. In 1998, the calculation led to 54.72% of the subscription being standard rated.

Surprisingly, both parties prepared to debate the substantive issue before the FTT, even though it concerned the application of an ESC – normally that would have to be heard in the High Court or Upper Tribunal as a judicial review matter. The Tribunal invited the parties to agree that it would have jurisdiction; HMRC decided to accept this, without prejudice to its position in any other case involving this or any other ESC.

The club decided that the floor area method was not fair. Its attempt to agree a revision was getting nowhere, so it submitted an error correction claim in respect of its period to September 2013 in order to force an argument. It wanted to exclude the floor area occupied by the restaurant and the bedrooms, because they generated only standard rated income for which separate charges were made. The club believed that the inclusion of areas that generated additional standard rated income resulted in double taxation: there was output tax on the separate charges, and the inclusion of those areas increased the output tax on the subscription income.

The judge did not agree with the logic of this proposition. He considered that there was no double taxation: there was separate taxation of separate supplies. The issue was what the member enjoyed in return for the subscription. That included access to the various facilities, even if additional consideration was required to use them.

The judge was not able to conclude that the present method was fair or reasonable, but he could not accept that the club's suggestion was logical, and it was therefore not more fair or more reasonable than the existing method. On the basis on which it was brought, the appeal had therefore to be dismissed.

First-Tier Tribunal (TC04433): *The Reform Club*

2.9 Agency

2.9.1 Article

In an article in *Taxation*, Neil Warren discusses the problem of three-way supplies. It is important to analyse the contracts between the parties, and the "commercial and economic reality" – that will include what the customer believes is happening.

Taxation 7 May 2015

2.10 Second hand goods

2.10.1 Global accounting

A salvage dealer operated the global accounting scheme to calculate output tax on supplies. A HMRC officer visited the business and concluded that the conditions of operating the scheme were not being complied with. Assessments totalling £22,193 were raised to cover the four periods in 2010. The trader appealed, arguing:

- the value of opening stock in the calculations had been understated, which meant that there was no margin on which output tax should be paid;
- there should be a reduction for goods returned by customers;
- the assessment did not take into account the cost of vehicles purchased as insurance write-offs from an insurance company.

The judge considered the background to the scheme, which allows a second-hand dealer to calculate output tax simply as the VAT fraction of the difference between the cost of margin goods purchased and the amount received for margin goods sold. That was beneficial for a trader who could not identify individual items, and also to a trader who might make losses on some goods and profits on others – in the "normal" margin scheme, there is effectively no relief for losses on any individual item.

Where a global margin trader builds up stock, costs will exceed revenues; the excess is carried forward as a "negative margin" that will be deducted from future sales. A visiting officer in 2008 had recorded negative margin at that time to be £118,772. This was the most reliable piece of information about the state of the business at that time.

The trader's problem was that the records were inadequate and somewhat contradictory. They claimed that there had been additional vehicles purchased from the insurance company, but they had been affected by a long-running legal dispute and the history was unclear; there was no evidence for the customer returns. One of the conditions for operating the margin scheme was to have adequate records. Without them, output tax was due on the full value of sales.

The judge commented that he had no reason to think that the traders had done anything other than their honest best to account for the output tax due on their sales. However, on the basis of the evidence before him, he had no choice but to dismiss the appeal.

First-Tier Tribunal (TC04420): *R & M Stansfield Enterprises Ltd*

2.11 *Charities and clubs*

2.11.1 Charitable construction?

A charity operated a residential centre at which it ran various courses to promote the Christian faith. It constructed a new conference hall, and claimed that the work involved should be zero rated as the building was for a relevant charitable purpose. HMRC considered that charges made to people attending the courses meant that business use was too significant to qualify for the relief.

The question was whether the charity's use of the building, and in particular the charging for courses, was "economic activity". The charity based its arguments on the *Finland* case, claiming that there was not the required link between the service provided and the amount paid by the recipient. The FTT (TC03750) also considered four UK cases where a payment had been held not to be consideration for an economic supply:

- *Lord Fisher* (private shooting parties);
- *ICAEW* (regulatory activities);
- *St Paul's Community Project* (nursery for disadvantaged children);
- *Yarburgh Children's Trust* (renting a hall to a nursery).

The FTT decided that:

(1) the exceptions to the general rule arise where the inherent nature of the activity is not economic, and the circumstances and nature of an organisation may be relevant to this;

(2) if the nature of what is received is that it is not consideration for the supply or adequately linked to the supply there will be no economic activity either because the general rule is not satisfied or because that affects the nature of what is done; and

(3) the Lord Fisher indicia, as we understand them, remain a useful tool in deciding whether or not an activity is economic.

The FTT also had to consider whether the ground floor of the hall was used as "residential accommodation for students", which would qualify for zero rating as a relevant residential purpose. It set out a number of factors which it regarded as relevant in defining "residential" and "students or school pupils".

Having set out these principles, the FTT examined the facts and attempted to apply the principles to them. Although the organisation did not try to make a profit, the students made payments and received something in return for them; the fees were lower than they would have been had the organisation been commercial, but they were not so low that they could be regarded as not being consideration.

The use of volunteers was considered as something that might affect the decision, but the FTT held that a subsidy in kind was not different from a financial subsidy. It was not enough to change the intrinsic nature of the organisation's activities, which were the provision of a service in return for payment. The *Lord Fisher* criteria also did not suggest that the organisation was one of the exceptional cases which would be outside the scope of VAT.

The occupation of the residential parts was not similar to those activities normally considered to be "relevant residential". The occupants were not students on a formal course leading to any examination or qualification; they were only in residence for short periods, akin to the type of stay that might be enjoyed in a hotel. The participants were serious about their learning, but it seemed that they came for a holiday as well as study, and they could not really be called students.

Use of the upper floor for worship was not an economic activity, but the whole of the building was used at some time for the paid courses. None of it could therefore qualify as being for a relevant charitable purpose.

The appeal was dismissed by the FTT. The charity appealed, and in the course of correspondence agreed with HMRC that both parties would like a question referred to the CJEU. The Upper Tribunal therefore heard a joint application for such a reference.

The issue on which the charity is appealing is whether the FTT made an error of law in holding that the conference hall did not qualify for RCP treatment as used "otherwise than in the course or furtherance of a business". Both parties considered that the meaning of "economic activity" (which they both agreed was the same as "business" for this purpose) was unclear.

Judge Berner did not agree that this was appropriate. It might be that, after hearing all the arguments, the Tribunal would decide that it could not with complete confidence come to a decision without a reference to the CJEU; but it could only come to that conclusion after hearing the arguments. Referrals to the CJEU are covered by art.267 of the 2009 Treaty on the Functioning of the EU:

The Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning:

(a) the interpretation of the Treaties;

(b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union;

Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court to give a ruling thereon...

It is therefore for the Tribunal or court to decide whether it needs to make a reference; even though both parties wanted one, that was not sufficient to decide the matter. It must be necessary, not simply desirable. The judge considered a number of precedents, and also examined the questions that had been drafted by the parties. He commented that questions should relate to the construction of a Directive, not to its application to the facts of a particular case. In the judge's view, there was a great deal of CJEU precedent case law on each of the matters in the draft questions, and the Tribunal hearing the full appeal would be able to come to a decision based on the principles established in those decisions. He refused the joint application to make a reference.

Upper Tribunal: *Capernwray Missionary Fellowship of Torchbearers v HMRC*

2.11.2 Manual published

HMRC have published a new guidance manual on determining charitable status and charitable activities for VAT purposes.

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

2.11.3 CASC guidance notes

HMRC have issued detailed guidance notes for Community Amateur Sports Clubs. These are treated in a similar way to charities for direct tax purposes, but do not enjoy all the reliefs available to charities for VAT. They will in general be able to qualify as "eligible bodies" for the sporting exemption, and will also enjoy the exemption for fund-raising events.

www.gov.uk/government/publications/community-amateur-sports-clubs-detailed-guidance-notes

2.12 Other supply problems

2.12.1 Domestic reverse charge

HMRC have updated their Notice on the reverse charge that applies to "specified goods and services", including certain supplies of mobile phones. It has been amended to cover the new reverse charge on wholesale supplies of gas and electricity introduced in July 2014, and its title has been changed to emphasise that it is a reverse charge that applies to domestic supplies (as opposed to the reverse charge on cross-border supplies of services).

The definition of "mobile phone" has been updated to reflect the fact that there are now very similar tablet devices.

Notice 735

2.12.2 Road fuel scale rates

HMRC have published the new table of scale rates applicable from 1 May 2015.

https://www.gov.uk/government/publications/vat-road-fuel-scale-charges-table/vat-updated-valuation-table-road-fuel-scale-charges-from-1-may-2015

2.12.3 Article

In an article in *Taxation*, Neil Warren discusses possible problems arising from descriptions of supplies on invoices. A charge may be described in a way that is intended to produce an advantage, but may have other unfortunate consequences – not least that HMRC may argue that the invoice is misleading.

Taxation 22 April 2015

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Land and services

A public sector body was responsible for letting state land and buildings. It charged tenants for electricity, heating, water and refuse disposal. The tenants generally paid the landlord in advance and the amounts were adjusted at the end of the year to reflect the underlying cost. The Polish authorities decided that there was a single supply of immoveable property that was, in the circumstances, all taxable at the standard rate. As some of the utilities were eligible for lower rates, it was important to determine whether they could be separate supplies. Questions were referred to the CJEU.

The court considered that it was possible for such ancillary supplies to be part of a single supply or separate supplies; it was also possible for the payment by the tenant and collection by the landlord to be a disbursement arrangement, with the underlying supply being made directly from the utility company to the tenant. It would be for the national court to determine the facts. However, the evidence in the referral suggested that this case involved supplies being made to and by the landlord: the tenants were not contracting with the underlying suppliers, even if they only paid the underlying cost. Further, the fact that supplies were metered and itemised on invoices was suggestive of separate supplies rather than a single supply.

The cases of *Field Fisher Waterhouse LLP* and *BGZ Leasing* were considered. The terms of the tenants' leases could be relevant: if they were free to make their own arrangements for the ancillary supplies and choose their own providers, that would be indicative of separate supplies; if the payments were effectively a mandatory part of the agreement between landlord and tenant, and non-payment could lead to termination of the lease, they were more likely to be part of a single supply.

CJEU (Case C-42/14): *Minister Finansow v Wojskowa Agencja Mieszkaniowa w Warszawie*

3.1.2 Entry to craft fair

A sole trader organised craft fairs in and around Dorset. She charged stall holders for space to sell, and she charged entrance fees to the public. The stall fees were regarded as exempt, while the entrance fees were treated as taxable.

In May 2013, HMRC wrote to the taxpayer to tell her that the stall fees were in reality for a "package of services" rather than purely for land, and they did not qualify for exemption. This decision was upheld after a review, and she appealed to the Tribunal.

The taxpayer's counsel argued that the essential supply was simply of space. If there was any additional element, it was ancillary and incidental to the supply of land. HMRC's counsel responded that the essence of the supply was a licence to use land: the land, like food in the supply of restaurant services, is not ancillary but of central and indispensible

importance to a single supply, namely the organisation of a craft or garden fair at which stallholders are able to exhibit their wares for sale.

The Tribunal examined the way in which the fairs were organised. The taxpayer hired marquees and other facilities such as portable toilets, and employed staff to act as ticket sellers and car park marshals. The advertising material to the stallholders included the following:

Our affordable stall prices and reasonable entrance charges ensure that you reap the financial rewards you deserve at a Craft Carnival fair. Everything we do is designed to make your experience of our events pleasurable and stress-free, as well as profitable. Your comments and suggestions are always welcome and, as ever, we will do our best to accommodate any special requirements you may have.

The contracts between the taxpayer and the stallholders were also considered in detail. This described the supply as "a licence to use a stall or pitch at the event specified overleaf ("the Show") to offer certain goods for sale."

The Tribunal considered precedents on economic reality, compound and multiple supplies, and the exemption for supplies of land, including *Sinclair Collis*. There were some very old Tribunal decisions about stall hire – *Tameside Metropolitan Borough Council* (VTD 733), *WB Enever* (VTD 1,537), *Miller Freeman Worldwide plc* (VTD 15,452), as well as *Southport Flower Show* (TC01938).

The judge was satisfied that the supply was, according to the contract and in reality, a licence to occupy land. It differed from *Enever* (where the taxpayer lost) because that involved only a supply of a table rather than a pitch; it differed from *Sinclair Collis* in that the taxpayer allocated a specific location to the stallholder for the duration of the fair. It would also be impossible for anyone else to use the same pitch during that period – in effect, the right to admit or exclude others had been granted.

HMRC argued that leasing or letting was essentially a passive activity, while the taxpayer added considerable value through her efforts in promoting and organising the events. The judge did not consider this to be a matter of principle that excluded such an operation from being a letting of land.

The appeal was allowed.

First-Tier Tribunal (TC04428): *Kati Zombory-Moldovan t/a Craft Carnival*

3.2 Option to tax

3.2.1 TOGC?

An individual was in business running a general store. She owned the premises, which included residential accommodation and a hairdressing salon, which was rented out to another business. In 2005 she opted to tax the building, following which she charged VAT on the rent but was able to fully deduct VAT on works to the building.

On 1 August 2011 the trader sold her business, including the building, to her daughter. No VAT was charged. HMRC subsequently issued an assessment to the trader in respect of the building, because the conditions for a TOGC of an opted property had not been met.

The judge observed that there would be no VAT loss if the daughter could fully recover the VAT charged. HMRC stated that, if the daughter had charged VAT on the rent to the hairdressing salon, they would accept a belated notification of an option to tax and allow the deduction of the VAT that they insisted the mother should pay.

The trader had a number of complaints about the way she had been treated by HMRC, but the judge (while sympathetic) could find no legal basis for her appeal. Even if a belated notification was accepted by HMRC to enable the daughter to deduct the VAT, a TOGC of opted property required the purchaser to opt and to notify before the tax point for the transaction. That clearly had not happened. The appeal had to be dismissed; the judge expressed the hope that HMRC would “sit down together with the appellant and her daughter” and explain the implications. If she wished to pursue her complaints, she would have to go to the Adjudicator.

First-Tier Tribunal (TC04460): *Nora Harris*

3.3 Developers and builders

3.3.1 Construction in phases

York University obtained planning permission to construct a new research facility in two phases. The first phase was completed in August 2004, and was used as a stand-alone building. It was designed so that one wall could easily be removed when sufficient additional funds became available to complete the plan. This was commenced in 2011 and completed in 2013. The works were carried out by a subsidiary of the university.

HMRC issued a ruling that the phase 2 works were standard rated, because they created an extension to the phase 1 building. The company appealed, arguing that there was a single building that was only complete after phase 2.

The Tribunal considered a range of precedent decisions on whether something is an extension of another building or part of a single construction. In nearly all the precedents, on varying facts, the Tribunals had concluded that there was an existing building that was complete, then something else was added to it. This case was no different from them. The phase 1 building could have been used in its existing state indefinitely. The construction of phase 2 was envisaged in the planning permission, but it was not required. The existence of the removable wall was of marginal relevance.

For the purposes of VAT, the phase 2 building was an enlargement of phase 1, and the appeal was dismissed.

First-Tier Tribunal (TC04417): *York University Property Company Ltd*

3.3.2 Not demolished

The owner of an end of terrace Victorian house in Islington obtained planning permission to convert it into three flats. It was sold with the benefit of that permission to someone who decided it made more sense to reconstruct the property, redesigning the interior, and to sell it as a single dwelling.

There was a problem with this: it appeared that demolishing the building entirely would cause the party wall with the next house to collapse. The only way of preventing this during the construction project was to retain half the front facade, which was effectively acting as a prop to the party wall. This was not required by planning permission.

The question was whether the retention of the facade could be disregarded in deciding whether a building has been completely demolished, just as the retention of the party wall itself is disregarded by Notice 708. The judge agreed with HMRC that this was not possible. The words of the law were not satisfied, so the Tribunal could not find for the appellant; the situation was not directly covered by Notice 708, so it was hard to see how HMRC could be constrained by their own policy from issuing an assessment. The sale of the property was exempt, and the input tax claimed by the building company on the property was irrecoverable. The appeal was dismissed.

A separate argument arose about whether the conditions of Note 2(d) were satisfied. It appeared that planning consent for the demolition and construction had not been obtained, because the parties were satisfied that planning consent was not required. HMRC raised this for the first time at the hearing: if the works did not satisfy Note 2(d), they would not be zero-rated. The judge decided not to express an opinion on this argument, because the appellant had not come prepared to deal with it, and in any case the decision on Note 18 meant that it was not necessary. He referred to some precedent case law which suggested that a specific formal consent might not be required if it could be shown that the planning authority had authorised the project in some other way; but the fact that the project was not "carried out in an unauthorised manner" was not necessarily enough on its own to satisfy Note 2(d).

First-Tier Tribunal (TC04488): *M Lennon & Co Ltd*

3.4 Input tax claims on land

Nothing to report.

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 MOSS developments

HMRC have pointed out on Twitter that a simplification for micro-businesses has been extended beyond 30 June. This was initially announced as something that would only apply for the first 6 months of the POSMOSS system:

A business which makes cross-border digital service supplies must obtain and keep 2 pieces of information to evidence where a consumer normally lives. This demonstrates that the correct rate of VAT has been charged and will be accounted for to the correct member state tax jurisdiction. For many micro and small businesses this requirement may be challenging. So, for micro and small businesses that use payment service providers, we suggest the following approach:

At the point of sale, ask the consumer to provide details of either their:

- *billing address, including the member state*
- *telephone number, including the member state dialling code*

When the consumer pays for the digital service, obtain from the payment service provider a notification advice containing the 2 digit country code of the consumer's member state of residence as listed in their records.

The Twitter announcement stated that "We've listened to #VATMOSS microbusinesses & extended simplification of customs location requirements indefinitely." However, the following requirement is still going to be difficult to meet:

If the 2 pieces of information tally, that will be sufficient to define the consumer's location and you can record the details in your accounting records. However, if the information doesn't tally, you must contact the consumer and ask them to reconcile the discrepancy between the 2 pieces of information.

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

Enterprise Nation is a membership organisation for business owners and would-be entrepreneurs. In April it published a report into the impact of MOSS on UK micro-businesses. The report urges the introduction of a threshold below which MOSS will not apply. Particularly striking is a disagreement with HMRC about how many businesses are affected by the rules:

Nevertheless, the issue is that no impact assessment carried out before 2008 could have foreseen the rapid evolution of the digital market, which took place over the past decade. Once taken into account, it undermines the validity of any such assessments. Similar is also the case with the impact assessment by the HMRC (2013). According to it, 34,000 businesses were going to be affected by the new rules. Out of them only 5,000 were approximated as not yet registered for VAT. The consequent increase in annual costs for them was projected to be around £220.

Yet, according to the Small Business Survey (Department for Business, Innovation & Skills, 2014), there were 3,965,775 businesses with no employees in 2014 in the UK. Out of them 2,062,203 (52%) had no VAT registration, of which 17% were in the sectors of 1) Information and Communication, 2) Education, and 3) Arts, Entertainment and Recreation. This by itself suggests that the number of potentially affected businesses may actually amount to 350,574, a figure much larger than the initially estimated by the HMRC 5,000.

The basis of this calculation is questionable, and it appears that the figures are not in concept directly comparable, but the discrepancy is striking: it does seem likely that the number of businesses adversely affected is nearer 350,000 than 5,000.

http://tinyurl.com/ppzy8yw

HMRC have issued guidance for agents on using MOSS to file returns on behalf of clients making cross-border supplies of digital services. It covers:

- VAT MOSS for Agents online service – an overview
- Enrolling for VAT MOSS for Agents
- Online agent authorisation
- More useful links

An authorised agent can do the following things for clients:

- *set up online authorisations which let you act on behalf of your clients for VAT MOSS*
- *request changes to your clients' registration details, for example:*
    - *business or trading name*
    - *business contact details*
- *receive messages from HMRC through the customer communications service - including confirmation of any changes to your clients' details you have requested*
- *send returns and payments on behalf of your clients for:*
    - *businesses registered for Union VAT MOSS from 1 April 2015*
    - *businesses registered for Non-Union VAT MOSS from 7 April 2015*
- *get immediate confirmation that HMRC has received your client's return*
- *complete returns at your own pace – saving part-completed returns for submission later*

The guidance is very brief – probably the most useful part is a run-through of getting authorised to act.

www.gov.uk/government/publications/vat-mini-one-stop-shop-agents-online-service

The guidance was further updated in June 2015 to remind users to keep their bank details up to date in the VAT MOSS system if they think they

may have overpaid and are due a refund. However, the text still refers to a registration threshold of £81,000, so it is not fully up to date.

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

4.1.2 MOSS exchange rates

HMRC have published the usual – albeit the first under the new rules – table of exchange rates to be used by traders registered for the MOSS for the quarter to March 2015. The second quarter's rates were published on 1 July.

Information Sheets 2/2015 & 3/2015

4.1.3 Digital strategy

The Commission has issued a statement about plans for the new "digital single market strategy", due to be introduced in 2016. There is a welcome (if belated) proposal to review the operation of the POSMOSS rules introduced on 1 January 2015, holding out some hope that the effect on small businesses might be reduced (if there are any such businesses still operating in the B2C marketplace by then).

Other radical proposals, that will be less popular in the UK, include extending the current single electronic registration and payment mechanism to cross-border online sales of physical goods; setting a common EU-wide VAT threshold; and abolishing the small consignments relief for non-EU imports.

The Commission appears to believe that this will help stimulate the economy and create hundreds of thousands of new jobs – those businesses that have to deal with new and unfamiliar systems may not agree.

http://europa.eu/rapid/press-release_IP-15-4919_en.htm?locale=en

4.2 Where is a supply of services?

4.2.1 Work on goods

The CJEU has given a ruling on the place of supply of work on tangible moveable property before the VAT Package was introduced in 2010. Under the old rules, work on TMP was generally treated as taxable where it was physically carried out; however, where the customer was VAT-registered in a different country, and the goods were transported out of the country where the work was done, the supply could be treated as made in the country where the customer was registered.

The case concerned a group that included the following members:

- SMK kft, which was established and registered for VAT in Hungary;
- SMK UK Ltd, which had VAT registrations both in the UK and in Hungary;
- SMK Europe NV, which was established in Belgium but registered for VAT in Hungary.

SMK kft carried out work on goods in Hungary as a sub-contractor for SMK UK. SMK UK then sold them to SMK Europe, which sold them on

to customers throughout the EU and in third countries. SMK kft was responsible for transporting the goods to the customers. The goods all left Hungary and none came to the UK. SMK kft treated the supplies of assembly services to SMK UK as outside the scope of VAT.

The Hungarian authorities investigated and concluded that the conditions of art.55 PVD were not satisfied. The company appealed, and questions were referred to the CJEU. The court ruled that the derogation in art.55 only applied if the goods left the country where the work was carried out as part of the transaction at issue – not as a result of a subsequent transaction. In this case, the sale to SMK Europe took place while the goods were still in Hungary, so the conditions for the derogation were not satisfied. The Hungarian company was liable for Hungarian VAT.

As the UK company was registered for VAT in Hungary and carrying on a taxable activity there, it seems that it should have been able to recover the VAT. It is not clear whether there would be a VAT loss to the authorities from the way the transactions were recorded, or a VAT loss to the companies arising from the decision and the length of time since the transactions took place.

CJEU (C-97/14): *SMK kft v Nemzeti Adó- és Vámhivatal Dél-alföldi Regionális Adó Foigazgatósága and another*

4.2.2 Reverse charge mix-up

A German company supplied technical and consulting services to a Bulgarian customer. The customer was unaware that the German company had a fixed establishment in Bulgaria, and therefore accounted for a reverse charge on the supplies. The Bulgarian authorities became aware of the German company, ruled that it had an establishment, and assessed it for output tax.

The authorities then refused a deduction of this additional VAT payment to the customer on the grounds that it did not have a valid Bulgarian tax invoice; Bulgarian law prevented the correction of tax documents once a definitive tax liability had been determined. The supplier therefore applied for a refund of the output tax, arguing that the principle of fiscal neutrality should prevent such a double charge.

Questions were referred to the CJEU about the interaction of art.193 and art.194 PVD to determine which of the supplier and customer should be liable for the VAT in this circumstance, and also whether the principle of fiscal neutrality would come to the taxpayers' aid.

The court ruled that the primary liability for VAT on a supply from a fixed establishment within the territory fell on the supplier under art.193, and art.194 did not permit that liability to be transferred to the customer. However, the principle of neutrality precluded a double charge such as that resulting from the Bulgarian authorities' action: they had to refund the VAT to someone, either back to the supplier or by allowing a deduction to the customer (in spite of the rules about not adjusting tax documents).

CJEU (C-111/14): *GST – Sarviz AG Germania v Direktor na Direktia 'Obzhalvane i danachno-osiguritelna praktika' Plovdiv pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite*

4.3 *International supplies of goods*

4.3.1 Alleged release to the home market

HMRC assessed a warehouse-keeper to excise duty (£369,000) and VAT (£84,000) on the basis that duty-suspended whisky and vodka had been 'slaughtered' – that is, released to the home market – rather than being despatched to a customer in Spain as the documents showed. Suspicions were initially aroused by the records showing that the same lorry had collected goods twice for delivery to Spain within too short a period. A further investigation revealed that the Spanish warehouse to which they were supposed to have been delivered had never received them, and the supposed customer for which they were to be held in Spain did not exist. The transactions took place in 2000, and the assessments were raised in October of that year.

The FTT (TC02945) considered that the crucial question for the appellant was to show that the goods had left the UK – if they had reached Calais, the assessments would not be valid, even if they did not arrive in Cadiz, because the diversion would not have taken place in the UK.

There were a number of problems in HMRC's handling of the case – they had initially failed to identify the correct basis of assessment, and then raised an assessment of which no copy could be traced – but the FTT decided that these were not fatal to the assessment. On the main factual issue, the FTT concluded that the appellant had not demonstrated that, on the balance of probabilities, the goods had left the UK; and a number of legal arguments put forward by the appellant were rejected. The assessments were confirmed.

The company appealed to the Upper Tribunal. Its counsel revisited the question of whether the assessment had been incorrectly issued; complained that HMRC should also have issued an assessment to the transporter, and the FTT had had no evidence that this had been done; and claimed that the FTT decision was unreasonable in rejecting the evidence of the transporter that different lorries had been used to take the goods to the continent. The judge rejected all three arguments, holding that the FTT had been entirely justified in all its conclusions.

Upper Tribunal: *TDG (UK) Ltd v HMRC*

4.3.2 Import reliefs

In 2011, an individual imported 8 BMW Z8 cars into the UK from the USA, with a view to their immediate re-export to Germany. The trader claimed the benefit of Returned Goods Relief for customs duty (goods exported from the EU within the last 3 years) and Onward Supply Relief for VAT (goods imported to be despatched to another EU country within one month). HMRC assessed for duty of £57,428 and VAT of £127,064.

HMRC's view was that the conditions for RGR were not met; but they were not sure whether the conditions for OSR applied. The only question was whether the trader was acting as a principal or undisclosed agent (in which case he could claim the benefit of OSR) or as a disclosed agent (in which case he could not, and would bear the burden of the import VAT, which should be recovered from the client).

The FTT agreed with HMRC that the claim for RGR was based on a misunderstanding of the rules. The cars would have had to have been exported from the EU within the previous 3 years, and this clearly had not happened – the Z8 was only manufactured up to 2003, and all these cars appeared to have been exported shortly after they were built. It appears that the trader had been unaware of the time limit, and simply believed that reimportation of EU goods would not carry a liability to duty. Several arguments were considered in turn and dismissed.

With regard to the OSR point, there were a number of factors that made the transactions appear to involve a disclosed agency arrangement. The trader's purchase and sale prices were essentially the same, with the profit margin being separately invoiced and called "commission"; and one of the customer and supplier pairs had short-circuited the payment arrangements and made payment of the net amount directly from Germany to the USA. The US supplier had agreed that payment would not be required until the sub-sale had been made.

Nevertheless, the FTT concluded that the trader was acting as a principal. The supplier could not have sued the German customer directly for the proceeds. The documentation reflected two principal transactions. Some of the confusing factors arose from the trust existing between the supplier and the trader from previous dealings.

The FTT went on to consider whether, if this decision were overturned on appeal, the trader could in the alternative rely on being an undisclosed agent "acting in his own name". That would have the same effect for VAT. The judge made the point that HMRC's references to "agent acting in own name in relation to the onward supply" were misguided: if the agent was acting in his own name, that must apply to both parts of the transaction. The trader was either an agent for a transaction that he was not directly involved in, or he was to be treated as making both a purchase and a sale.

Having emphasised that, the judge went on to note that the supplier knew the identity of the customer from the direct payments that were made. Literally, therefore, the agency had been "disclosed". However, it was not possible that the supplier would have concluded that there was a direct contract with the German customer. The supplier produced invoices showing the UK trader as its customer, and this indicated that the UK trader was at the very least "acting in its own name".

The appeal against the VAT assessment was therefore allowed, on the grounds that OSR was available.

First-Tier Tribunal (TC04389): *Donald Salvage t/a Wheels Abroad*

4.3.3 Imported coins

An individual imported two consignments of 500 US Silver Eagle dollar coins. He had enquired in advance whether there was a VAT charge on importation of legal tender, and was told that currency was generally exempt; but collectors' items were standard rated. HMRC charged VAT on the importation. He claimed it back, arguing that the imports should have been exempt. The coins were worth between $22.79 and $23.55 each.

The individual claimed to have been given "wrong information" by HMRC which led him to order the coins when he would not otherwise have done so. He appealed against a refusal of repayment.

The Tribunal considered the question of whether coins that were legal tender were exempt. It concluded that they were only exempt if they were "normally used as legal tender" – whether or not these coins actually were legal tender in the US (the individual did not attend and provided no evidence), their value meant that they surely would not be so used. They were therefore not exempt under the law.

The appellant also asked for the appeal to be allowed on the basis that he had received misleading advice. The Tribunal did not have jurisdiction on such a question. The appeal had to be dismissed.

First-Tier Tribunal (TC04431): *Antonio Savidis*

4.3.4 Seizure

An individual appealed against a refusal by HMRC to restore silver coins and bars that were seized when he tried to import them into the UK from Guernsey. He and a friend had entered the Green Channel at Poole Harbour; when asked by a Customs officer if they had anything with them, they volunteered that they had bought cigarettes and alcohol within their allowances, but did not mention the silver. The officer considered this to indicate dishonest concealment. This counted against the appellant when he applied for restoration of the seized goods.

The officer making the seizure had made "procedural errors" in that he had indicated, incorrectly, that the goods would be restored on payment of the VAT. However, this error was subsequent to the non-declaration and cannot have influenced it. It was unfortunate and misleading, but it did not constitute an exceptional reason to restore the goods. The appeal was dismissed.

First-Tier Tribunal (TC04440): *Samuel Ottey*

4.3.5 Goods for test

A company appealed against HMRC's refusal of relief from customs duty and import VAT in respect of some goods which it claimed to have imported for testing. The VAT "goods for test relief" is in the Value Added Tax (Imported Goods) Relief Order 1984 (SI 1984/746) at reg.5:

Subject to the provisions of this Order, no tax shall be payable on the importation of goods of a description specified in any item in Schedule 2 to this Order.

And in Sch. 2 Group 4:

Goods imported for the purpose of examination, analysis or testing to determine their composition, quality or other technical characteristics, to provide information or for industrial or commercial research.

The company makes machines which apply labels to products. It imports labels and products from its customers in order to test its machines before selling them. Various explanations of this point were given to HMRC in correspondence. HMRC responded that the reliefs were available where

the imported goods were to be tested, not when they were to be used to test something else.

The Tribunal noted that it was possible that part of the testing was carried out on the goods, in that it was necessary to be sure that the products were suitable for labels to be applied to them. If that was a significant purpose of the company in importing them, it might qualify for the relief. However, the explanations given in correspondence had been contradictory on this point, and the Tribunal decided that the burden of proof was not satisfied.

A separate ground of appeal based on legitimate expectations could not succeed. The appeal against both duty and VAT was dismissed.

First-Tier Tribunal (TC04472): *Harland Machine Systems Ltd*

4.3.6 Goods back and forth

A company held goods in the free port of Copenhagen. It despatched two consignments to Sweden. Documents for the transit procedure were drawn up by the Danish authorities; they were to be presented to the Swedish authorities on arrival. According to the company, the customer refused to accept the goods, which were returned to Copenhagen and subsequently included in other despatches back to Sweden. However, the original transit documents were not cancelled. The Danish authorities disputed the company's account, and sought to collect customs duty and VAT on the goods that had been released from the free zone.

The CJEU provided the following guidance. A customs debt would not be incurred as a result of an unsuccessful delivery attempt in these circumstances, provided it could be proved that the goods were returned to the free zone and included in a subsequent despatch that was charged to duty. However, if it could not be proved, the failure to complete the first transit procedure would create a customs debt.

The Customs Code (art.204) and Implementing Regulation (art.859) provided conditions for rectifying an omission to present the documents on the first transit procedure. If those conditions were not satisfied, the late presentation of the documents for the first transit procedure would not rectify the situation – a customs debt would be incurred.

If the transporter became liable to pay VAT as a result of undertaking import formalities on behalf of a customer, that did not become input tax of the carrier, who was neither the importer nor the owner of the goods. It could therefore not be deducted by the carrier, who would have to try to recover it from the customer.

CJEU (Case C-187/14): *Skatteministeriet v DSV Road A/S*

4.3.7 Introduction of the Union Customs Code

UK implementation of changes to import and export procedures under the new Union Customs Code is expected on 1 May 2016. HMRC have updated their guidance with further detail, including: transitional arrangements; new authorised economic operator criteria; guarantees for temporary storage; simplified customs declarations; and exceptions from "right to be heard" in respect of adverse decisions.

www.gov.uk/introduction-of-the-union-customs-code-ucc

4.4 *European rules*

4.4.1 Cross Border Rulings Project

The Commission has announced that the VAT Cross border rulings pilot project will run until 30 September 2018. The EU pilot project, which started in 2013, involves several Member States.

The following appears in an "inventory" of rulings given so far:

2013/1	Place of supply of goods and services and correct accounting process following business restructure
2014/2	Providing "in house" training
2014/3	Organizing a symposium to present new products to clients
2014/4	Renovation of buildings in another Member State
2014/5	Supply of SIM cards for mobile phones
2014/6	Separate sales of machinery and tyres assembled to the machinery
2014/7	Trading in precious metals spots and deliverable forwards using unallocated accounts
2014/8	Assigning pitch space to various race tracks, supply of VIP passes and personalization services at international events
2014/9	Goods sold and transported from one Member State to another and installed or assembled by the supplier
2014/10	Supply chain, intra-Community sales, possibility to divide an intra-Community supply into a transfer followed by a local supply
2014/11	Transformation of crude oil
2015/12	Organisation of in-service teacher training courses in other Member States
2015/13	Exemption for supply of services by independent groups of persons – cross-border application

ec.europa.eu/taxation_customs/taxation/vat/traders/cross_border_rulings /index_en.htm

4.4.2 New Commission website

The Commission has revamped its taxation and customs union website, providing easier access for business and individual users. The improvements are based on studies of the site's usability and also on visitor feedback.

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

4.4.3 Public postal services

After Sweden ended the state monopoly of postal services in 1993, it abolished the exemption for VAT on such supplies. The Commission took infringement proceedings, arguing that such an exemption was a requirement of the PVD for "the public postal services" other than passenger transport and telecommunications services. Sweden responded

that, in the absence of a state provider, there was no public postal service, and it could better achieve fiscal neutrality in the postal market by ignoring the exemption both for supplies and for stamps.

The CJEU disagreed. The designated universal service provider in Sweden was Posten AB, a commercial company, and it fulfilled the function that the PVD ruled should be exempt. The exemption would not distort competition because of the special legal regime that governed the USP – it was not in the same position as other operators, at least in those parts of its business that were covered by the special regime.

The court ruled that supplies of postal services by Posten AB should be exempt under art.132(1)(a). The supply of postage stamps at face value should also be exempt under art.135(1)(h).

CJEU (Case C-114/14): *Commission v Kingdom of Sweden*

4.4.4 Application of goods to non-taxable purposes

A company constructed an office building with the intention of selling it. In according with its accounting policy, it included interest paid on borrowings in the cost of the project in its accounts. The building was constructed between 1991 and 1994 and eventually sold in 2000.

In the meantime, from 1995 onwards parts of the building were rented out. The Belgian authorities discovered that no adjustment had been made to the input tax claimed in respect of the construction project, and raised an assessment to charge VAT on the whole cost – including the interest. The company agreed to pay back the VAT that it had claimed on VATable construction costs, but disputed the liability on the interest it had capitalised. Questions were referred to the CJEU.

The court ruled that the self-supply provision in the 6th Directive (art.5(7)(b)), as enacted by Belgium, allowed an assessment on the replacement cost of a building whose location, size and other essential characteristics were similar to those of the building in question. It was not based on the actual costs incurred in construction of this particular building, so it was irrelevant whether the company included interest in its calculation of that cost. The cost basis of valuation was only relevant for the taxable amount if a sale price could not be established, which was not the case here.

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

4.4.5 Rates in breach of the Directive

In Case C-639/13, the CJEU ruled against Poland's reduced rate for goods intended to provide fire protection. A new decision has come to the same conclusion on a reduced rate for general medical equipment and non-medical pharmaceutical products such as disinfectants and spa products. These are not mentioned in Annex III PVD, so the reduced rate could not comply with art.98. The CJEU agreed with the Commission that there was no justification for the failure to apply the Directive.

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

4.4.6 Taxable amount

A company holds the exclusive concession for the public service regional gas distribution network in municipalities around Lisbon. It is responsible for the development, operation and maintenance of the distribution network. As the distribution network comprises pipes which are installed on the publicly-owned property of certain municipalities situated in the concession area, the company is obliged to pay land use taxes imposed by those municipalities. The cost of these land taxes is passed on by the company to the company responsible for marketing gas in the concession area, and that company passes the cost on to consumers in their gas supply bill.

The company accounted for VAT at the Portuguese standard rate of 23% on the recharged land use tax. It sought repayment of that VAT, arguing that the tax should not be part of the taxable amount. Questions were referred to the CJEU. The Commission complained that the referring court had not specified which part of the PVD it was unsure about, making the question inadmissible; however, the Court decided to give an answer.

Other taxes (e.g. excise duties) are included in the taxable amount under art.78(a) PVD. However, those taxes are directly linked to the VATable transaction. This is not the case with these land-use taxes, which are incurred in relation to use of the land, not supply of particular amounts of gas. Art.78(a) is therefore not relevant.

Rather, the recharge simply formed part of the price set for the supply. Identifying it separately made no difference to that. It was part of the taxable amount under art.73. It could not be excluded as a disbursement under art.79, because it was not incurred on behalf of the gas marketing company or the consumers – it was a liability of the distribution company itself.

CJEU (Case C-256/14): *Lisboagás GDL, Sociedade Distribuidora de Gás Natural de Lisboa SA v Autoridade Tributária e Aduaneira*

4.4.7 Adjustment of taxable amount

In a case referred from Slovenia, the CJEU had to consider a complicated series of transactions:

- in February 2008, N lent D some money for the purpose of construction of housing;
- D purchased land with the loaned money;
- in April 2009, D sold the land to N and N leased the land back to D for a period of a few months;
- the leases provided that D would have to exercise one of the following three options:
  - to extend the leases;
  - to return the property to N on expiry of the leases; or
  - to exercise an option to buy the property by paying all the outstanding instalments to N.

N accounted for output VAT on the sums invoiced to D under the leaseback agreements, including sums representing the "option to purchase".

D did not extend the leases and did not pay all the outstanding amounts, so the property reverted to N. N sold the land to a third party as building land, and accounted for output tax on that sale price. It deducted from the sale price the VAT, the value of the unpaid purchase options, and the unpaid instalments, and paid over the remainder to D. N issued credit notes to D to reflect the cancellation of the purchase option instalments.

N then requested from the authorities a refund of the output tax charged on the purchase options on the basis that they had been cancelled. The authorities refused, and questions were referred to the CJEU.

The CJEU started with the referring court's question about the nature of the contract. Because it was a lease that provided for ownership to pass at the end of the lease term, it was likely to be a supply of goods – in effect, it was hire purchase. It was for the national court to determine the application of the law, but the court's answer indicates that this is the most likely conclusion.

The next question was whether the return of the property from D to N constituted a "cancellation, refusal, total or partial non-payment or price reduction" within art.90 PVD. The CJEU ruled that art.90 "must be interpreted as not permitting a taxable person to reduce the taxable amount where that person has in fact received all the payments in consideration for the service which he supplied or where, without the agreement having been refused or cancelled, the recipient of that service is no longer liable to the taxable person for the agreed price". Although it is not spelled out either in the answer or in the description of the transactions, it appears that the deduction of the outstanding amounts from the sum paid by N to D constituted receipt by N of all the instalments that D might have paid, including the purchase options. So there was no bad debt or price reduction; the credit notes appear to have been an attempt to turn taxable purchase options into outside-the-scope compensation for failure to conclude the contract, but that could not succeed.

The third question was an appeal to fiscal neutrality. N argued that it was paying tax twice, in that it had accounted for output tax in full on the invoices issued to D, and also accounted for output tax in full on the sale to the third party. The CJEU responded that it was in accordance with the PVD for the authorities to tax the two sales entirely separately, unless they constituted a single supply that it would be artificial to split. That seems unlikely, if the third party was a genuinely unconnected person.

It would be useful to see the amounts involved and to trace the invoices and payments back and forth. That would confirm whether N appeared to have accounted for output tax on more money than it had eventually received. Unfortunately, those details are not provided by the judgment. The implication seems to be that N had not been doubly taxed, but N appears to have believed that this was so.

CJEU (C-209/14): *NLB Leasing d.o.o. v Republika Slovenja*

4.4.8 Capital goods used in the business?

A company built a "recreational trail dedicated to Baltic mythology". When completed, its use would be free to the public. 90% of the cost was funded by grants from a public body. The Lithuanian authorities denied input tax deduction on the grounds that the costs were not intended for use for taxable supplies.

The company argued that the trail would attract customers to its site, and they would buy food, drinks and souvenirs. There was a direct link between the capital expenditure and future taxable income. Questions were referred to the CJEU.

Advocate-General Kokott has given an opinion (not in English) that favours the taxpayer. It is interesting that the UK government intervened in support of the Lithuanian position:

- there could only be a deduction of input tax if the costs of construction were "incorporated" in the costs of the future taxable supplies as "cost components";
- the fact that 90% of the costs were covered by public grants meant that at least 90% of the VAT had to be disallowed.

The Advocate-General disagreed with both of these arguments. In an opinion that is echoed by the FTT decision in *North of England Zoological Society*, she accepted that the construction objectively served the purposes of the taxpayer's taxable business. The trail clearly was built to attract visitors to whom taxable sales would be made. That was a sufficient link to make the VAT into input tax.

Precedent cases (including *Commission v France* Case C-243/03) showed that partial funding by public grant had no effect on the deductibility of input tax. Only exempt supplies would lead to a restriction. The input tax should be allowed in full where capital goods were purchased or provided as a means of attracting customers for a taxable business.

CJEU (A-G) (Case C-126/14): *Sveda UAB v Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos*

4.4.9 Public body

Advocate-General Jaaskinen has given an opinion (not available in English) about the status of a limited company owned by a local authority and carrying out work in the public sector.

The Advocate-General regarded the activities of the company as falling within the scope of VAT – it supplied consultancy and management services in return for consideration, and that was an economic activity.

The second issue was whether the company could be regarded as "a body governed by public law" and therefore not a taxable person. The UK government made submissions in support of the Portuguese and the Commission, and the Advocate-General agreed: the notion of "bodies governed by public law" should not refer to a concept of national law but rather to a separate concept established in Community law. There was no definition of the term in the Directive, and reference to the Procurement Directive did not help (as it served a different purpose). It was therefore necessary to consider national legal concepts of "body governed by public

law", but interpret them strictly as the result would be an exception to the normal rules of VAT.

A limited company is subject to private law under domestic law in each Member State. It was hard to see how it could then be regarded as a body subject to public law for EU legal purposes.

This opinion is consistent with the FTT and UT interpretation of these rules in the *Open University* case concerning the status of the BBC.

CJEU (A-G) (C-174/14): *Saudaçor — Sociedade Gestora de Recursos e Equipamentos de Saúde dos Açores S.A. v Fazenda Pública*

4.4.10 Too lenient Italians

The Italian law provides for the limitation period for prosecuting crimes to be extended only by a quarter following interruption of proceedings. As a result, crimes may become time-barred from prosecution even though the proceedings were brought in good time. The law was changed in 2005 with the effect of exempting many criminals from punishment. In relation to a VAT fraud, questions about the acceptability of this rule were referred to the CJEU.

Advocate-General Kokott has given an opinion that the leniency of the Italian law is unacceptable. The CJEU has the right to rule on this because a share of Italian VAT is due to the EU as part of its own resources; failing to collect it is therefore a breach of Italy's obligations. In her opinion, the EU treaties require Member States to provide for effective, proportionate and dissuasive penalties for irregularities in matters of VAT; in cases of VAT fraud these penalties must, in serious cases at least, also include penalties involving deprivation of liberty. A limitation period which had in many cases the effect of exempting perpetrators from punishment is incompatible with EU law. The national court must therefore not apply such a limitation period in criminal proceedings in relation to VAT fraud.

CJEU (A-G) (Case C-105/14): *Criminal proceedings against Ivo Taricco and Others*

4.4.11 Reference

The Polish court has referred the following question about the VAT status of public sector bodies:

In the light of Article 4(2), in conjunction with Article 5(3), of the Treaty on European Union, may an organisational entity of a municipality (a local government body in Poland) be regarded as a taxable person for purposes of VAT when it engages in activities other than as a public authority within the meaning of Article 13 of [the PVD] notwithstanding the fact that it does not satisfy the criterion of autonomy (independence) set out in Article 9(1) of that directive?

CJEU (Reference) (Case C-276/14): *Gmina Wrocław v Minister Finansów*

4.5 Eighth Directive reclaims

Nothing to report.

5. INPUTS

5.1 Economic activity

5.1.1 Abuse of rights (1)

At the end of a long process of legal ping-pong, the Supreme Court has found for HMRC in the *Pendragon* case, holding that the FTT's decision was wrong: the scheme was an abuse of rights, and the tax advantage resulting should be cancelled.

Background

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

The scheme worked as follows:

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

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

In the Commissioners' view the Dealership Companies:

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

The Captive Leasing Companies

In the Commissioners' view the Captive Leasing Companies:

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

PDS (the company that eventually sold the cars)

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

First-Tier Tribunal

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

Upper Tribunal

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

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

This was supportive of HMRC's case because it suggested that the more convoluted transactions in the case were "artificial", and also that they subverted the purpose of the law. The Tribunal's analysis of the transactions agreed that the scheme had the effect which the accountants and taxpayers intended if the principle of abuse did not apply.

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

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

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

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

29. First, notwithstanding formal application of the conditions laid down in the relevant provisions of the Sixth Directive and in the national legislation transposing it, the transactions concerned must result in the accrual of a tax advantage the grant of which would be contrary to the

purpose of those provisions (see Halifax (para 74), and Part Service (para 42).

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

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

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

(1) the creation of the scheme by KPMG;

(2) the timing of the scheme;

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

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

(5) the implementation of the scheme.

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

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

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

The FTT had taken and relied on a considerable amount of evidence from the finance director. The FTT decision stated that it had tried to exclude subjective factors and considered only objective indications of the purpose of the transactions, but the Upper Tribunal noted that this was a

very difficult exercise. It therefore reconsidered all the FD's evidence as recorded in the FTT decision, and concluded that the decision of the FTT was 'plainly wrong'.

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

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

Court of Appeal

The company appealed to the Court of Appeal in 2013. The appeal judges ruled that the Upper Tribunal had erred in treating the FTT's conclusions the finance director's evidence as a question of mixed fact and law: the findings in relation to the reliability of that evidence were findings of fact, and the Upper Tribunal had not shown that there were any errors of law in the FTT's treatment of the evidence.

The question of the aim of the scheme was a mixed issue of fact and law. The FTT had described it as a finding of primary fact, and this was incorrect. However, once again the UT had not identified any error of law in the way in which the FTT had addressed these issues. The FTT had found as a primary fact that the company had needed the finance which flowed from the scheme; the UT's finding that this was not so was a conclusion that an appellate tribunal was not entitled to reach. The UT had described the proposition that the VAT advantage was subordinate to the financing objective as a 'fact': it was not a fact, but an evaluation. The UT had not shown that the FTT had misunderstood the task it was undertaking – to carry out an objective assessment of the aims of the scheme, and draw a conclusion.

The decision of the Court of Appeal to allow the company's appeal was unanimous.

Supreme Court

The decision of the Supreme Court was also unanimous, and opposite. The five law lords considered the purpose of the EU law and its relationship to UK law. The margin scheme was intended to prevent double taxation where a car was purchased without input tax credit. To apply it selectively to this chain of transactions would defeat the purpose of the law: it would mean that no taxation was levied on the consideration received. That was contrary to the purpose of the law, satisfying one of the *Halifax* tests.

A sale and leaseback arrangement could be a normal commercial transaction. However, the features of this scheme included elements that were only necessary to make the tax advantage available, and had no other commercial purpose. These were: first, the leasing of the cars by the

captive leasing companies, and secondly, the subsequent acquisition of the business by the second associated company. Objectively, they were artificial transactions that were only carried out to obtain the tax advantage, satisfying the other *Halifax* test.

The emphasis of the FTT and the CA had been wrong. The FTT had decided that there was a commercial reason for the transactions, so it was not abusive. The CA had decided that there had been various different ways of achieving a commercial objective, and the company had been entitled to choose one of them which produced a tax advantage. The Supreme Court held that all the features of a scheme have to have some commercial purpose. If there are features that have no commercial rationale at all, that will indicate that the scheme as a whole is tax-driven; it will then be abusive if the result is contrary to the purpose of the law.

The arrangements should be recharacterised as suggested by HMRC: it would be taxed as a sale and leaseback followed by a sale to customers outside the margin scheme.

The Supreme Court commented that the Court of Appeal should have considered the rightness of the Upper Tribunal decision on its own merits, rather than concentrating so specifically on whether the UT had been entitled to overturn the FTT decision. It is often difficult to draw a clear distinction between matters of fact and matters of law; it is rare for a disagreement to be purely one of fact. Here, there were no significant differences between the parties in matters of primary fact – the disagreement, and therefore the decisions in the FTT and UT, depended on the understanding of the principle of abuse of law and the evaluation of the primary facts in the light of that understanding.

Supreme Court: *Pendragon plc and others v HMRC*

5.1.2 Abuse of rights (2)

By contrast the Upper Tribunal has refused HMRC's appeal against the FTT's decision in the *Newey* case. Even though HMRC believed that the CJEU's judgment favoured them, the Upper Tribunal agreed with the FTT that the arrangements were not abusive.

Background

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 (Alabaster) 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 (by a Channel Islands advertising agency to a Channel Islands loan

broker) 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).

First-Tier Tribunal

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.

Upper Tribunal

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?*

CJEU (Case C-653/11)

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

"*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.*"

Upper Tribunal

The Upper Tribunal (Mr Justice Warren) summarised the disagreement as follows:

HMRC say that the CJEU was giving new guidance when it said that the correct approach was to assess the economic and commercial reality of the transactions at issue and that the contractual arrangements were a factor, but only a factor, to be taken into account. They say that the Tribunal was in error because it did not apply that approach but instead assigned decisive importance to the contractual structure which had been brought about solely for the purpose of obtaining a tax advantage rather than for any commercial reason. Mr Newey contends that the CJEU was doing no more that to re-state existing established principles and that the Tribunal applied those principles correctly.

The judge examined the facts and arguments at great length. His interpretation of the CJEU decision was that it was only possible to depart from the contractual position if HMRC could first show abuse of rights – they could not show abuse by recharacterising the contracts.

Even so, he considered whether it was open to the FTT to conclude that the relevant supplies were made by and to Alabaster or by Mr Newey personally. He concluded that the decision was justified, and indeed correct. Mr Newey was entitled to set up a company in Jersey, and that company was entitled to enter into business on its own account. It was incorrect to compare the new situation with what had gone before: there had been a change of situation.

The judge considered that a tax-driven arrangement might nevertheless be genuine and commercial. The fact that a different arrangement had existed beforehand did not make a change to a more tax-efficient one abusive. Although there were some flaws in the way the FTT had reached its decision, when viewed in the light of the CJEU judgment, it had reached a justifiable conclusion with which the UT would not interfere.

Upper Tribunal: *HMRC v Newey*

5.2 *Who receives the supply?*

5.2.1 Legal fees

A partnership of four individuals entered into a legal dispute when one of them neared retirement and instructed solicitors who demanded the dissolution of the firm. The other three partners also instructed solicitors: two of them – against whom allegations of bad faith had been made, leading to the demand for dissolution – used the same lawyers, and the third consulted a different firm. The partnership reimbursed the legal fees and claimed the input tax.

HMRC ruled that the supplies had been made to the individual partners, not to the partnership. Reimbursement of the fees could not make the VAT into input tax of the partnership.

Judge Mosedale agreed with HMRC. The partners might have had opposing interests, which was no doubt why they consulted different advisers. The contracts and invoices were issued in the names of the individual partners, not the firm. The partners had not exercised the power they enjoyed under the Partnership Act 1890 s.5 to contract on behalf of their partnership – they had contracted individually. Even though it was possible that the firm's business benefited, that was not enough on its own.

The VAT was not input tax of the existing four-partner firm, nor was it input tax of a future firm comprising the three remaining partners. The appeal was dismissed.

First-Tier Tribunal (TC04358): *A partnership*

5.2.2 Legal and accountancy fees

A company claimed back £17,358 in input tax charged by accountants and solicitors. HMRC ruled that the supplies were not made to the company, but rather to its shareholders. They had related to a corporate restructuring exercise in 2012 which removed minority shareholders.

The engagement letters and invoices of both the accountants and the solicitors were addressed to the company. The company argued that *Redrow* applied; the advice was essentially given to the company, with any advice to the individuals being incidental. HMRC had a completely opposite view: virtually all the tax advice was given to the specific shareholders and no service was then supplied to the board of the company itself.

The Tribunal noted that the company appeared to have made the decision on whether to restructure before engaging the professionals. The reality of the situation was therefore that the advice mainly concerned the tax effects on the individual shareholders. Although the accountants' engagement letter was with the company and referred to providing advice to the board, the record of the "workstream" revealed very little of that. The eventual fee of £54,500 was considerably in excess of the estimate of £7,000 to £10,000 in the engagement letter, and included the completion of tax returns for two directors.

The Tribunal concluded that the services failed the "to whom" test – the services were in the main provided to the individual shareholders, or else

to the Newco vehicle that was created as part of the restructuring. The Tribunal also concluded that the services failed the "purpose" test – they were not purchased in connection with any business carried on by the company.

The appeal was dismissed.

First-Tier Tribunal (TC04487): *Danesmoor Ltd*

5.3 Partial exemption

5.3.1 Use of buildings

A partnership owned a number of buildings. Some were opted and some were not. One was a farm, acquired in 2008 and used for a "DIY livery" business by a company set up for the purpose by the partners in April 2009. A licence fee was paid by the company to the partnership, which had not opted this property.

A dispute arose about certain inputs claimed by the partnership in relation to works done on the farm between 2009 and 2013. The appellant accepted that some of the works were directly attributable to its exempt supplies of the licence to the company; HMRC accepted that works involved in moving the entrance to the farm and general fencing work was "residual". The matter in dispute related to general repairs to outbuildings, including repairs to the roofs of barns.

The taxpayer's witnesses did not attend the hearing and therefore could not be cross-examined. HMRC's representative said she did not object to their witness statements being admitted as evidence, but they were effectively only hearsay and the Tribunal stated that their importance would be judged accordingly.

The taxable supplies that the appellant hoped would make the barn repair work residual included an ongoing intention to run a farming business on the premises, and the possible sale of eggs from hens using the barn or the storage of motor vehicles in the barn. Alternatively, they argued that the works were simply an overhead of the business.

The Tribunal considered the relevance of the *Briararch* decision: an intention to make a future taxable supply could make the current input tax residual, even if there was only exempt use in the present period. Although the records of the amounts and dates of inputs was not clearly presented, the Tribunal was satisfied that the works were carried out at a time when the barns were used for the purposes of the livery business, and there was therefore clearly a direct and immediate link with the exempt letting. As there was such a link to specific outputs, the costs could not be "overhead of the business as a whole".

The assertion that the barns were used for an egg business was made in a written witness statement. The judge described this as "not just hearsay [but] also extremely sketchy". Although there was some evidence that egg sales were taking place at a later date, there was nothing to indicate on whose behalf the eggs were sold. There was simply not enough evidence

to form a link between the partnership's input tax and this source of taxable income, if it existed.

Similarly, the evidence about car storage was sketchy, and did not show a link between the expenses on the buildings and the making of taxable supplies.

The judge accepted that the lead partner had a genuine intention to return the property to use as a working farm, and that could mean that expenditure would be linked to future taxable supplies as well as current exempt supplies. However, the nature of the works on the barns were such that they would probably have to be reversed if this plan came to fruition – the works were aimed at making the barns suitable for use in the livery business. The costs were therefore not linked to any possible future farming business.

The judge concluded that all the input tax associated with the disputed works was directly attributable to making exempt supplies of letting the land, and none of it was recoverable.

First-Tier Tribunal (TC04393): *NK Motors*

5.3.2 Attribution at the zoo

Chester Zoo has been the subject of a previous appeal which went to the High Court in 1999; it was decided that it could not claim the education exemption for its admission charges. Since the *London Zoo* decision, it has instead been able to claim the cultural services exemption. It now returned to the Tribunal with a dispute about the recovery of input tax under the rules of partial exemption.

The zoo argued that the standard method of recovery was a fair method. Costs of maintaining the animals were a cost component of all its supplies, including taxable catering and retail sales as well as the admission income.

HMRC wanted to attribute the animal maintenance costs only to the admission charges. They argued that a special method was appropriate, and the standard method did not produce a fair result. The assessments were in fact based on the standard method override in regs.107A and 107B SI 1995/2518.

HMRC raised protective assessments year by year to claw back VAT that they argued the zoo should not have recovered. By the time the matter went to the Tribunal, the assessments covered a span of 9 years and totalled £1.3m. The Tribunal was not concerned with the quantum: it proposed only to consider the question of principle, whether the standard method gave a fair result, or whether an override should apply.

The precedents on apportionment included *Lok'n'Store*, *Mayflower Theatre Trust*, *St Helen's School Northwood* and *London Clubs Management Ltd*. In this last case, the CA had commented:

"*A fair and reasonable attribution to a taxable supply must, for the purposes of art 17(2) and (5) 6th Directive and reg.101(2)(d) of the Regulations, reflect the use of a relevant asset in making that supply. In assessing that use, and its extent, consideration is not limited to physical use. The assessment must be of the real economic use of the asset, that is*

to say having regard to economic reality, in the light of the observable terms and features of the taxpayer's business."

The distinction between "residual" and "overhead" input tax from the *Mayflower* case was also noted – overheads are used for no particular supply, whereas residual inputs are used for more than one specific supply. The standard method override can more easily be applied to residual inputs than to overheads, because it is possible to identify what they have been used for. Overheads more naturally relate to the whole of the business.

HMRC argued that any link between animal costs and catering income was no more than a "but for" relationship, and precedents showed this was not enough to justify attribution. The Tribunal accepted the taxpayer's submission that in an input tax case it is the objective purpose of the supplier that it relevant, rather than the objective purpose of the customer. The purpose of the Society in incurring the animal related costs must be objectively ascertained from the evidence and from the observable terms and features of the zoo.

The taxpayer's counsel argued that it was impossible to try to disentangle the different revenue streams. The zoo spent money on the animals to achieve its charitable objects, but it required catering and merchandising income as well. The catering and sales outlets were carefully positioned to take maximum advantage of the animals; the zoo was operated with an explicit objective of increasing "dwell time", the time people spent on the site, in order to maximise the other sources of revenue. Everything was linked together.

The Tribunal agreed. The purposes, objectively ascertained, include maintaining the income streams of the zoo from all sources. This was not a case where one of the income streams was "the main event", as in *St Helen's School* or *VW Financial Services*. The judge was satisfied that there was a direct and immediate link between the animal costs and the catering supplies, and the inputs were therefore residual and properly to be apportioned using the standard method.

The appeal was allowed.

First-Tier Tribunal (TC04479): *North of England Zoological Society*

5.3.3 Investment management costs

The University of Cambridge has an endowment fund in which it invests donations. It pays professional fees to managers to look after this money, and the income and capital growth on the investments are used to support the various activities of the university, amounting to some 6% of its operational expenditure. As a charity, the university has activities that are business and non-business, and the business activities are taxable (mainly commercial research, sales of publications, consultancy and hire of facilities) and exempt (education).

The university generally claimed input tax in accordance with the 'CVCP guidelines' agreed between HMRC and higher education institutions. These enabled it to avoid preparation of detailed partial exemption calculations. For some years it did not include the investment management costs as residual input tax in the CVCP workings. It made a

claim in 2002 which was refused and not pursued, but then claimed again in March 2009 following *Fleming*. The amount claimed was £182,500.

HMRC argued that the investment activity should be regarded as a 'free-standing activity' and therefore 'a supply made not by a taxable person acting as such', in line with the decisions in *NSPCC* and *Wellcome Trust*. Overheads relating to a non-economic activity undertaken for the purpose of an economic activity should not be regarded as recoverable.

The FTT (TC02836) did not agree. In line with the decision in *Kretztechnik*, something that did not involve the taxable person making a supply – whether the issue of shares, or in this case the receipt of dividends – should be related to the activities of the entity as a whole. As the endowment fund financed all the activities of the university, the management fees were residual, and the input tax was partly recoverable.

The FTT decision reviewed each of the major precedents in turn and comments on the reasons for following or not following them. In particular, HMRC's reliance on *BLP Group* was rejected: in that case, the sale of shares was held to constitute an economic activity, whereas the university was not engaged in such activity in relation to its investments.

HMRC appealed to the Upper Tribunal (Mr Justice Simon and Judge Sinfield). Their counsel's argument is summarised as follows in the decision:

In order to be regarded as overheads, the costs incurred in acquiring the input transactions must be cost components (in the sense of being incorporated in the price) of all the taxable person's economic activities. Putting it another way, the input transactions must 'burden' the cost of the taxable person's economic activity as a whole. Mr Singh contended that the costs of F&CM's investment management services do not burden the cost of all of the University's economic activities. He submitted that F&CM generates investment income from the Fund and that income subsidises the University's economic activities, thereby reducing the cost to the University of making supplies of education, research, catering, bar sales and conferencing services. He submitted that, in principle, the costs of generating investment income from the Fund do not have a direct and immediate link with and cannot be cost components of the price (or burden the cost) of the University's economic activity as a whole. Mr Singh submitted that the correct analysis was that the costs of the investment management services are cost components of the price of the University's disposals of its investments for consideration and are thus directly and immediately linked with those disposals. He further contended that it is not permissible to 'look through' the disposals of investments for consideration in order to attempt to attribute the costs of the investment management services to the University's economic activity as a whole.

By contrast, the taxpayer's counsel put forward a simple question based on *Kretztechnik*: for what purpose is the outside the scope activity carried out? He submitted that, in the present case, the answer was straightforward: the investment activity is not carried on for its own sake, but for the benefit of all the University's activities.

The Upper Tribunal reviewed *BLP Group*, *Abbey National* and *Kretztechnik* for authority on the treatment of overheads. The principle of

BLP Group was that an exempt supply to which costs were directly attributable "broke the chain" between overheads and taxable activities of the business as a whole. Here, there was no such chain-breaking event, because the sale of investments was outside the scope investment activity rather than exempt economic activity.

The judges also considered *Securenta* and *AB SKF* for VAT on costs relating to investment activities and the sale of shares. The costs of the investment activity did not "burden the investment activity in the sense that fees were incorporated into the price of investments that were sold". According to *AB SKF*, then, they could be overheads of the business as a whole. HMRC's counsel tried to find a distinction between the raising of capital and the generation of income, but the judges considered that this only arose in the CJEU cases because of their facts, not as a principle of law.

The FTT had found that the investment activity was not carried out for its own sake but for the benefit of the University's economic activity in general. It followed that the costs associated with that investment activity were part of the University's overheads. HMRC's appeal was dismissed.

Upper Tribunal: *HMRC v Chancellor, Masters and Scholars of the University of Cambridge*

5.4 Cars

5.4.1 Reclaiming input VAT on vans

HMRC have updated their list of car-derived vans and combi vans, indicating whether these are classed as vans on which input tax is recoverable, or passenger cars on which recovery is not normally available. The guidance states that "clarification is necessary in the light of recent developments in the car-derived van market, which have resulted in the manufacture of vehicles with a payload of less than one tonne that have blurred the distinction between cars and vans. This means that these vehicles are difficult to categorise in relation to the definition of motorcars in VAT legislation."

www.gov.uk/government/publications/hm-revenue-and-customs-car-derived-vans-and-combi-vans

5.5 Business entertainment

5.5.1 Not provided free

HMRC assessed a LLP for £128,000 of overclaimed input tax after concluding that certain business meeting costs constituted "business entertainment". The LLP appealed against this VAT decision, as well as a disallowance of the costs in its income tax computations. Although the rules for the two taxes are slightly different, HMRC determined that the income tax treatment should follow the VAT in this case, so the FTT only had to consider the VAT rules.

The disputed costs were payments made by the LLP for the provision of meeting facilities at a property situated in the Cotswolds. HMRC's view was that these predominantly related to the provision by MSL of business entertainment free of charge to MSL's clients and their contacts. They disallowed 2/3 of the input tax on the payments. The property belonged to Lady Evans, the wife of Sir Chris Evans, who was the prime mover behind the LLP. The meeting facilities were supplied by another LLP also owned by the couple.

The LLP argued that HMRC had misunderstood the contractual arrangements. The LLP's business involved making available consultancy services of Sir Chris to an associated company which was an international fund management and corporate finance business specialising in the medical services sector. That associated company requested the meeting facilities to be made available. The argument was therefore that the meeting facilities were an ancillary part of a supply of consultancy services. If there was any business entertainment element in the LLP, it was insignificant. If HMRC wanted to pursue a disallowance, it should be in the company, not the LLP.

After considering the background, the evidence of Sir Chris, the documentation and the correspondence in detail, the Tribunal concluded:

(1) There was a supply of business entertainment, but of a minimal amount;

(2) the LLP provided that business entertainment to the company as part of the onward supply of the facilities made available to the appellant LLP by the second LLP; and

(3) the company paid for that business entertainment by settling the LLP's invoices which included sums in respect of the onward supply of the meeting facilities and accordingly it was not provided by the LLP free of charge.

Accordingly, the LLP was entitled to full credit for the input tax claimed on the costs. The income tax deduction followed from this. Both appeals were allowed.

First-Tier Tribunal (TC04441): *Merlin Scientific LLP*

5.6 Non-business use of supplies

Nothing to report.

5.7 Bad debt relief

Nothing to report.

5.8 Other input tax problems

5.8.1 Missing traders

The case of *S & I Electrical* was first heard by the FTT in 2009 (TC00076). The sum at stake was approximately £4.3m of disallowed input tax. The decision (for HMRC in respect of 79 out of 90 disputed transactions) 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?*"

In 2013 (TC02702), 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 FTT 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.

The company appealed to the UT again. The first ground of appeal related to the fact that the FTT (in the first hearing) had not found that all the transactions were connected to fraud. The company's counsel argued that, if not all the transactions were connected to fraud, it was reasonable to suppose that there were other possible explanations for the rest of the trade. The second FTT hearing had considered this point but had rejected it: it might still be that the only reasonable explanation was fraud, but on further investigation the company might have found that there was an "unreasonable but possible" innocent explanation. The problem was that the company had not carried out that investigation, and the transactions were connected with fraud.

The UT examined the background, the history of the appeal and the arguments in detail. The judges noted that the "only reasonable explanation" test has to be considered at the time of the transactions on

the basis of matters within the knowledge of the directors of the company at that time. The decision as to whether in fact there is a connection with fraud is made at a different time and may be decided by reference to different evidence.

The judges were satisfied that the evidence and the findings of fact of the FTT fully justified the conclusions. It did not matter that there were other transactions in which fraud was not proved, nor that there was a legitimate grey market trade. The features of these 79 deals were such that the directors should have, on the basis of what they knew at the time, concluded that they had to be connected with fraud.

The company also criticised the way in which the FTT had applied what is called the "reasonable businessman" test. The UT considered that there were some errors of law in the detail of the FTT's reasoning in this area, but no error in its conclusion.

Lastly, the company argued that the FTT had not been entitled to reach various findings of fact about the state of the directors' knowledge. Underlying this attack was the proposition that all of the five factors that the FTT had considered to indicate the likelihood of fraud were in fact entirely consistent with legitimate grey market transactions. The UT considered that the FTT had adopted a balanced and thorough approach to the evidence and the questions arising from it, and there was no error of law in its conclusions.

The appeal was dismissed again.

Upper Tribunal: *S & I Electrical plc v HMRC*

A company claimed £303,000 in respect of transactions in July, October and November 2006. At the end of a very long decision (648 paragraphs), the Tribunal (Judge Mosedale and Mrs Salisbury, TC01509) came to the conclusion that the directors knew that their transactions were connected with fraud, even though they were contra-traders only involved in a "clean chain". The company appealed to the Upper Tribunal. Leave to appeal was twice refused, but eventually allowed on 6 of the 18 grounds initially advanced by the company.

The UT went through the grounds of appeal and the FTT decision in detail, and found nothing of significance in the appellant's arguments. There was ample justification for the FTT's overall conclusion, and very little wrong with the details of how that conclusion was reached. The appeal was dismissed again.

Upper Tribunal: *Earthshine Ltd v HMRC*

In the first quarter of 2014, Judge Bishopp had to consider an application by HMRC to have 6 MTIC appeals by traders struck out. All had lost before the FTT, and had permission to appeal to the UT. HMRC argued that all their appeals were based on the claim that *Mobilx* had been wrongly decided and the FTT decisions relying on it were therefore unsound; as the UT has recently and repeatedly confirmed that it regards *Mobilx* as good law, at the very least the appellants should be required to amend their grounds of appeal to strike out these particular arguments. HMRC should not be forced to litigate the same points over and over again.

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

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

The appeal returned to the Upper Tribunal for further hearings. The decision shows the hearing dates as February 2014, but the decision is dated June 2015. It is not clear from the document what happened in the meantime, or whether the hearing date is a misprint.

Mr Justice Henderson and Judge Malcolm Gammie considered another set of representations on MTIC issues by Mr Patchett-Joyce QC. A request for a reference to the CJEU was turned down because the issues appeared to have been covered by the recent *Italmoda* decision (Case C-131/13). Arguments based on the translation of the Kittel tests from French to English were also considered: Mr Patchett-Joyce contended that the French expressions "*Impliquée dans*" and "*savait ou aurait dû savoir que*" suggested a more restrictive test than that applied by the UK courts. The UT considered these arguments carefully and analysed a number of the precedents on which the company relied. However, it was satisfied that the FTT had been entitled to conclude that the directors were evasive witnesses whose evidence was not to be believed. The FTT was also entitled to conclude that they were aware of the connection with fraud, regardless of the precise meaning of the *Kittel* tests.

The final grounds of appeal were that HMRC should have explicitly pleaded conspiracy if they considered that the company was knowingly involved in a fraud. The UT examined this argument and came to the conclusion that the FTT had been entirely justified in deciding that the directors had actual knowledge, and there was no deficiency in the way the case had been presented.

The appeal was dismissed.

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

HMRC assessed a company to recover just over £1m in input tax deducted on the purchase of memory cards that HMRC alleged did not exist in the quantities claimed (late 2005) and denied payment of £321,000 claimed in relation to purchases of mobile phones in the period to 05/07 on the normal MTIC basis. The company appealed against both decisions.

HMRC had written to the company in June 2007 to point out that the manufacturer claimed only to have made 5,000 of the memory cards in the whole of 2005, while the company claimed to have sold 15,535 of them in October and November 2005.

It seems that the company did buy some memory cards, but they were counterfeit. This meant that the descriptions on the invoices were not accurate, and the invoices were therefore not valid for input tax deduction.

In relation to the MTIC dispute, the judges decided on a whole range of factors that the director actually knew that the company's transactions were connected with fraud, and therefore must also have had the means of knowledge. Both appeals were dismissed.

First-Tier Tribunal (TC04412): *Devi Communications Ltd*

An unusual MTIC case involved input tax of £122,937 claimed on 4 purchases of watches in March 2011. There is an interesting observation in the decision after the first 89 paragraphs review the precedent case law and set out the issues:

We should note at this stage that following our reading of the evidence but prior to any witnesses being called we were asked on behalf of the Appellant whether we would provide an indication as to the likelihood of success in this case. Whilst we were sympathetic to the financial implications of running an appeal we did not consider it appropriate to do so on the basis that we had not heard the case fully argued nor had we heard evidence from any witnesses.

Although most missing trader cases are won by HMRC, it would not be appropriate for the Tribunal to say "we are likely to find against the taxpayer" without hearing any of the evidence.

The FTT decision contains a great deal of verbatim cross-examination of the four directors. The judges concluded that the directors were not truthful witnesses; from a range of evidence, they concluded that the directors knew that their transactions were contrived and connected to fraud, and they therefore definitely had the means of knowledge. The appeal was dismissed.

First-Tier Tribunal (TC04377): *My Digi Ltd*

HMRC denied input tax credit of £22.367m in relation to purchases of mobile phones and other electronic components in the VAT return periods 10/05, 04/06 and 07/06. The judge commented on the two versions of the trading of the company:

The first account, that of the Respondents, provides a detailed analysis of not just the transactions in respect of which repayment of input tax has been refused but integral part.

The second account, Rioni's account, is of a trader recently embarked on a new venture which has yielded improbably high profits over a short period of time from a turnover which can only be considered as extraordinary in its size. The success of this remarkable enterprise is said to be accounted for by the hard work and dedication to his task by Mr Gligic.

He concluded:

The tribunal unreservedly accepts the Respondents' evidence for what it is, namely an overwhelmingly persuasive account of a dishonestly conceived, carefully planned and executed fraud on the public purse. Mr Gligic's account of his trading is nothing short of a work of fiction which bears not even a passing resemblance to the truth.

On the basis of a range of evidence, the FTT concluded that the director was actively involved in the fraud, and dismissed the appeal.

First-Tier Tribunal (TC04360): *Rioni Ltd*

An unusual MTIC case involved input tax of about £460,000 in relation to wholesale transactions in soft drinks in the periods 03/11 and 06/11. The company was long-established and had operated a mixture of scrap metal and confectionery for some years. The disputed input tax related to 115 transactions in which soft drinks were purchased in Northern Ireland and sold to five different customers in the Republic.

The Tribunal considered that one of the 115 transactions was not shown to be connected to a fraudulent tax loss – it did not fit into the same pattern of supply chains as the others. However, the rest were so connected, and the deals had the normal features of MTIC transactions: suppliers and customers were known to each other, so the insertion of the appellant into the chain appeared to serve no commercial purpose or logic other than to generate VAT repayments. The only reasonable explanation was that the director knew of the connection. If he did not know, he should have known.

First-Tier Tribunal (TC04449): *Ulster Metal Refiners Ltd*

A MTIC case concerned the refusal of £1,192,100 of input tax relating to mobile phones purchased in the period 04/06. One point of interest is a very brief description of the deal chains involved:

34. Both deals were transacted on 28 April 2006 and in each of the two deals the appellant's immediate supplier was a UK trader, Saphire Limited. The immediate customer was C.E.M.S.A. ("CEMSA"), a Spanish company. There is a consistent cell of traders in both deals and the transaction chain for the telephones proceeds: PZP ENA (Slovenia) >Swindon Star Ltd (defaulting trader)> Realtech Distribution Ltd >Fonedealers Ltd>Electron Global Ltd> Trimax Trading International Ltd>Saphire Ltd> the appellant>CEMSA> Ignite Technology (Danish).

35. The analysis of the FCIB records then shows identical links in both deals from Fonedealers Ltd to Ignite Technology (and then to CEMSA) in terms of flow of funds, namely: Fonedealers Ltd>Multimode Marketing (Spanish)> Intertech Sarl (French)>RCCI High Tech (Cypriot)> Ignite Technology.

36. There is no retailer, manufacturer or authorised dealer within either deal chain.

37. The same margin is made, or lost by the traders in the chains despite the fact that the deals involve different models of mobile phones. In each deal:

(a) Fonedealers Ltd makes 5p per unit

(b) Electron Global Ltd makes 30p per unit

(c) Trimax Trading International Ltd makes £1 per unit, and

(d) Saphire makes a loss of £1 per unit.

38. The payment chains are circular for both of the deals. For deal 1 (the appellant's invoice 4), the start and finish of the payment chain is the appellant's customer, CEMSA. For deal 2 (the appellant's invoice 5), the

start and finish of the payment chain is the supplier (Ignite Technology) to CEMSA. All of the payments were made in quick succession.

The trader argued that he had no knowledge of any of the other parties, and until he had heard the evidence in the Tribunal, he had had no knowledge or means of knowledge that the transactions were connected to fraud. The Tribunal examined all aspects of the trade and agreed with HMRC: his assertions were not credible. The cumulative effect of all the evidence was that he must have known, and certainly had the means of knowing, that the trading was contrived and was therefore likely to be connected with fraud.

First-Tier Tribunal (TC04504): *Connections GB Ltd*

5.8.2 Input tax evidence

HMRC refused to accept invoices as adequate evidence to support deductions of £28,476 in respect of supplies by sub-contractors. HMRC ruled that the purchase invoices did not conform to SI 1995/2518 in that they failed to state "a description sufficient to identify the goods or services supplied" (reg.14(1)(g)) and/or "for each description, the quantity of the goods or the extent of the services"(reg.14(1)(h)).

The background to the case was a successful prosecution by HMRC of a number of suppliers who had raised invoices for fictitious supplies. Substantial prison sentences were imposed. Four of these contractors had rendered invoices to the appellant. HMRC did not allege that the appellant was involved in the fraudulent activities of the suppliers, but were concerned that invoices issued by these suppliers might not be genuine if the descriptions on them were vague and imprecise.

HMRC refused to exercise their discretion under reg.29 to accept alternative evidence. The trader had provided a considerable amount of further information, showing how the invoiced supplies related to outputs of his business. HMRC considered that this was not enough.

The Tribunal was clearly impressed with the director as a witness, and with the information that he was able to provide. It was not possible for him to have provided the services to his customers without the inputs that were described on the invoices; that was persuasive evidence that genuine supplies had been received. Even though the suppliers had been dishonest in respect of other activities, they did have some proper business activities, of which these appeared to be part.

The Tribunal concluded that, as a matter of law, the invoices actually complied with the regulations: the descriptions were adequate, in spite of HMRC wanting more detail. If the Tribunal was wrong about that, it was satisfied that the decision to refuse to accept the further evidence was unreasonable. The appeal was allowed.

First-Tier Tribunal (TC04408): *North & South Groundwork Services Ltd*

In a case concerning mobile phones, HMRC argued that the invoices could not properly describe the subject matter of the transactions because the types of phones described had not been manufactured at the dates shown. The input tax at issue was about £11m.

In the FTT in 2012, Judge Porter ordered some of HMRC's evidence to be struck out. HMRC appealed against this particular point to the Upper

Tribunal. However, as the judge noted, this was not HMRC's only objection to the input tax claim: they considered that the whole course of business dealing was fraudulent.

The UT judge commented that he could not accept HMRC's contradictory assertions that they were not alleging fraud against the company, but nevertheless did allege that it was not acting in good faith. The two were effectively the same.

It was essential that someone accused of fraud should know the nature and extent of the case against them. The struck out evidence appeared to indicate that a fraud had taken place, but did not implicate the appellant in it. It was therefore hard to see how it was relevant to the appeal, unless HMRC intended to raise the question of fraud. Accordingly, the judge dismissed HMRC's appeal against the striking out of the evidence.

He described this as an unsatisfactory state of affairs. The appellant should be fully apprised of the case against them. HMRC could return to the FTT and reapply for inclusion of the material, if they could explain how it was relevant to the case. Presumably this means that they have to "put up or shut up", and alter their approach to the rest of the case accordingly.

Upper Tribunal: *HMRC v Infinity Distribution Ltd (in administration)*

5.8.3 Mobile phone runners

A company appealed against the refusal of about £944,000 of input tax on individual purchases of mobile phones bought for cash by "runners". HMRC argued that either the company had not bought the phones in a taxable transaction, or it did not have proper VAT invoices.

The decision goes into great detail about the facts, which are similar to other cases about so called "box breaking" and "box consolidation". The Tribunal concluded that the company's record-keeping in respect of retail purchases was so poor – and that was the company's fault – that HMRC's decision had to be the correct one. The company could not demonstrate that it was entitled to any input tax at all, even though it probably had bought some phones.

In respect of wholesale purchases, which had taken place in the period 02/11, there were valid VAT purchase invoices. HMRC did not base their case on *Kittel* ("knew or ought to have known of connection to fraud"), but rather on whether there was a supply at all. Given that there was prima facie evidence that supplies had taken place, the evidential burden had shifted to HMRC to show that they had not. In the Tribunal's view, HMRC failed to meet this burden, even though there were some doubts about the reliability of a witness and irregularities in the behaviour of the suppliers. If the supplies had not taken place, the company would have had to have been an active participant in a fraud – and this had not been alleged by HMRC. Allegations of fraud have to be pleaded clearly and not merely by implication. The appeal was allowed in respect of these wholesale purchases.

First-Tier Tribunal (TC04418): *Global Cellular Ltd*

5.8.4 Pre-registration VAT

In an article in *Taxation*, Neil Warren discusses an apparent change in HMRC's internal guidance – but not in public notices – to require reg.111 SI 1995/2518 claims for pre-registration VAT to be based on the depreciated cost of fixed assets rather than simply the amount incurred regardless of how long the asset had been in use by the unregistered business. The article considers whether the change in policy is justified by EU law.

Taxation, 11 June 2015

5.8.5 New Notice

HMRC have published a new Notice *VAT refund scheme for certain charities*. It explains the schemes introduced by the 2015 Budget to add the following types of charity to the refund scheme in .33 VATA 1994:

- palliative care charities;
- air ambulance charities;
- search and rescue charities;
- medical courier charities.

Notice 1001

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

6.1.1 Article

In an article in *Taxation*, Angela Lang-Horgan discusses the Advocate-General's opinion in *Larentia-Minerva*, and the possibility that Member States may have to change their rules to allow more entities to join VAT groups.

Taxation 29 April 2015

6.2 Other registration rules

6.2.1 Partnership notice

Two individuals carried on a removals business in partnership. Notice of the dissolution of that partnership was provided to HMRC on 18 August 2010. One of the partners claimed that the partnership had ended on 1 May 2008, and that he had notified HMRC of that fact on 3 May 2008. HMRC said that this notice had not been given, and sought to enforce an assessment on the business for the period 12/08 against the former partner.

The Tribunal considered the effect of s.45 VATA 1994. Agreeing with the High Court's 2002 decision in *HMRC v Jamieson*, the judge confirmed that a partnership is deemed to continue for VAT purposes until the proper notice has been given to HMRC.

The judge had to pick through a complex history of the relationship between the two partners and how that relationship came to an end. There were separate questions of whether the partnership had actually ended on 1 May 2008, and whether the partner had sent the letter. There were arguments both ways on both issues. Having considered them, the judge concluded on the balance of probabilities in favour of the appellant on both: his appeal against the ruling that the partnership continued, and therefore that he was liable for its VAT, was allowed.

First-Tier Tribunal (TC04407): *Gordon Lye*

6.2.2 Deregistration

A trader wished to be deregistered from 8 April 2014. HMRC accepted that she was entitled to be deregistered from that date, but said they had no power to deregister retrospectively: they had received her request on 3 June 2014, and that had to stand as the date of deregistration. The result was that supplies between the two dates, amounting to £10,170, were subject to output tax (charged at 13% under the FRS).

It seems that the trader had noticed that her turnover was below the threshold on the earlier date and had asked her accountant how she should deregister. He took five weeks to send her the form; she completed it and took it back the same day, as he had asked her to do so, and thought he

would send it in immediately. In the event, HMRC did not receive it for another two weeks.

The judge had considerable sympathy for the trader, who had acted reasonably throughout, and went through the legislation in some detail to show that he could not find in her favour – the law was exactly as HMRC described it. The appeal was dismissed. The judge did not make the fairly obvious comment that the accountant might be invited to contribute to the extra liability.

First-Tier Tribunal (TC04505): *Hayley Mundy t/a Hayley's Hair Design*

6.2.3 Updated Notice

HMRC have issued a revised (March 2015) edition of their Notice *Cancelling your registration*. Changes have been made to make the notice suitable for publication on GOV.UK and to provide information on how to cancel registration online.

Notice 700/11

6.3 Payments and returns

Nothing to report.

6.4 Repayment claims

6.4.1 Compromise agreement?

A company made supplies of dental nurses on which it had accounted for VAT. It made a *Fleming* claim for repayment under s.80 on the understanding that the supplies should have been exempt; HMRC paid the claim with interest, totalling £1.4m. However, they then decided that the supplies should have been taxable all along, and raised assessments to claw back the repayments.

The trader argued that the settlement of the repayment claim had constituted a binding compromise agreement. The claim had not been paid in full, and the company had agreed not to pursue it further. The argument over which a compromise had been reached related to the issue of unjust enrichment. HMRC had initially resisted the claim on this ground; they then proposed a payment of 50%; finally they accepted that they should pay 74%.

The FTT (TC03226) agreed that, even though there were no specific words expressing this intention, it was what had been agreed between the taxpayer and HMRC. Such a compromise was within HMRC's powers, and the department was bound by its agreement. It therefore had no right to assess to claw back the repayments.

HMRC appealed to the Upper Tribunal. It identified three issues:

- whether s.80 ruled out a compromise agreement because it provided a comprehensive regime for repaying output tax – it was not possible for output tax to be repaid under any other legal provision;
- whether any such agreement was ultra vires and therefore void;
- whether there had in fact been such an agreement in this case.

On the first issue, the UT noted that s.85 expressly permitted HMRC to enter into a compromise to determine an appeal; there was no reason for the same procedure not to be allowed just because there had not been an appeal.

On the second issue, the fact that HMRC subsequently changed their view, or that the original repayment had been based on an incorrect view of the law, did not render the agreement void or ultra vires. The UT considered a number of precedents on the concept of ultra vires and the powers of HMRC to manage the tax system. HMRC had not acted irrationally or for an improper purpose; the decision-maker took a decision that was reasonable based on what was known at the time. He had therefore not made a fatal error of law in deciding to make a repayment.

Lastly, the UT noted that the pattern of correspondence between the parties appeared to represent a negotiation intended to lead to a binding agreement. Words such as "offer" and "accept" were used. HMRC argued that they had not asked the company to undertake not to litigate for the balance of the claim, so they had not received consideration – but they had in effect obtained complete protection from such a claim, because any fresh claim would have been time-barred.

HMRC were bound by a contract with the taxpayer and could not go back on it. Their appeal was dismissed.

Upper Tribunal: *HMRC v Southern Cross Employment Agency Ltd*

6.4.2 Further problems with group *Fleming* claims

The representative member of a VAT group (T) made a claim in respect of output tax accounted for on the takings of gaming machines between 1973 and 1996. Initially, this claim was made in November 2007 by the company that owned the gaming machines (C), which had left the VAT group under a management buy-out in 1998. T applied on 31 March 2009 for the VAT group to be formally disbanded; although it did not make a formal claim under s.80 for the repayment of the output tax, and appeared to have no knowledge of the claims made by C, in April 2009 HMRC paid to T the amount due under the one *Linneweber* claim made by C that HMRC accepted (repaying about £667,000 with almost as much in statutory interest). Presumably this was because C would have used the group's VAT number in relation to its claim, and HMRC paid the claim to the representative member which still owned that number.

HMRC then assessed (in July 2009) to claw back the repayment, having decided that it had been paid to the wrong company – C was the correct person to receive any refund. Following a protest, HMRC changed their view again in October 2009, stating that they then believed that T was the correct claimant, so the assessments would not be enforced, but noting that C had also made a competing claim. By September 2010, they had

gone back to the earlier view, and decided to uphold the July 2009 assessment against T.

The situation was further complicated by the fact that the appellant company (T) had originally carried on the trade itself; it had entered into a group reconstruction in 1990, changing its name and transferring the trade to the other company (C). The claim therefore related to VAT that had been accounted for at one time or another by both companies.

The FTT (TC02443, December 2012) reviewed the complex background and a number of precedent cases. It concluded that T could not take over C's timely claim when it had not itself made any claim at all. Any claim made by T as part of the appeals process was after the *Fleming* time limit; C had not made the claim on behalf of T or acting as its agent, and T could not take the benefit of the fact that C had made a claim in time.

The FTT went on to consider the consequences of the assignment of the trade in 1990 and the management buy-out in 1998. The 1990 assignment of trade from T to C carried with it any rights to reimbursement of overpaid VAT. At that time, T was the representative member of the VAT group, so it would have made any such claim; but when C left the group in 1998, it took with it the rights to make claims in respect of its own VAT overpayments, including those rights that had been assigned to it in 1990. Accordingly, it was the correct person to receive repayments.

The FTT considered that the disbandment of the VAT group, which seems to have been coincidentally applied for at about the same time, had no effect. C was not a member of the group in 2009, and T could no longer act as its representative. Even if that was wrong, HMRC had agreed to give effect to the cancellation of the group registration with effect from 28 February 2009, when T had ceased to trade; that was before the repayment was incorrectly made to T, and confirmed further that C was the company entitled to repayment.

T appealed to the Upper Tribunal in 2014, arguing that the 1990 agreement had not assigned the right to reclaim VAT; and even if it had, the fact that T was the representative member of the group at all material times, it would still have had the right to make a claim. Both HMRC and the appellant agreed with the reasoning of the FTT in the subsequent case of *Standard Chartered plc* and disagreed with the FTT's decision in *MG Rover Group Ltd* – it was the representative member, and not the "real world supplier" (in Judge Mosedale's expression) that accounted for VAT and should be entitled to reclaim it.

T's representative argued that it was not necessary for a claim to have been made by the appellant: s.80 only required "a claim being made for the purpose", which could be made by someone else. She also argued that the principles of equivalence and effectiveness supported her construction.

HMRC responded that the meaning of s.80 was clear, and in accordance with its purpose: a claim had to be made by or on behalf of the person to whom the money was to be repaid. T had not made a claim by the time limit; it was unaware of the claim that had been made. The principles of equivalence and effectiveness did not assist the appellant, as the time-bar had been held to comply with EU legislation in principle. The judge

preferred HMRC's as the more natural construction of the law. The appellant's version could lead to absurd results.

The one area in which the UT disagreed with the FTT was in relation to the question of entitlement to claim. As the judge agreed with the FTT in *Standard Chartered*, he considered that the representative member was the person entitled to claim, even after the trade had been transferred in 1990. He did not accept that the 1990 agreement assigned the right to make such reclaims to C.

The appellant's action was dismissed. The language suggests that neither C nor T will now be entitled to a repayment: the judge states that "*Prior to 1 April 2009 the appellant as representative member of the VAT group would have been entitled to claim repayment of output tax overpaid by it in respect of the period 1973 – 3 December 1996. The appellant made no s. 80 claims before the expiry of the limitation period. Its claims are time-barred.*" The implication is that C was not a person entitled to make a claim, so presumably the claims that it made – and that HMRC accepted, in part – are not valid.

T sought leave to appeal against the UT decision. As this is a Scottish case, the appeal lies to the Court of Session. As Philippa Whittle QC had represented T in the FTT and UT hearings, assisted by a Scottish advocate, the company applied for her to be allowed to lead the appeal. This would require the Court of Session to grant permission, because in general only Scottish advocates have rights of audience there.

The application was refused. The Court referred to a number of ancient statutes, including the Scottish College of Justice Act 1532, as well as modern legislation on recognition of professional qualifications. It concluded that the Court should not grant ad hoc rights of audience, and that T's appeal would not be prejudiced if the Scottish advocate led the appeal.

Court of Session: *Taylor Clark Leisure plc v HMRC*

6.4.3 Compound interest

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

1. Where a taxable person has overpaid VAT which was collected by the Member State contrary to the requirements of EU VAT legislation, does the remedy provided by a Member State accord with EU law if that remedy provides only for (a) reimbursement of the principal sums

overpaid, and (b) simple interest on those sums in accordance with national legislation, such as section 78 of the VATA 1994?

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

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

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

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

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

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

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

are to be determined by the Member States in accordance with the principles of effectiveness and equivalence."

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

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

The full Court's decision (Case C-591/10), handed down in 2012, is one of those which passes responsibility to the national court. It is much briefer than the opinion, giving only a single combined answer as follows:

European Union law must be interpreted as requiring that a taxable person who has overpaid value added tax which was collected by the Member State contrary to the requirements of European Union legislation on value added tax has a right to reimbursement of the tax collected in breach of European Union law and to the payment of interest on the amount of the latter. It is for national law to determine, in compliance with the principles of effectiveness and equivalence, whether the principal sum must bear 'simple interest', 'compound interest' or another type of interest.

This seemed to validate s.78 – the most obvious conclusion is that the CJEU did not hold that s.78 is plainly incompatible with EU law. The detail of the judgment did impose conditions, however: the domestic law can only be valid as long as it is applied in accordance with the principles of effectiveness (member states do not make it excessively difficult or effectively impossible to enjoy legal rights) and equivalence (domestic claims are not treated more favourably than foreign claims). As the UK courts had ruled out the claims on the basis of generally applicable UK legal principles, it seemed that HMRC had won, unless the courts could be persuaded that simple interest was so derisory that it was not "effective" in giving traders their rights.

High Court

The case was referred by Vos J, who has since been promoted to the Court of Appeal, so it returned to be heard by Henderson J in the High Court. Not surprisingly, given that the decision awarded £1.2bn to the appellants, it is long and detailed: 450 paragraphs of close reasoning. The overall conclusions were as follows:

(a) it is not open to HMRC to reopen the underlying tax issues, because it would be an abuse of process to permit them to do so;

(b) EU law entitles the claimants to receive an adequate indemnity for the loss occasioned to them by the overpayments of VAT;

(c) as a matter of EU law, such an indemnity requires the payment to the claimants of an amount of interest which is broadly commensurate with the loss of use value of the overpaid tax, running from the dates of

payment of the tax until the dates when the loss of use value is fully restored to them;

(d) sections 78 and 80 of VATA 1994 cannot be construed conformably with EU law, and must therefore be disapplied in such a way as to permit the claimants to pursue both their *Woolwich* claims and their mistake-based *DMG* claims;

(e) as a matter of English law, the correct approach to quantification of the claims is to ascertain the objective use value of the overpaid tax, which is properly reflected in an award of compound interest;

(f) since the claimants are content to receive the use value of the overpaid tax to the Government, which is admittedly less than the loss of use value to themselves, the award of compound interest should be computed in accordance with the unchallenged rates and methodology advanced by the claimants' expert, Professor Kay;

(g) the actual benefit derived by the Government from the overpayments is irrelevant to the objective use value of the money, and even if actual benefit were the correct measure of restitution under English law, it would be precluded by EU law if the actual benefit fell short of the objective use value of the money;

(h) if, however, actual benefit were the correct measure of the restitution to be made by the Government, I would quantify it as equivalent to an award of simple interest only, following the general approach of the Government's expert, Dr Richardson; and

(i) in quantifying the claims, no account should in any event be taken of the additional corporation tax which would have been paid by the claimants if the overpayments of VAT had never been made.

Of these, the conclusions of most widespread application are these:

- first, that HMRC sought to argue that "if we had realised we would not be protected by the cap, we would not have given in on the technical liability issue". They wanted to argue again that the underlying tax should not have been repaid, which would obviously negate the claim for interest. The judge considered that this would amount to an abuse of process – the litigation about the principal amount was settled years ago, and HMRC had to take all the consequences of conceding that case.
- second, that simple interest was not, in the circumstances, an adequate remedy, in spite of the implications of the CJEU judgment that it might be. HMRC (see below) emphasise that the circumstances of the *Littlewoods* claim are exceptional, and they do not apply to current claims – the overpayments arose over 30 years during which interest rates were high, so compounding made a very significant difference. Over three or four years at a time of low interest rates, HMRC will argue that simple interest is not so much less, and s.78 is therefore an adequate remedy.

High Court: *Littlewoods Retail Ltd and others v HMRC*

Not surprisingly, HMRC appealed this decision. They stated in *Revenue & Customs Brief 20/2014* the view that the decision was based on exceptional circumstances that are peculiar to the case, and they said they

would apply for a stay of any other compound interest claims pending the outcome of the litigation.

HMRC's view was that there is no Community law right or domestic law right to compound interest and that s.78 VATA 1994 provides an exhaustive statutory scheme by which only simple interest is payable. In their view, this was supported by the judgment of the CJEU.

Court of Appeal

HMRC appealed to the Court of Appeal. The company cross-appealed on a basis that would allow them to win by a different route, if HMRC's appeal succeeded.

The issues were identified as follows:

1. whether claims to compound interest were excluded by s.78 and s.80 as a matter of English law;
2. if so, whether that exclusion was contrary to EU law, in that the right to interest under s.78 was so inadequate that it violated the principle of effectiveness;
3. if so, whether s.78 and s.80 could be construed in a manner that complied with EU law, or whether they had to be disapplied;
4. if so, whether they should be disapplied so as to allow "*Woolwich*-type restitution claims" only, or both *Woolwich* claims and mistake-based restitution claims (the *Woolwich* case established the existence of a claim in restitution based solely on payment of money pursuant to an unlawful demand by a public authority);
5. whether the benefit to the government for the purpose of a restitutionary claim was to be the objective use value of the money by reference to the cost to the government of having borrowed money equal to the sums overpaid, or the actual use value by reference to the actual benefit which the government had derived from the overpayments;
6. lastly, if compound interest was payable, if it should continue to run after the principal amounts of the overpaid VAT had been repaid until the date of the current judgment.

The Court dismissed both the appeal and the cross-appeal, effectively agreeing with Mr Justice Henderson. In summary, the conclusions on the above issues were as follows:

First issue

Although the words of s.78(1) ("if and to the extent that they would not be liable to do so apart from this section, they shall pay interest") appear to allow the possibility of a restitutionary claim for interest, it was clearly the intention and effect of s.78 to rule out any claims for the time value of money as alternatives to the simple interest offered under s.78(3).

Restitutionary claims for VAT itself were certainly ruled out by s.80(7), so as a matter of English law, the claims to compound interest were excluded by s.78 and s.80.

The Court rejected the company's argument that the words of s.78(1) allowed an alternative claim for interest in any case. If that was true, the rest of s.78 would have no application.

Second issue

The CJEU had left it up to the national courts to consider what was an adequate remedy for the loss of the money. On the facts of this case, the Court was satisfied that s.78 did not provide an adequate remedy. The difference between simple and compound interest might not be significant when the period of time was short, but where a claim covered many years, simple interest would be wholly inadequate.

Third issue

The exclusion of other ways to claim repayment was a fundamental feature of the UK legislation. It could not be construed in a manner that conformed with EU law, so it had to be disapplied.

Fourth issue

That meant that the company was free to pursue any other legal avenue available to it, such as a claim in restitution. This could either be under the doctrine of the *Woolwich* case or based on mistake. The significant difference between the two bases is that a *Woolwich* claim has to be made within six years of the erroneous payment, while a mistake-based claim can be made within six years of the time at which the mistake could, with reasonable diligence, have been discovered.

Fifth issue

The aim of a claim for repayment of money paid under a mistake was to make the defendant restore the gain he had made and not to confer some windfall on the claimant or to compensate him for his loss. An innocent recipient of a mistaken overpayment could rely on that principle to argue that the actual use benefit should be paid over, not the market value or some other calculated amount.

However, HMRC should not be regarded as an "involuntary recipient" of overpayments of tax. As a result, the objective use value should be calculated instead of the actual use value.

Sixth issue

Compounding required that the unpaid interest should continue to accrue interest until it was paid. The repayment of the principal amounts would significantly reduce the accrual of interest after that date, but the amount of the compound interest to 2007 would itself be so great that several further years' compound interest on top will also be a great deal of money.

The Court agreed with Henderson J on all points. The value of the claim to Littlewoods exceeds £1bn.

Court of Appeal: *Littlewoods Retail Ltd and others v HMRC*

HMRC are seeking permission to appeal this judgment to the Supreme Court. Since the judgment was based on the circumstances specific to the Littlewoods claimants, HMRC do not regard it as generally applicable. They note that "The court maintained that statutory provisions will provide an adequate amount of interest in many cases, therefore it is not the case that compound interest will always be payable where there has

been an overpayment of tax." The judgment also fails to provide a method for computing compound interest if it is eventually held to be due, so there may be further arguments about quantum in this and in other cases.

HMRC will continue to ask for a stay of other compound interest claims already lodged and refuse new claims until litigation is final.

Revenue & Customs Brief 9/2015

6.4.4 Unjust enrichment

A company (P) paid approximately £4m in VAT to a supplier, QCL, on supplies of food that should have been zero-rated. When the error was discovered, QCL claimed the output tax back. As it had gone into administration by that time, any repayment would have fallen into its general assets and only a reduced percentage would be repaid to P. It was agreed that QCL was the only person that could claim a repayment of the output tax under s.80. At the same time, HMRC raised assessments to recover the input tax incorrectly claimed on the supplies by P.

P proposed to HMRC that they should refuse to make a repayment under s.80 unless undertakings were given to the effect that QCL would make full repayment to P. Alternatively, HMRC should make the s.80 payment directly to P, rather than putting it in the hands of the QCL administrator. HMRC did not agree to this proposal.

The company sought judicial review of HMRC's actions on the basis that the resulting loss to P would be contrary to EU principles of fiscal neutrality and effectiveness, and HMRC's approach was irrational and disproportionate. QCL made representations as an interested party, observing that the CJEU in *Reemtsma Cigarettenfabriken GmbH* (Case C-35/05) had ruled that recovery by a customer directly from the tax authorities might be appropriate if the supplier had ceased to exist, but QCL was still in existence.

The High Court judge referred to the CA decision in *Investment Trust Companies*. The key question was not whether the supplier existed, but whether the customer would be able to recover the VAT by suing the supplier. As QCL was insolvent, P would not recover all of it. P therefore had a valid claim under *Reemtsma*.

Because HMRC had assessed P to recover the input tax, any use of the s.80 repayment by QCL other than to repay P would constitute unjust enrichment of QCL. Even though that would be indirect enrichment, in that the money would be paid to other creditors rather than enjoyed by QCL, nevertheless the principle applied. The judge granted P's application: the payment should not be made to QCL because of unjust enrichment under s.80(3), and the assessments should be quashed. QCL would also be bound by the decision.

High Court: *R (on the application of Premier Foods (Holdings) Ltd) v HMRC*

6.4.5 New or amended claim?

A golf club lodged a *Fleming* claim on the basis of exemption for green fees in 2009 covering the periods April 1991 to December 1996 and October 2005 to September 2007. It wrote to HMRC again in January 2014, purporting to make a claim for the period from 1 October 2007 to 30 September 2013. HMRC refused the claim on the grounds that it was out of time. The club argued that it was simply an amendment to the 2009 claim.

The FTT agreed with HMRC that a claim must be related to prescribed accounting periods (SI 1995/2518 regs.35 and 37). Although the subject matter of the claims was the same, they related to different periods. The 2009 claim did not even express itself as including or protecting the periods after those to which it explicitly related. The 2014 claim was not a mere amendment of the 2009 claim but a new claim, and those periods more than four years before January 2014 were out of time. This was consistent with the 2014 CA decision in *Reed Employment Ltd*.

The time limits were not affected by the fact that the 2009 claim had been held over ("sisted" in Scotland) pending the outcome of the CJEU hearing in *Bridport & West Dorset Golf Club*. This meant that it was properly appealed when HMRC refused it in 2009, and is currently subject to HMRC's arguments about unjust enrichment.

HMRC's application to have the appeal struck out was granted. The out-of-time periods could not be appealed, and the in-time part of the claim had not been rejected, so there was no appealable decision.

First-Tier Tribunal (TC04379): *Nairn Golf Club*

6.4.6 Scottish health boards

A Scottish NHS body failed to convince the FTT (TC03397) that any of its *Fleming* claim should be allowed. It had to produce sufficient evidence of the amount of VAT that had been incurred and had not been claimed under the contracted-out services provisions; and to provide a method that could be agreed as a fair and reasonable way of calculating the recoverable amount. The Tribunal was not satisfied that it had discharged the burden of proof laid on it by the law. The decision was detailed and probably only of direct interest to those involved in *Fleming* claims and/or NHS partial exemption methods.

The board appealed further to the Upper Tribunal, arguing that the FTT should have adopted a two-stage approach, similar to that used in a "best judgement assessment" case. It should have considered whether there was an overpayment (for which, the board contended, there was ample evidence) and then considered the amount. The board argued that deciding the claim failed in its entirety was an error of law.

The UT did not agree that the FTT was obliged to carry out such a two-stage procedure. It could find against a claim either on the basis that no repayment was due, or that it was impossible to say how much was due. In this case, the FTT had decided the second: although it was satisfied that there probably had been an under-recovery on certain capital expenditure, it concluded that it was not possible to carry out even a "tolerably acceptable calculation" of the amount on the basis of the evidence available. The onus was on the taxpayer to make out the claim on the

basis of evidence, and it had failed to do so. The FTT had been entitled to reach the conclusion that the claim failed.

Upper Tribunal: *Lothian NHS Health Board v HMRC*

6.5 Timing issues

6.5.1 Updated Notice

HMRC have issued a revised version of their Notice *Cash accounting*.

Notice 731

6.6 Records

6.6.1 Updated Notices

HMRC have issued a revised (May 2015) edition of their Notice *Electronic invoicing*. It has been updated to make it suitable for publication on GOV.UK.

Notice 700/63

HMRC have issued a revised (June 2015) edition of their Notice *Keeping VAT records*. It has been updated with a reference to guidance for the VAT mini one-stop-shop for digital services.

Notice 700/21

6.7 Assessments

6.7.1 Best judgement

A company was assessed to tax for periods 10/11, 01/12, 04/12 and 07/12. The assessments were reduced following correspondence and Alternative Dispute Resolution. However, the trader appealed against the remaining liability.

HMRC stated that two of the issues under appeal were resolved in their favour by ADR. As they had not been aware that these matters were still claimed by the trader before the hearing, they had no evidence that they had already been settled by agreement. The Tribunal decided not to make any findings on this matter: if the appellant wanted to pursue it, it should make a written submission after the hearing, giving HMRC time to find evidence to support its assertion that those points had been determined.

The hearing considered other arguments about whether an assessment on missing invoices was raised to best judgement, whether part of the assessment was valid on the basis that purchase invoices had not been

paid, and whether HMRC were correct to assess for the full amount of VAT shown on an invoice that the trader said had only been paid in part.

Judge Mosedale considered the evidence, which was presented by the company's external accountant rather than the director, who did not appear. The explanations offered for the missing invoices was not convincing; there was no evidence to support the assertion that the purchase invoices had been paid; and as there was also no evidence that the company had pursued the customer for the unpaid balance on the invoice, HMRC were correct to assess for the whole of the output tax shown. The appeal was dismissed.

First-Tier Tribunal (TC04376): *M & R Marble Ltd*

6.7.2 Clawback of *Fleming* claim

A motor trader made a *Fleming* claim in respect of sales from 1974 to 1986. This was paid with statutory interest. HMRC subsequently decided to review such claims after the *Nordania Finans* case suggested that a partial exemption restriction might be appropriate; however, they concluded on different grounds that the claim should not have been paid, because the business had been incorporated in 1986: the rights of repayment had been transferred to the company with its VAT registration number. They issued a s.80(4A) clawback assessment for £18,852 plus £39,627 of statutory interest overpaid. The *Fleming* claim was made in November 2008 and paid in July 2010. The clawback assessment was raised in March 2012.

The trader could not produce details of the agreement on incorporation, but was certain that it would not have explicitly included any reference to VAT repayment rights, because no such rights were believed to exist at that time. However, the Tribunal agreed with HMRC: the TOGC of a business with its registration number transferred all rights concerning VAT to the successor. The *Fleming* claim had not been made by the right person, and the appeal against the clawback assessment was dismissed.

First-Tier Tribunal (TC04400): *Alan Stringfellow*

6.7.3 Assessment for period 00/00

HMRC raised an assessment on the LSE for £1,442,597 of input tax repaid under a *Fleming* claim. The assessment was dated 10 September 2012 and was stated to be for period "00/00". The LSE accepted that everything else about the assessment was correct; however, it argued that the failure to state the period correctly meant that the assessment was invalid. A subsequent attempt to correct this defect would have been out of time – the potentially invalid assessment was issued at the very end of the time available for raising it.

The repayment of the *Fleming* claim was authorised on 9 September 2010. An officer wrote to LSE on 4 September 2012 announcing HMRC's intention to assess and recover the whole amount on the basis that they had decided the repayment should not have been made. The matter had not been discussed up to that point, for which the officer apologised. The letter explained the basis of HMRC's revised view and invited LSE to show that it was in fact entitled to the money.

According to authorities such as *House (t/a P & J Autos)*, notification of an assessment may be set out in a number of related documents, even if those documents do not refer to each other on the face of them, as long as it is clear that they are together intended to comprise the notification of assessment. The Tribunal decided that the notification of the assessment in this case included the letter of 9 September 2010 (because the letter of 4 September 2012 referred to it), the letter of 4 September 2012, and the VAT 655 that was issued to the taxpayer on 10 September 2012 (but was dated 4 September and arrived at the LSE on 17 September).

The LSE argued that an assessment had to show a return period, and the VAT 655 did not do so. HMRC responded that the correct return period for this clawback assessment was the period in which the repayment had been made, and it was identified clearly in the totality of documents that comprised the notification of the assessment.

The Tribunal considered precedents on the correct accounting period for the assessment, including *Croydon Hotel & Leisure*, *Laura Ashley* and *DFS*. There were various possibilities for the correct period – it could be that in which the overclaimed input tax was:

(a) incurred;

(b) reclaimed by the taxpayer; or

(c) repaid by HMRC to the taxpayer.

The Tribunal decided, on the basis of *DFS*, that it was C. *Laura Ashley* had gone for A and *Croydon Hotel* for B, but *DFS* was a more recent Court of Appeal precedent and was binding. The Tribunal was satisfied that it was an essential part of the decision and not a comment made in passing.

The Tribunal (Judge Mosedale) commented: "*Applying common sense, it seems to us that Parliament did not intend an assessment to be unenforceable for a minor technical defect in dating which has misled no one. We take the view that Parliament intended notification of an assessment to inform a taxpayer why and for what he has been assessed. That necessarily assumes that for a s 73(2) assessment the taxpayer is informed which repayment is being recovered by assessment.*" The precedents were confused and a definitive ruling from a higher judicial authority would be helpful to all. However, after further considering arguments about all three options, the judge upheld the validity of the assessment and dismissed the appeal.

First-Tier Tribunal (TC04484): *London School of Economics and Political Science*

6.8 Penalties and appeals

6.8.1 Default surcharge

Several of the Tribunal decisions this quarter are “paper hearings” considered by Presiding Member Peter Sheppard. He has a standard approach to such hearings, which is as follows:

- state the basic facts about the penalty;
- refer to the statute;
- cite three cases – *Total Technology*, *Enersys Holdings* and *Garnmoss Ltd t/a Parham Builders*, and give a summary of the surcharge system from the first of those cases;
- rehearse the appellant’s submissions;
- summarise HMRC’s submissions, which generally include the fact that the trader had been warned by various SLNs, as well as setting out the previous defaults that have led to the present surcharge;
- give “the Tribunal’s observations”, which refer back to *Enersys* and *Total Technology* to support the dismissal of any defence based on proportionality, and to *Garnmoss* for comments about “muddle” and simple mistakes not constituting a reasonable excuse;
- give the decision, which is normally against the taxpayer.

A company appealed against a £417 surcharge imposed for the quarter to March 2014. This was charged at the 2% rate and was just over the de minimis level. The VAT of just over £20,000 arose on a management charge between two connected companies; after a visit by HMRC, the companies agreed that on future inter-company charges, VAT would be paid by one and recovered by the other.

The recipient of the supply submitted a repayment return on 23 April. The repayment only arrived on 6 May. The paying company then filed its payment return and instigated a BACS transfer, which therefore arrived late. The director appealed on the grounds that it was unfair to charge a surcharge when the company had been waiting for the repayment to arrive, which was a prudent and reasonable course of action.

The Tribunal judge expressed sympathy with the director’s position, but could not accept that there was a reasonable excuse, and proportionality was not a defence to a surcharge of this size. The appeal was dismissed.

First-Tier Tribunal (TC04345): *Garland Hoff Ltd*

A company appealed against a surcharge of £788 charged at 2% for its May 2014 quarter. The company was in a surcharge period because of a late payment for May 2013, so it was just about to leave the surcharge system. Initially, the company claimed it had a reasonable excuse, but withdrew that argument before the hearing; it sought only to rely on *Trinity Mirror* and the principle of proportionality.

The judge distinguished that case from this: a surcharge of £70,906 was of a different order to a surcharge of £788. The questions to be posed according to the Total Technology decision were directed to determining whether the penalty was wholly unfair to the appellant in all the

circumstances: the judge did not think that it was, and dismissed the appeal.

First-Tier Tribunal (TC04348): *Nuneaton Roof Truss Ltd*

A company appealed against a surcharge of £1,076 for its July 2014 quarter. The appeal was considered "on paper" rather than at a full hearing. The director stated that he had asked for time to pay during the week before the due date and had then complied with the terms. HMRC had no record of the alleged first phone call before the due date; according to them, he had only rung on 8 September to state that an instalment had just been paid and the remainder would follow within two weeks.

The judge held that there was no evidence of the earlier call, which therefore could not constitute a reasonable excuse. As TTP had only been applied for after the due date, it could not suspend the surcharge. The appeal was dismissed.

First-Tier Tribunal (TC04351): *David R Yeaman & Associates Ltd*

A paper hearing confirmed a surcharge of £55.62 levied by HMRC in respect of late payment of a liability of £556. The trader's appeal amounted to no more than "innocent mistake" and hardship: there was no reasonable excuse. However, the FTT judge did agree with the trader (in dismissing the appeal) that the preparation and copying of HMRC's statement of case and enclosures, totalling 49 pages, must have cost far more than the penalty.

First-Tier Tribunal (TC04352): *Paul Edward Harrison t/a Building Mechanical Services*

A publican appealed against a default surcharge levied for late payment of VAT for the period 04/14. The return was submitted electronically on 6 June and payment arrived by five separate electronic transfers on 13 June, 6 days late. The 15% surcharge was £16,219.

The trader's accountant said that she had attempted to set up a direct debit on 5 March 2014. The January quarter's payment was not taken on time, so she paid the liability through the bank, and expected that it would take effect for the following quarter. As it did not, she argued that the company had been let down by HMRC's system and the surcharges for both 01/14 and 04/14 should be reviewed.

HMRC agreed to cancel the surcharge for 01/14 and to reduce the 04/14 surcharge to 10% as a result. However, they did not accept that the accountant's belief that the DD had been set up constituted a reasonable excuse.

The judge found as a fact that the accountant did have an honest and reasonable belief that the DD had been set up; she had also acted promptly on both occasions when it became apparent that the VAT had not been paid. The judge said:

"*We do not agree that paragraph 6.3 of Public Notice 700/50 is a correct statement of the law. It is correct that a, 'genuine mistake, honest and in good faith,' is not sufficient in its own right to give rise to a reasonable excuse. However, the Public Notice gives the impression that such a mistake can never be a reasonable excuse. This is wrong. As set out*

above, a mistake that has been made reasonably is, in principle, capable of being a reasonable excuse."

However, the accountant was on notice that there was a problem with the DD after payment had not gone through in March. It was therefore not reasonable conduct to have assumed that the DD would operate in June without further checking. The defence of disproportionality was also rejected, and the surcharge at 10% was confirmed.

First-Tier Tribunal (TC04396): *County Inns Ltd*

A company appealed against a 5% surcharge of £3,057 for its 06/14 accounting period. The excuses put forward were a temporary difficulty with making payments because all the directors were on holiday, and also that the bank had a £20,000 daily limit on electronic payments; there was a temporary cash flow shortage because the company's rent had inadvertently been paid twice; a director's father was seriously ill and this contributed to the difficulties; and that time to pay had been agreed, albeit on 8 August.

The Tribunal did not regard any of this as a reasonable excuse. A surcharge had been paid for the previous period, so the company should have been well aware of the consequences of late payment. The due date was entirely predictable, so arrangements could have been made in advance for payment. The TTP application was left until a day after the due date, which was too late to suspend surcharges. The director's father's illness would have had an impact, but it was not enough on its own to constitute a reasonable excuse. The appeal was dismissed.

First-Tier Tribunal (TC04402): *Brand Interiors Ltd*

A company appealed against a surcharge of £4,933 for the period 07/14. The director had regularly applied for Time To Pay; on 9 June 2014 HMRC refused the latest request, due to the large number of previous payment promises and because future compliance was not assured. HMRC notified the company that its direct debit mandate would be cancelled. The director did not apply for TTP in relation to the July period because the situation had improved and the funds were available; the return was filed on time on 5 September, but the payment was not made until 9 September, by CHAPS. As this was the third default in the surcharge period, a 5% penalty was levied.

The director did not argue that he had believed the payment would be made by DD: it appears rather that he had been confused by the past DD payments into believing, incorrectly, that the due date was ten days after the month end. He had intended to pay the VAT a day early, and had made a "genuine mistake". This could not be a reasonable excuse. The company was not new to VAT, and had been warned. The penalty was harsh, but that could not be a defence. The appeal was dismissed.

First-Tier Tribunal (TC04438): *Sandland Packaging Ltd*

A trader appealed against a surcharge of £565 for the period 09/14. The basis of the appeal was in essence "reliance on another", as the company's accountant had failed "to forward the return by e-mail". The director also claimed not to have seen previous SLNs. HMRC pointed out that he had phoned about an earlier surcharge, which suggested that he had seen at least one of the notices.

The Tribunal made no explicit reference to this in the decision, but ruled that reliance on another and unfairness could not succeed. The appeal was dismissed.

First-Tier Tribunal (TC04456): *Steve Ashall Ltd*

A trader appealed against a surcharge of £1,790 for the period 06/14. He claimed in correspondence that the payment was made only one day late, but HMRC recorded it as arriving on 12 August. He had made several late payments and was surcharged at 15%. The Tribunal considered the matter as a paper appeal, and went into considerable detail about various possible reasons to find for the appellant – including the possibility that the SLN extension notice might not have been received – but could find no defence. The appeal was dismissed.

First-Tier Tribunal (TC04459): *William Wallace*

A group of hotels appealed against a series of surcharges. They argued that they had a reasonable excuse; that HMRC had incorrectly allocated various payments, so increasing the surcharges unjustly; and the penalties were disproportionate.

In respect of the allocation of payments, HMRC had generally allocated amounts paid to the oldest debt first, which meant that the current debt was always paid late. As default surcharge is a fixed amount regardless of how late the payment is, it would be beneficial to the taxpayer to settle the current debt on time and leave an old debt outstanding. Under common law, debts can be allocated by the debtor to particular debts, but only if this is done before the money changes hands. The taxpayer argued that HMRC ought to have acted proportionately and fairly, and allocated the money in a way that was advantageous to the taxpayer. HMRC argued that, in the absence of any allocation by the trader, they were entitled to allocate all receipts to the oldest debt.

The Tribunal examined arguments and precedents about allocation of debts, and could find no evidence that HMRC had failed to allocate payments in respect of existing debts in accordance with any wishes expressed by the appellants. There is a problem: until the due date for a particular period, the debt for that period is not in fact due. So it is theoretically only possible to request an allocation of a payment to the current period's debt, as opposed to previous debts outstanding, if the payment is made on that last day. Any payment made before the last day cannot be allocated to a debt that is not yet due.

The reasonable excuse argument was based on a shortage of funds arising from problematic financing arrangements entered into on the advice of bankers – interest rate hedging instruments that proved disadvantageous. Although the problems caused might not have been anticipated in detail, they were broadly predictable. They did not constitute a reasonable excuse within *Steptoe*. The rest of the argument about insufficiency of funds failed to produce any other defence.

Some adjustments to the surcharge amounts were made, at HMRC's request, because payments had been reallocated during the course of the dispute, reducing the outstanding amounts on which surcharges were based. However, apart from that, the appeals were all dismissed.

First-Tier Tribunal (TC04466): *Swanfield Ltd and related appeals*

A trader appealed against a 5% surcharge of £916. He protested that it was one day late because on the day it was due, the HMRC website would not accept the submission. The trader said he had received a message saying that he should log off and check later, which he did, but the return was still in the submission process. He logged in again the following day and found that the return had disappeared. He therefore resubmitted it but was a day late.

HMRC responded that the return was actually received four days late. The trader replied that by "the following day" he really meant "the Monday following the Thursday which was the due date", but he had tried to file on time. HMRC still did not accept his excuse.

The judge considered that the reasonable action on having difficulty logging in would be to contact HMRC on that day, not to wait until it was too late. HMRC had no record of an attempt to log in or any computing difficulties on the date in question, and the judge concluded that the appellant had not made out a reasonable excuse.

First-Tier Tribunal (TC04500): *Veal & Son*

In a paper appeal, a trader protested a surcharge of £522 levied at 10%. The defence was essentially "hardship" and shortage of funds, which could not succeed. The judge noted that the trader had not made use of the Time To Pay facility; as he was only 3 days late paying, that would probably have been successful.

First-Tier Tribunal (TC04501): *Andrew Paul Bear*

In a paper appeal, a trader protested a surcharge of £1,214 levied at 10%. The trader stated that newly appointed accountants and the office manager had both thought the other had set up a direct debit; the office manager was on holiday on the due date, and immediate action was taken to correct the failure as soon as it was noticed. The judge described this as a "muddle", but it was not a reasonable excuse.

First-Tier Tribunal (TC04502): *Goodflo Ltd*

A company appealed against surcharges totalling £20,247 over three successive quarters. The Tribunal expected the taxpayer to be represented, but no one attended; after checking, it appeared that they were aware of the hearing, so it proceeded without them. The appeal was lodged very late, but HMRC appeared not to have noticed and raised no objections, so the Tribunal considered the substantive issues.

The Tribunal reviewed the long history of disputes, differences, payments and surcharges, requiring paragraphs (a) to (nn) to set out all the details from a bundle of documents. The trader's main argument was that payments had been allocated in a disadvantageous way. The judge asked for an explanation of how this would be done, and was told that payments are not reallocated between taxes; however, he noted from the record that this had actually happened between VAT and PAYE. Even so, this could not be a reasonable excuse, because the payment was still late for the VAT period that the trader wanted it to be allocated to – surcharge would still have been due.

Although there was clearly confusion, there was no other evidence of the trader giving a clear instruction on allocation which HMRC had failed to follow, and there appeared to be no effect on surcharges either in the

period concerned or through the knock-on effect to later periods. There was no reasonable excuse.

Proportionality was also discussed and dismissed.

First-Tier Tribunal (TC04489): *Zinc Group Ltd*

In a paper appeal, a trader protested a surcharge of £808 levied at 10%. The trader's accountant pleaded a misunderstanding, but compounded it by suggesting that the trader "thought he could pay by the 10th of the month but he needed to arrange the transaction by the 7th of the month for it to clear by the 10th." This was clearly wrong. He also argued that the client had initiated the payment before the weekend, and non-working days should not count.

The judge considered that there was plenty of guidance available, and these misunderstandings could not constitute a reasonable excuse.

First-Tier Tribunal (TC04491): *Asha Bangladeshi Cuisine Ltd*

In a paper appeal, a trader protested a surcharge of £482 levied at 5%. The trader had had some problems with a direct debit mandate, compounded in one case by submitting the return late, but he believed that the mandate was in force and he submitted the particular return on time. He claimed to have checked his bank statement every day for the money going out, and was surprised to find HMRC decided not to collect it but to charge a penalty instead.

HMRC claimed that the DD had been cancelled and the trader had been informed of this. The judge complained that there was insufficient evidence on either side to get a clear view of what had happened and why, but it did appear more probable than not that the trader had a reasonable belief that a DD mandate was in force. That was enough to constitute a reasonable excuse in the circumstances. The appeal was allowed.

First-Tier Tribunal (TC04492): *Profound Decisions Ltd*

In a paper appeal, a trader protested a surcharge of £1,466 levied at 10%. The company had moved floors within a Regus office building on Friday 5 December; its bookkeeper had emailed the return details at 16.30 that afternoon, which would normally have given enough time to process the return and payment, but because of the move the computer was turned off at 12.00. The email was not seen until Monday morning, so the payment was late.

The judge considered that the move was a foreseeable event. In the light of warnings contained in SLNs, the company should have been more alert to the risk of paying its VAT late. The appeal was dismissed.

First-Tier Tribunal (TC04493): *Protec IT Solutions Ltd*

In a paper appeal, a trader protested a surcharge of £300 levied at 15%. The director's PA had provided the wrong figure for the payment due – £5,374 instead of £7,374 – so the payment on the due date was £2,000 short. The director rang HMRC and was told that there would be no penalty for an "obvious error" lasting just 24 hours. However, a surcharge was issued and confirmed on review. The defence was no more than the harshness of the penalty for a failure that was rectified within one day.

HMRC made no comment about the trader's assertion about an assurance that there would be no penalty. The judge found the idea surprising, commenting that he sees plenty of surcharge cases where there was only a day's delay, and he saw no reason why HMRC (or he) would treat anyone differently. In the context of previous failures and warnings, he did not consider the circumstances constituted a reasonable excuse.

First-Tier Tribunal (TC04496): *Fresh Cleaning (Scotland) Ltd*

6.8.2 Careless error penalties

A second hand car dealer was selected for enquiry because it submitted a repayment return for 09/12, which was unusual for the business. The investigating officer discovered that the spreadsheets for the last three return periods appeared to be accurate, but only the third month of each period had been reflected on the returns. This was counted as a careless inaccuracy with prompted disclosure, and 15% penalties were imposed totalling £22,000. The trader appealed, arguing first that the errors had not been "careless" but had been "a series of one-off errors that would not be repeated", and second that the penalties should have been suspended.

The company had been subject to earlier VAT assessments in 2011 with penalties that were suspended. The suspension conditions included a requirement to check that the output tax calculated by the spreadsheet was correct at the end of each month. Between that enquiry and the current one, the company had moved from monthly to quarterly VAT returns. The trader argued that he had complied with the suspension conditions in that he had checked and double-checked the monthly calculations. HMRC responded that the new error showed that the suspension had not improved the company's compliance, and that was a relevant factor to consider when deciding on a further suspension.

The judge considered that HMRC have discretion to suspend penalties or not, and that suspension is the exception rather than the norm. Crucially, it must be possible to impose specific conditions that will improve the taxpayer's compliance, and which are capable of demonstrable fulfilment. In this case, the errors were too general: the conditions would have to be "not to make careless errors", which could not be demonstrated at the end of the suspension period. The appeal against non-suspension was dismissed.

First-Tier Tribunal (TC04380): *Automotion CPM Group Ltd*

A company appealed against an inaccuracy penalty of £1,267 for the period 04/14. An officer had visited to check a repayment return and discovered two problems:

- the company had acquired a photo booth on hire purchase. This was said to be intended to be leased to the owner's son's business, which was not registered for VAT. No lease rentals had been charged in the five months from purchase to visit.
- the input tax included VAT charged on a supply of services of constructing a new house, that should have been zero-rated. The supplier had not yet filed its tax return for the relevant period; its owner and sole director was the same individual who owned the appellant customer.

The officer decided that a “careless” penalty was appropriate, and allowed reductions for “telling” (20% out of a possible 30%), “helping” (30% out of a possible 40%) and “giving access” (15% out of a possible 30%). As it was a prompted disclosure, the reduction from the maximum 30% penalty was set at 65% of 15%, leaving a penalty rate of 20.25%.

The director protested about the penalty, arguing that it was completely unfair and criticising the basis of mitigation. However, the judge considered that HMRC’s view of this as “careless” rather than “deliberate” was if anything generous, and dismissed the appeal. He did not change the level of mitigation.

First-Tier Tribunal (TC04451): *Gdeco Ltd*

A trader operated the flat rate scheme with an appropriate percentage of 10.5%. He calculated his FRS liability on the basis of his VAT-exclusive turnover rather than his gross receipts. He also claimed input tax of £7,177 and £4,405 charged on services of solicitors and surveyors in connection with a sale of land. HMRC discovered these issues on a visit in 2014, and raised assessments to correct the output tax and disallow the input tax. They subsequently notified the taxpayer that they were seeking penalties of 15% of the potential lost revenue for a careless error. The maximum mitigation was allowed for co-operation within the context of a prompted disclosure.

The trader appealed, arguing that:

- he had not made any mistake in connection with the invoices.
- he was not careless.
- HMRC should have mitigated the penalties altogether.
- even if the penalties were correctly determined, HMRC should have suspended them.

There was no doubt that the supplies on which input tax was claimed were services, so no claim under reg.55E was possible.

The Tribunal reviewed the information available to a FRS trader. The appellant was familiar with Notice 733, although he had not read all of it. The judge was satisfied that even a non-tax specialist should be able to understand the rules on calculating turnover from it. The trader complained that the VAT return form ought to contain warnings about the different calculations for FRS traders, but the judge considered he had failed to take advantage of the information that was available. His explanations of his actions showed that he had made reckless assumptions rather than checking how the scheme operated.

The trader pointed out that he had had an earlier VAT visit in 2008, and the officer had not commented on his method of calculating FRS VAT. Indeed, the officer’s file note stated “Checked for application of correct FRS percentage and found satisfactory. Correct tax base applied to calculations.” HMRC claimed that the trader must have changed from a correct method in 2008 to an incorrect one later; the trader denied that he had ever changed his method, and the Tribunal was satisfied that this was true. It was not possible to explain how the officer had come to such a mistaken conclusion.

The Tribunal concluded that the claim for input tax was “careless”. However, the reassurance given in 2008 on the calculation of turnover meant that this error was not “careless”. The comments of the judge are interesting:

In reaching the conclusion at [45] I am not, of course, saying that a reasonable taxpayer would always accept every confirmation of an HMRC officer at face value, no matter how outlandish it appeared. However, Ms Pavely based her case on “carelessness” on the appellant’s failure to digest Notice 733 properly. She did not submit that a reasonable taxpayer would have concluded that Officer Rickwood’s confirmation was obviously questionable and that further researches were necessary to determine the true position. I have concluded that HMRC have not shown that the inaccuracies stemming from the incorrect calculation of “relevant turnover” are due to the appellant failing to take reasonable care.

The disclosure was clearly “prompted” within the meaning of the legislation, and there were no special circumstances warranting extra mitigation above the maximum 15% allowed. As the trader had already applied to cancel his VAT registration, no suspension condition could be imposed to improve compliance in the future, so suspension was not possible.

The appeal was allowed in relation to the penalties based on underdeclaration of output tax.

First-Tier Tribunal (TC04468): *Simon Thomas t/a The Stableyard*

6.8.3 Dishonest conduct penalty

HMRC levied a s.60 penalty of £111,349 on a company and transferred the liability to a director under s.61 VATA 1994. He initially appealed on three grounds:

(1) the VAT assessment on which the penalty was based was issued well outside the permitted time limit;

(2) there was no basis for the assessment; and

(3) neither the VAT assessment nor the penalty assessment had been received.

The decision states that grounds (1) and (3) were dropped by way of written submissions after the hearing – presumably they were raised at the hearing, but the taxpayer or his representative realised that they would not succeed.

The defence against the assessment was based on two quite different arguments:

- that the company had sufficient unclaimed input tax to greatly reduce or even eliminate any unpaid output tax, so the underlying VAT was not due;
- that the director had genuinely and for good reason delegated the conduct of the company’s affairs (he was illiterate) and could not therefore be guilty of dishonesty in relation to that conduct.

In reviewing the background to a dispute that started in 2005, the judge criticised HMRC's "apparent carelessness and lack of attention to detail" in dealing with records. This caused an immense amount of wasted time and effort in making sense of the disjointed picture emerging from the documents.

The company provided temporary flower-picking staff to other businesses. HMRC carried out an inspection in 2005 and over the next two years concluded that there had been a substantial underdeclaration. The decision to impose the penalty and to collect it from the director was made in January 2007. The company's accountant protested that sub-contractor invoices had not been taken into account and appealed the assessment; nevertheless, HMRC filed a bankruptcy petition, and the company was put into liquidation. The liquidators withdrew the appeal against the assessment, and HMRC maintained that the penalty would be due from the director.

Although the facts were hard to establish, the Tribunal was satisfied that it had enough information to conclude that there had been dishonesty, and that the director was in control of the bank account. There were large amounts shown on sales invoices that did not go through the books, and the director could not explain what had happened to the money. Although HMRC had performed very poorly in the conduct of the investigation and the appeal, that did not in the circumstances engage the Human Rights Act.

The s.61 assessment was confirmed, and the 5% mitigation already allowed by HMRC was appropriate.

First-Tier Tribunal (TC04391): *Mohammed Azam*

HMRC formed the view that a scaffolding contractor had underdeclared output tax. Penalty notices of £202,000 and £192,000 were issued respectively to him under s.61, for the period up to 31 March 2009, and to his company under Sch.24 para.19 FA 2007 for the period after that.

85% of the taxpayer's work was for business customers covered by the Construction Industry Scheme for income tax deduction. The remaining 15% was for private householders, many of whom would pay in cash, thinking they would avoid VAT by doing so.

HMRC carried out "street sweeps" in which they noted the company's boards attached to scaffolding on 10 different occasions between 2008 and 2010. When they later examined the accounting records, only one of these contracts was recorded in the books. The officer applied an extrapolation factor of 10 to the recorded sales, producing total assessments to VAT of over £500,000, and the penalties that were the subject of the current appeal.

It seems that the director did not appreciate that the penalties would become his personal liability if the company was wound up. He decided not to fight the assessments, believing that the company was a write-off in any case, but then found that the penalties survived the liquidation. He appealed against both on the grounds that the assessments were excessive and not to best judgement.

HMRC's counsel accepted that the extrapolation by a factor of 10 was extreme. He considered that there was clear evidence of suppression, and

by implication (without formally accepting it) agreed that it was more likely that suppression would apply to the private customers than the business customers. It also appeared that one of the unrecorded sales was in fact one of the taxpayer's friends using his board. A revised extrapolation based on a factor of 8 rather than 9, and applied to the 15% residential sales, reduced the underdeclaration from £529,000 to £70,000.

The taxpayer's representative argued that this was still too high. If a calculation was based on the number of working days available and the average price of a job, this was an unachievable level of turnover. The judge found this persuasive. Although there was evidence of dishonesty, and therefore there was justification for the assessments and the penalties based on them, the amounts of those penalties should be reduced to £1,902 and £5,905. Although the formal words of the decision were to dismiss the appeal, this must nevertheless have looked like a victory to the appellant.

First-Tier Tribunal (TC04419): *Matthew Hodges*

A trader registered for VAT as a welder in 2009. His first return claimed a repayment of about £11,000. Following an assurance visit, which showed that sales had been omitted due to a tax point error, this was revised to VAT payable of £1,608. A penalty for careless behaviour was raised but suspended.

At the visit, the officer discussed future trading and concluded that the next few returns would be payment returns. However, the next three returns all claimed repayments. Further investigations followed, during which it proved difficult to obtain information from the trader. Eventually assessments were raised, together with penalties. The trader appealed out of time.

The Tribunal decided to allow the appeal to proceed, in spite of HMRC's objections. HMRC had continued to correspond with the trader from when the decision ought to have become final (November 2011) until the appeal was formally lodged (February 2014). It was understandable that the trader thought that the matter was still under negotiation.

However, the trader had no explanation for the inaccuracies in the VAT returns. His evidence effectively admitted that the returns were false. The assessments for VAT and for a "deliberate behaviour, prompted disclosure" penalty were confirmed.

First-Tier Tribunal (TC04476): *David Alan Long*

An individual appealed against an assessment of £79,454 and a penalty of £2,485. She arrived at the hearing and applied for an adjournment to pursue the possibility of pro bono representation. Judge Mosedale refused an adjournment on the basis that the appellant had been very slow to seek help. She also brought with her a bundle of documents that she asked to be admitted to the hearing. An hour's adjournment was allowed for HMRC's representative to read it; she then declared she had no objection to it being admitted, nor to an appeal being allowed to proceed out of time.

The individual had registered for VAT in 2004 and was also the director and owner of a VAT-registered company. She had submitted repayment returns for the two businesses totalling over £150,000 by 2011. She was

subsequently convicted of fraudulently inflating her VAT repayment claims and given a suspended prison sentence of 18 months.

The basis of the assessment was considered and found to be satisfactory (charging the net amount of repayments claimed by the trader as an individual). She had no evidence to back up any input tax claim at all: although there may have been some, it was impossible to say how much.

The form of the assessment was also acceptable. Although it gave a total amount for a long period, this was broken down into individual return periods as required by the law.

The trader argued that the assessment was issued out of time because it was raised more than a year after the fraudulent returns were submitted. The Tribunal did not accept this version of s.73: there was nothing on the face of the returns to suggest that they were inaccurate. As the VAT loss arose from dishonesty, the extended time limit of s.77 applied, so all the assessments were issued in time.

The trader asked whether it was possible that she could be convicted of a criminal offence and then assessed for the "same VAT". Judge Mosedale confirmed that this was correct: she should be punished for the dishonesty and should repay the VAT falsely claimed. There was no evidence to support her assertion that she had pleaded guilty on the basis of an assurance that HMRC would not try to collect the VAT.

The penalty was assessed at 70% of only the final VAT claim that triggered the VAT visit. Here, there was a possible defence that the penalty could be a double punishment for the same offence; however, there was no evidence to suppose that her conviction was in relation to that particular VAT period, when much larger losses had arisen over the preceding 7 years.

The Tribunal confirmed the assessments and the penalty.

First-Tier Tribunal (TC04486): *Monica Bircham*

6.8.4 Costs

An individual imported a vessel to live aboard. HMRC assessed for import VAT on the basis that it was not a "qualifying ship". The individual appealed, and withdrew their resistance to the appeal half a day into a two-day substantive hearing in August 2014. The individual applied for costs on the basis that HMRC had acted unreasonably in defending or conducting the proceedings.

The Tribunal reviewed the history of the appeal, in which the individual had provided a range of evidence to support his argument that the ship qualified for zero-rating. HMRC had refused Alternative Dispute Resolution on the grounds that the decision was in accordance with HMRC's established policy position, which made ADR impossible. The individual submitted evidence including an expert witness statement in March 2014. His representative suggested in an accompanying letter that this clearly showed that the conditions were satisfied, and that HMRC would be acting unreasonably if they did not accept that.

HMRC argued that the expert's responses to cross-examination provided important details that were not in the written report before the hearing. They also realised that they would not be able to counter the factual

assertions of the witness without their own expert, which meant that they had no reasonable prospect of success. They therefore conceded as soon as it was reasonable to do so.

The appellant argued that HMRC had had the expert report and had neither questioned it nor tried to rebut it. In his view, that was unreasonable conduct. In effect, they should have known that they would lose at the hearing if they did nothing more, and they should therefore have given up earlier (or appointed an expert and tried to argue properly).

The judge considered the progress of the original appeal in great detail, and concluded that HMRC had an arguable case. Although the appellant had acted very reasonably in trying to persuade HMRC before the hearing, it was still not unreasonable conduct to proceed to the cross-examination and then give up. The application for costs was dismissed.

First-Tier Tribunal (TC04387): *Steven Gee*

Two connected companies appealed against MTIC rulings disallowing £3.3m of input tax. A hearing was listed for three weeks starting on 15 July 2013. An adjournment was applied for on 26 June 2013 on the basis that the representatives had withdrawn; this was granted, and Judge Berner awarded HMRC their wasted costs. The hearing was relisted for eight days commencing 18 May 2015. The appellant's accountants notified HMRC that the appeal was being withdrawn on 14 May. No explanation was offered. HMRC applied for costs against both the appellants and the accountants. Following a response from the accountants, the application against them was withdrawn.

At an earlier hearing attended by both parties, the Tribunal had ordered that reg.29 of the 1986 Tribunals Rules would apply under the transitional provisions. The appellant had therefore agreed that costs should follow the event. There was no good reason to find otherwise. As he had withdrawn, HMRC had won, and costs should be awarded on the standard basis.

First-Tier Tribunal (TC04485): *Solutions Center Ltd and another*

6.8.5 Late appeals

A company appealed against the imposition of a series of misdeclaration penalties and assessments totalling over £200,000. The assessments covered periods from 03/06 to 03/11, but an appeal was only lodged in February 2012. At an earlier hearing (TC02675), the FTT considered the time limits and issued a number of directions that the company had to comply with. However, in July 2013, the whole of that decision was set aside by the Tribunal on the Appellant's application, on the ground that the Appellant had not received notice of the hearing on that occasion and had not been represented.

The company argued on a further appeal that some of the decisions had not been properly addressed, so that time had not begun to run in respect of appealing against them. The decisions had either been sent to its usual place of business, which it shared with its solicitors, or its registered address, which it shared with its accountants; but all the decisions issued before February 2012 had been addressed to the accountants or the solicitors, not to the company. It applied for leave to appeal out of time against others.

The FTT (TC03675) reconsidered the long and complex history of the disputed assessments, some of which appeared to bear the wrong address, and considered whether they had been properly served or notified. It decided that, on the balance of probabilities, they had; there was no good reason for the delay in making a formal appeal; only one decision, which the 2013 hearing had held could be appealed out of time, should be allowed to proceed to a substantive hearing.

The company appealed to the Upper Tribunal in respect of six of the nine decisions, and HMRC cross-appealed in respect of the one that the FTT had decided should be allowed. The UT decided that service on the accountants or solicitors could not constitute valid service on the company, so the FTT had been wrong to conclude that the six appeals were out of time – the company had only received the decisions in February 2012.

In respect of the cross-appeal, the UT also considered the FTT's decision to be flawed, and ruled that appeal out of time. The delay was only three months, and the matter could relatively easily be combined with the other decisions under appeal, but there was no good reason for the delay. The finality of litigation was an important principle, and should not be departed from in this case.

Upper Tribunal: *Romasave (Property Services) Ltd v HMRC*

A mail delivery company was approved by HMRC to operate a "low value bulk imports" system for claiming "low value consignment relief" on goods it carried. HMRC decided it was not operating in accordance with the conditions of their approval, and in November 2011 issued a post clearance demand note for £4,153 of import VAT and a penalty of £2,500 based on it. This was followed by another PCDN for £911,740 with a penalty of £24,488, issued in January 2013. The trader appealed – considerably late for the 2011 PCDN, but in time for the much larger one.

The judge considered the history in considerable detail and decided against allowing the late appeal to proceed. Even though it could be swept up into the other part of the case without significant extra time or cost, nevertheless the reasons for not allowing a late appeal outweighed this: there was a very significant delay without good reason, and it was important to preserve fairness between taxpayers.

The rest of the case is still subject to discussion between the parties, so the only matter for the Tribunal at this time was the eligibility of the appeal against the small first PCDN. The company's application was dismissed.

First-Tier Tribunal (TC04446): *Citipost Mail Ltd*

6.8.6 Legitimate expectations

A partnership traded as management consultants. They made a supply to the University of Warwick which they treated as exempt from VAT. The appellants' case was that one of the partners had been informed by an HMRC officer that the supply was exempt as it was in respect of medical research and funded by the Wellcome Trust.

It was acknowledged by the appellants' representative that the supply could not be exempt as a matter of law: the only possibly applicable

exemption was Item 1(b) Group 6 Sch.9 VATA 1994, but that required the supplier to be an eligible body itself, and the partnership clearly was not.

In one of her briefest ever decisions, Judge Barbara Mosedale dismissed the appeal. She did not need to make any findings of fact about whether incorrect advice had been given by HMRC: the Upper Tribunal in *Noor* had established that the FTT could not decide for the taxpayer on the ground of legitimate expectations.

First-Tier Tribunal (TC04359): *Nicholas John Aspinall and others t/a Oxford Retail Consultants*

6.8.7 Procedure

In a case about the change of place of supply rules on 1 January 2010, HMRC applied to have a company added as a second respondent to the taxpayer's appeal. The appellant (B) objected, while the other company (G) consented.

The background was that B, a UK company, made supplies to W, a US company. They were in the same corporate group but had separate VAT registrations in the UK. Until 1 January 2010, VAT was correctly charged by B and recovered by W. For three years after that, the change of rules was overlooked and B continued to charge VAT and W to recover it (it appears that the supplies must have been for the purposes of the US establishment). At the point at which the mistake was realised, the business of W was transferred as a going concern to G, which at the time was also in the same corporate group. G was then sold to an unconnected buyer in the USA.

In correspondence with HMRC, B and G suggested that the error should be left uncorrected, as the money had moved around in a circle. Then, in October 2013, B made a s.80 claim for repayment. HMRC resisted this on the basis of unjust enrichment.

B argued that, following a dispute with the purchasers of G, it had paid a settlement of $2m to them, and this included an amount in respect of the overcharged VAT. It was therefore now due a repayment from HMRC. HMRC did not accept that the settlement with G's purchasers had this effect. To protect their position, HMRC had issued a protective assessment on G, but preferred the status quo (i.e. B not entitled to repayment, W/G keeping its input tax credit).

HMRC sought to join G in the action to avoid the risk of G also appealing in relation to the assessment and HMRC losing both cases through inconsistent findings of fact about the nature of the settlement.

Judge Mosedale considered a complex set of arguments and possible outcomes, and concluded that it was appropriate to join G in the action. Although it seemed unlikely that HMRC were really at risk, it was possible that there could be different legal proceedings that might come to inconsistent findings of fact, and that should be avoided if possible.

First-Tier Tribunal (TC04421): *Bradonbay Ltd*

6.8.8 Strike-out

A trader appealed against a letter in which HMRC had asked for further justification for a claim to input tax on the purchase of cars. HMRC did not see how the cars could be mainly used for self-drive hire if the trader could not obtain appropriate insurance. However, the letter concluded "I await your comments", and did not appear to contain a decision.

The Tribunal agreed with HMRC that the letter was not an appealable matter within s.83 VATA 1994. This did not bar the trader from making an appeal when and if such a decision had been taken.

First-Tier Tribunal (TC04406): *Saleem Iqbal t/a Platinum Executive Travel*

6.8.9 Scottish procedures

The Scottish Tax Tribunals (Time Limits and Rules of Procedure) Regulations 2015 set out the practice and procedures for the Scottish FTT and UT, including the time limits and the routes of appeal to the Court of Session. It appears that the rules mirror those in the rest of the UK, but with amendments for Scottish legal terminology and differences of practice.

SSI 2015/184

6.9 Other administration issues

6.9.1 The VAT Guide

HMRC have issued a revised (April 2015) edition of the *VAT Guide*. The main changes relate to the treatment of prompt payment discounts from April 2015.

Notice 700

6.9.2 Clearance service

HMRC have updated their guidance in relation to the non-statutory clearance service – that is, the circumstances in which they will give a taxpayer a ruling on a proposed transaction even though no statutory clearance procedure exists.

The introduction states that taxpayers must:

- have fully considered the relevant guidance and/or contacted the relevant helpline, and
- have not been able to find the information you need, or
- remain uncertain about HMRC's interpretation of recently-passed tax legislation.

HMRC will then set out their advice in writing.

They will not provide advice if:

- the taxpayer has not provided all the necessary information – the checklists at Annex A, B, C or D give details of what needs to be provided;
- HMRC don't think that there are genuine points of uncertainty – they will explain why they think this and direct the applicant to the relevant online guidance;
- the taxpayer is asking HMRC to give tax planning advice, or to 'approve' tax planning products or arrangements;
- the application is about treatment of transactions which, in HMRC's view, are for the purposes of avoiding tax;
- HMRC is checking the taxpayer's tax position for the period in question, in which case the taxpayer will need to contact the officer dealing with the check;
- any related return for the period in question is final;
- there exists a statutory clearance applicable to the transaction.

The update adds a new Annex D to give the relevant details for VAT clearances. The checklist gives the following requirements:

1. Information about the applicant and the application:

1.1 The name and address of the person or company carrying on the business, plus a telephone number and/or email address

1.2 The VAT Registration Number of the business (if registered)

1.3 If you are an agent representing the business, your name, address, telephone number and/or email address (please note we can only respond to authorised agents)

2. Information about the transaction:

Provide a narrative of the transaction. This should include all of the relevant facts of the transaction, for example:

- *a detailed description of the goods and/or services being supplied and what is being received and/or paid in return;*
- *the date (or proposed date) of the transaction;*
- *details of all parties to the transaction;*
- *details of how the transaction will take/has taken place;*
- *any special reasons for arranging the transaction the way it is.*

3. Information about legal points:

Explain what causes you uncertainty about the correct VAT treatment of your transaction. You need to:

- *explain why you believe our guidance, or the application of the relevant legislation, is open to different interpretations;*
- *provide a summary of those different interpretations and why the tax consequences are uncertain;*
- *include reference to the specific part(s) of the law, our published guidance and/or case law which create your uncertainty;*

- *indicate which of the possible interpretations you think is correct, and why.*

4. Other requirements:

4.1 Supporting documents and/or samples where appropriate

4.2 Details of all relevant advice previously received from HMRC

4.3 Details of other advice previously obtained from third parties, which you are content to disclose

4.4 If there is a tax avoidance scheme which covers all or part of the transaction you must provide details of any disclosure made to HMRC under the rules for disclosure of tax avoidance schemes.

www.gov.uk/non-statutory-clearance-service-guidance

6.9.3 Compliance checks – information notices

HMRC have issued a new factsheet about the procedures for issuing a notice to a person requesting certain information and documents concerning their tax position. The factsheet will be issued to anyone who is being served with a notice, and it explains the duty of the recipient to provide the information demanded. It also explains any rights of appeal, reasonable excuses, and matters that cannot be demanded by HMRC.

CC/FS2

HMRC have issued a new factsheet about the issue of information notices to third parties requesting certain information and/or documents concerning the tax position of another person. It explains the legal basis of the issue of such a notice, and will be issued to the person who receives the notice.

The factsheet explains the limitations of a notice – HMRC cannot require a person to give them information or documents:

- that are not in their possession and they cannot get the documents, or copies from whoever holds them;
- that relate to the tax position of a person who died more than 4 years before the notice is issued;
- that have been created as part of the preparation for a tax appeal;
- that are concerned exclusively with a person's physical, mental, spiritual or personal welfare;
- that are privileged communications between lawyers and clients for the purpose of getting or giving legal advice;
- if the third party is an auditor, tax adviser or journalist and the information or documents have been created for the purposes of their profession;
- if the third party is the subject of journalistic material and the information or documents have been created by a journalist for the purposes of their profession.

CC/FS23

6.9.4 Customer service

HMRC's remaining 0845 helpline numbers will be taken out of service completely from 30 June 2015.

www.gov.uk/government/news/changes-to-hmrc-telephone-numbers

HMRC have announced that they are allocating £45 million to improve customer service, following the release of statistics which showed an inconsistent call handling performance in 2014-15.

The allocation is paying for around 3,000 additional staff to join customer service teams, on top of around 2,000 staff who are being moved over from other parts of HMRC to help with the tax credits deadline and letters and forms.

HMRC receive more than 60 million calls a year, peaking around key deadlines such as 31 January for Self Assessment, and 31 July for tax credits renewals.

The statistics show that while 73% of calls were answered last year, service standards were inconsistent across the year, with some months falling well short of HMRC's 80% target. The figures also show that in some months as many as one in five customers heard a busy tone and could not join a phone queue.

www.gov.uk/government/news/hmrc-acts-to-improve-customer-service

6.9.5 Updated Notice

HMRC have updated their Notice *Insolvency* (replacing the April 2014 version). The main changes are:

- transfer of some insolvency VAT processing work between HMRC offices;
- clarification that, when a pre-appointment repayment claim is received, HMRC will conduct set-off enquiries to determine whether there are any pre-appointment debts owed to the Crown by the same taxpayer, and that the time taken to conduct such enquiries is discounted for the purpose of the 30-day repayment supplement clock;
- removal of the £500 de-minimis level for Crown set-off – this will be undertaken wherever it is cost effective to do so.

Notice 700/56

6.9.6 Conspiracy?

The liquidators of a company (Bilta (UK) Ltd) issued proceedings against the directors and a third party company, alleging that they had caused the company loss by entering into a fraudulent conspiracy to obtain VAT repayments through the European Emissions Trading Scheme. The company had been left with losses of some £38m when HMRC refused to repay its input tax claims, and was put into liquidation after HMRC presented a winding-up petition in 2009.

The directors put forward the defence that the company itself was party to the fraud, and a party to a wrong cannot sue in relation to it. This is referred to as "ex turpi causa non oritur actio". They also argued that

claims by the liquidators under s.213 Insolvency Act 1986 had to fail because some of the defendants were resident abroad.

The Supreme Court agreed with the High Court and the Court of Appeal that the directors' defence failed. Where a company has been the victim of wrong-doing by its directors, the wrong-doing or knowledge of the directors could not be attributed to the company so as to prevent it suing the directors. This is sometimes referred to as "the fraud exception", but could be more widely described as "the breach of duty exception". In addition, the Insolvency Act provision applied internationally.

Supreme Court: *Jetivia SA and another v Bilta (UK) Ltd and others*

6.9.7 Confiscation

Two individuals appealed against a confiscation order following on from their conviction for involvement in a MTIC fraud. The benefit to the defendants had been calculated as being in excess of £20m; the confiscation orders were for £438,000 and £55,000. The appeals were based on arguments about how the "benefit" should be calculated and allocated where there was a chain of supply, and also on the alleged harshness of the orders.

The appeals were dismissed. It was established law that someone who incurred expenditure for the purposes of carrying out a fraud was not entitled to offset that expense. Unless there was a risk of serious injustice, there would be no discount. The way in which the judge had calculated the benefit did not have a disproportionate effect. The orders were confirmed.

Court of Appeal: *R v Chahal and another*

6.9.8 Proposed legislation

The Queen's Speech contained very little in relation to VAT. The main points were the promise not to increase the three main personal taxes – income tax, NIC and VAT. This is stated to cover both the main rate and the scope of the tax.

The Scotland Bill will provide the Scottish Parliament with the first ten percentage points of standard rate VAT revenue raised in Scotland (and 2.5% reduced rate).

www.gov.uk/government/publications/queens-speech-2015-background-briefing-notes

In an article in *Taxation*, Richard Curtis reviews the proposed tax measures in the Queen's speech, including the promise not to raise VAT rates in the life of this Parliament.

Taxation, 4 June 2015

6.9.9 Extra-Statutory Concessions

HMRC have issued a revised (May 2015) edition of the ESC Notice. It has been updated to include details of ESCs that have been granted, or become obsolete.

The following VAT ESCs have become obsolete:

3.1 – VAT: VAT on purchase of road fuel (Legislated Finance Act 2013)

3.2 – VAT: group supplies using an overseas member: anticipation of legislative changes

3.2.1 First part of concession legislated Finance Act 1997

3.2.2 Second part of concession legislated Finance Act 2012

3.32 – VAT: electronic face value vouchers

3.36 VAT: imported works of art, antiques etc (Legislated SI 2009/730)

Notice 48

6.9.10 Payments in contempt

HMRC presented an insolvency petition against a company for over £7.7m of unpaid VAT. The court appointed a provisional liquidator to take possession of the assets of the company. The liquidator attended the company's premises and served court orders on the directors in the presence of the company secretary. The orders spelled out that preventing the liquidator carrying out his duties, or impeding him, was a contempt of court. Nevertheless, three substantial payments were made later that day and on the next day to a Dubai company. HMRC brought committal proceedings against the two directors and the secretary for contempt, which they admitted.

The court had to consider the appropriate sanction. In this context, it was important to demonstrate to the commercial community that abusing a position of trust to frustrate a liquidator would have serious consequences: a custodial sentence was essential. The defendants had not been lining their own pockets directly, which reduced the seriousness of the case, but they had sought a commercial advantage by giving one creditor (a supplier) a preference over another (HMRC). The size of the sums involved and the proportion of the company's assets that they represented, together with the deliberate thwarting of a court order, meant that this was a serious case. The starting point for sentence would be nine months' imprisonment; each defendant was sentenced to six months, three to be served in prison.

High Court: *HMRC v Munir and others*

6.9.11 Professional conduct in relation to taxation

A number of professional bodies have jointly issued updated guidance on professional conduct in relation to tax work. This replaces the February 2014 version. It has new material on electronic filing, decisions of Courts and Tribunals, DOTAS, POTAS, Accelerated Payments and Follower Notices as well as an expanded chapter on tax planning.

The guidance includes further commentary to reflect the ongoing developments and the public concern about aggressive tax avoidance and evasion. This update does not include any specific changes following the paper published by HM Treasury and HMRC on 19 March 2015 *Tackling tax evasion and avoidance*. This paper asks"the regulatory bodies who police professional standards to take on a greater lead and responsibility in setting and enforcing clear professional standards around the facilitation and promotion of avoidance."

Now that the new government is in place the professional bodies will hold further discussions with HM Treasury and HMRC about how this challenge should be progressed. CIOT state that the updated guidance is being issued in the meantime as it contains extensive new material of practical benefit to members.

http://www.tax.org.uk/Standards/Professional-Conduct-in-Relation-to-Taxation.htm