VAT UPDATE
OCTOBER 2011

Covering material from July – September 2011

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VAT Update October 2011

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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 which reported the progress of appeals stopped being updated some time ago and for some time it was only possible to pick up clues to unsettled cases from Revenue & Customs Briefs which announced HMRC’s intention to appeal a decision or to concede defeat. However, a new “VAT Appeal Update” appeared on 21 January 2011, and it is to be hoped that this will continue. It says that it will be updated monthly, but as the first update to appear arrived on 23 May. At 3 October, the update is dated 14 July 2011.

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

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

Awaiting the CJEU:

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

UK appeals awaiting hearing:

- *David Finnamore t/a Hanbridge Storage Services*: HMRC have applied for leave to appeal to Upper Tribunal after First-Tier decided that a trader was supplying a licence to occupy land rather than storage services
- *DCM (Optical Holdings) Ltd*: HMRC have appealed to the Upper Tribunal after the FTT accepted that a floor-area based special method could be appropriate (Upper Tribunal hearing 20 – 23 September 2011)
- *GMAC UK plc*: HMRC appealed to the Upper Tribunal after the First Tier Tribunal held that the company was entitled to go back for many years in a bad debt relief claim because the UK rules were too restrictive – the last update included a preliminary UT decision, which was not to refer questions to the CJEU but to proceed with a substantive hearing (full hearing later 14 – 15 February 2012)
- *Greener Solutions Ltd*: HMRC have appealed to Upper Tribunal after First-Tier decided that a trader did not have the means of knowing about a carousel fraud (Upper Tribunal hearing 26 – 27 September 2011)
- *Isle of Wight Council and others*: remitted to Tribunal to consider evidence again in light of CJEU's ruling on how "risk of distortion of competition" is to be applied [does not appear on the HMRC list]
- *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 until 2012 pending the *Littlewoods* decision in the CJEU.
- *London Clubs Management Ltd*: HMRC have appealed to the Court of Appeal after the FTT and Upper Tribunal accepted that a floor-area based special method could be appropriate (Court of Appeal hearing 4 – 6 October 2011)
- *Newey (t/a Ocean Finance)*: HMRC have appealed to the Upper Tribunal after the First Tier Tribunal held that a scheme was effective in reducing irrecoverable VAT on advertising costs by moving a loan broking business to the Channel Islands (Upper Tribunal hearing December 2011)
- *Pendragon plc*: HMRC stated an intention to appeal to the Upper Tribunal after the First Tier Tribunal found a scheme "not abusive" [no longer on the update list, either as "dropped" or "appealed"]

2. OUTPUTS

2.1 Scope of VAT: linking supplies to consideration

2.1.1 Flat-rate farmers and sales of land

The cases on the liability of farmers to account for VAT on the sale of agricultural land (acquired VAT-free) have now received their CJEU judgments. The two cases were slightly different:

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

It is important to remember that the sale of building land is, according to the Directive, VATable – the UK's exemption (subject to the option to tax) is a transitional derogation. Art.12 VAT Directive also permits member states to designate one-off or occasional sales of land as economic activities, although it is not clear whether Poland has implemented that provision.

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

The judgment is slightly different. It states that the supply of land designated for development was subject to VAT if the member state has enacted the option in art.12(1) VAT Directive "*irrespective of whether the transaction is carried out on a continuing basis or whether the person who effected the supply carries out an activity of a producer, a trader or a person supplying services, to the extent that that transaction does not constitute the mere exercise of the right of ownership by its holder*". However, "*a natural person who carried out an agricultural activity on land that was reclassified, following a change to urban management plans which occurred for reasons beyond his control, as land designated for development must not be regarded as a taxable person ... when he begins to sell that land if those sales fall within the scope of the management of the private property of that person. If, on the other hand, that person takes active steps, for the purpose of concluding those sales, to market property by mobilizing resources similar to those deployed by a producer, a trader or a person supplying services ... that person must be regarded as carrying out an economic activity within the meaning of that article and must, therefore, be regarded as a taxable person for value added tax*".

The registration as a flat-rate farmer was not relevant, because the sale of land is not one of those activities which is within the flat rate scheme.

The application of this principle – which appears to be "it depends" – is left to the national court.

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

2.2 Disbursements

Nothing to report.

2.3 Exemptions

2.3.1 Financial transaction tax

The Commission has proposed levying a new financial transaction tax on transactions between financial institutions where one party is based in the EU. A 0.1% tax rate is suggested (0.01% for derivative contracts). The tax could be introduced from the beginning of 2014. The measure is described on the homepage of Algirdas Semeta, Commissioner for Taxation, Customs, Anti-fraud and Audit.

http://ec.europa.eu/commission_2010-2014/semeta/headlines/news/2011/09/201109282_en.htm

2.3.2 Special investment funds

A company which provides fund management services to pension funds has argued that the principles of the *JP Morgan Fleming Claverhouse* decision (Case C-363/05) should apply to exempt its services, because pension funds compete with investment trust companies and open-ended investment companies which are regarded as "special investment funds" for the purposes of the exemption.

HMRC argue that the schemes involved in the appeal, being "defined benefit" schemes (based on final salary rather than the value of a fund), are fundamentally different from investment funds which are regarded as subject to exemption. If they are not directly in competition with other special investment funds such as OEICs and investment trust companies, there is no reason to treat them in the same way for VAT.

The questions referred are:

Question 1

Are the words "special investment funds" in Article 13B(d)(6) of the Sixth VAT Directive and Article 135(1)(g) of Directive 2006/112 capable of including (i) an occupational pension scheme established by an employer that is intended to provide pension benefits to employees and/or (ii) a

common investment fund in which the assets of several such pension schemes are pooled for investment purposes in circumstances where, in relation to the pension schemes in question:

(a) the pension benefits receivable by a member are defined in advance in the legal documents creating the scheme (by reference to a formula based on the length of the member's service with the employer and the member's salary) and not by reference to the value of the scheme assets;

(b) the employer is obliged to make contributions to the scheme;

(c) only employees of the employer can participate in the scheme and obtain pension benefits under it (a participant in the scheme is here referred to as a "member");

(d) an employee is free to decide whether or not to be a member;

(e) an employee who is a member is normally obliged to make contributions to the scheme based on a percentage of his salary;

(f) the contributions of the employer and the members are pooled by the scheme trustee and are invested (generally in securities) in order to provide a fund out of which the benefits provided for in the scheme are paid to the members;

(g) if the scheme assets are greater than what is required to fund the benefits provided for under the scheme, the trustee of the scheme and/or the employer may, in accordance with the terms of the scheme and relevant provisions of national law, do any one or combination of the following: (i) reduce the employer's contributions to the scheme; (ii) transfer all or a part of the benefit of the surplus to the employer; (iii) improve the benefits to members under the scheme;

(h) if the scheme assets are less than what is required to fund the benefits provided for under the scheme, the employer is normally obliged to make up the deficit and, if the employer does not, or is unable to do so, the benefits received by members are reduced;

(i) the scheme permits members to make additional voluntary contributions ("AVCs") which are not held by the scheme but are transferred to a third party for investment and the provision of additional benefits based on the performance of the investment made (such arrangements are not subject to VAT);

(j) members have the right to transfer their accrued benefits under the scheme (valued by reference to the actuarial value of those benefits at the time of transfer) to other pension schemes;

(k) the employer's and members' contributions to the scheme are not treated for the purposes of income tax levied by the Member State as income of the members;

(l) pension benefits received by members under the scheme are treated for the purposes of income tax levied by the Member State as income of the members ; and

(m) the employer, and not the members of the scheme, bears the cost of charges made for the management of the scheme?

Question 2

In the light of (i) the objective of the exemption in Article 13B(d)(6) of the Sixth VAT Directive and Article 135(1)(g) of Directive 2006/112, (ii) the principle of fiscal neutrality and (iii) the circumstances set out in Question 1 above:

(a) is a Member State entitled to define, in national law, the funds that fall within the concept of "special investment funds" in such a way as to exclude funds of the type referred to in Question 1 above while including collective investment undertakings as defined in Directive 85/611, as amended?

(b) to what extent (if at all) are the following relevant to the question whether or not a fund of the type referred to in Question 1 above is to be identified by a Member State in its national law as a "special investment fund":

(i) the features of the fund (set out in Question 1 above);

(ii) the degree to which the fund is "similar to and thus in competition with" investment vehicles that have already been identified by the Member State as "special investment funds"?

Question 3

If in answer to Question 2(b)(ii) above it is relevant to determine the degree to which the fund is "similar to and thus in competition with" investment vehicles that have already been identified by the Member State as "special investment funds", is it necessary to consider the existence or extent of "competition" between the fund in question and those other investment vehicles as a separate question from the question of "similarity"?

First-Tier Tribunal (TC01381): *Wheels Common Investment Fund Trustees Ltd and Others*

The same exemption appears to be the subject of a reference from the German courts. However, the questions referred appear to relate to the problem of determining what constitutes "management" rather than what constitutes a "special investment fund":

For the purpose of interpreting the term 'management of special investment funds' within the meaning of Article 13B(d)(6) of Directive 77/388/EEC, is the service provided by the third-party manager of a special investment fund sufficiently specific and hence exempt from taxation only if

(a) the manager performs a management function and not only an advisory function or if

(b) the service differs in nature from other services by reason of a characteristic feature that qualifies for tax exemption under this provision or if

(c) the manager operates on the basis of a delegation of functions under Article 5g of Directive 85/611/EEC, as amended?

CJEU (Reference) (Case C-275/11): *GfBk Gesellschaft für Börsenkommunikation mbH v Finanzamt Bayreuth*

2.3.3 Insolvency practitioners

HMRC have responded to the Tribunal's decision in the *Paymex Ltd* case (TC001210). HMRC will not appeal the ruling that licensed insolvency practitioners are providing exempt services of "negotiation of credit" when conducting and supervising individual voluntary arrangements. Subject to the normal rules on input tax adjustment, capping and unjust enrichment, HMRC will pay claims for overpaid output tax arising from this ruling.

R & C Brief 27/2011

HMRC have issued further guidance in a second Brief. This makes it clear that they do not regard the ruling as restricted to the particular type of insolvency arrangement in the case (individual voluntary arrangements), but rather as applicable to the type of work the insolvency practitioners undertook. However, HMRC will reject claims in respect of Company Voluntary Arrangements and Partnership Voluntary Arrangements, because they do not believe that these are subject to the same principles.

The Brief provides more detail on the partial exemption consequences of making a claim, and confirms that HMRC will not seek to disallow past input tax if the IP chooses not to disturb the past by claiming back output tax.

R & C Brief 35/2011

2.3.4 Transfer of bad debts

The Advocate-General has given an opinion on the treatment of the transfer of a package of "non-performing loans" at below face value about €8m for face value of €15.5m). The tax authorities believed that the purchaser of the portfolio was providing a taxable service (debt collection) to the seller, following the decision in *MKG* (Case C-305/01).

The Advocate-General considered that the transaction amounted to a supply of services by the recipient of the transfer to the transferor, in line with the treatment of the transfer of reinsurance contracts in *Swiss Re* (Case C-242/08) and the exchange of currency in *First National Bank of Chicago* (Case C-172/96).

By contrast, the Advocate-General could not find a direct and immediate link to any consideration for the service. The discount against face value was not consideration, but rather a reflection of the current value of the debts. The transaction was therefore outside the scope of the Directive.

In case the court did not agree with this analysis, the Advocate-General went on to give further opinions that the transaction was not exempt as a "grant of credit" under art.13B(d)(1) 6th Directive, nor as "dealings in credit guarantees" within art.13B(d)(2), nor as "transactions in debentures" within art.13B(d)(5) (since the loans were to individuals and were therefore not tradeable securities, even if they were negotiable in the sense that they could be transferred by this transaction).

If the transaction was for consideration, the Advocate-General considered that the nature of it was debt collection, so it would be excluded from exemption under art.13B(d)(3). This was the fundamental nature of the supply, which should be treated as a single activity rather than a bundle.

If the court decides that there is consideration, the Advocate-General's opinion is that it should be measured as the difference between what the company eventually receives for the debts and what it paid the bank to acquire them – that would be analogous to the ruling of the court in *First National Bank of Chicago*, where the turnover was considered to be the profit on currency dealings over a period.

CJEU (Case C-93/10): *Finanzamt Essen-NordOst v GFKL Financial Services AG*

2.3.5 Post and postbus

HMRC have issued a Brief to clarify changes to the postal exemption following the enactment of the Postal Services Act 2011 in June, to take effect on 1 October. The new law removes the licensing arrangements which are referred to in the VAT exemption; the intention of the changes to the VAT law is to maintain the existing exemption under the new framework.

R & C Brief 34/2011

2.3.6 Gambling notice

HMRC have issued a new version of Notice 701/29 *Betting, Gaming and Lotteries*. It updates and replaces the previously separate notices 701/26 *Betting and Gaming* (February 2004), 701/28 *Lotteries* (August 2003), 701/27 Bingo (March 2002) and 701/13 *Gaming and amusement machines* (August 1995). It has been updated to include changes to the law in light of the Gambling Act 2005, in force from September 2007.

It also reflects the following:

- VAT exemption for all participation fees for games of chance;
- Treatment of electronic lottery and bingo machines;
- Treatment of an external lottery manager.

The preamble to the notice makes no reference to the major upheaval in policy in this area, nor the continuing uncertainty, arising from the *Rank* case and associated litigation. Presumably the detailed contents reflects the line that HMRC hope to hold in future.

Notice 701/29

2.3.7 CJEU ruling on gambling agents

The CJEU has ruled that agents collecting bets which are covered by the gambling exemption are themselves considered to be supplying bets covered by the exemption. The company in the case operated through a network of individuals who collected and registered bets in their own names, and were paid by commission. The Belgian authorities decided that this commission should have been subject to VAT (which the main company could not recover, because its supplies were undoubtedly exempt).

The court distinguished this situation from that of the call centre operation in *United Utilities plc* (Case C-89/05). The "buralistes" in this case were

much more like bookmakers in their own right; United Utilities was only providing an administrative service to the bookmaker.

CJEU (Case C-464/10): *Belgian State v Maître Pierre Henfling, Maître Raphaël Davin, Maître Koenraad Tanghe (acting as trustees in bankruptcy of Tiercé Franco-Belge SA)*

2.3.8 Personal training

A Reader's Query in *Taxation* poses the question of whether an individual providing training courses for a Limited Liability Partnership can benefit from the "personal tuition" exemption in Sch.9 Group 6 VATA 1994, or whether the decision in *Empowerment Enterprises Ltd* would apply (that incorporating a training business means that the principal is an employee and does not qualify as an independent trainer). The respondents to the query differed on whether a LLP would be treated as an "employer" for VAT – one suggested that the direct tax treatment (where the LLP is "transparent") would be followed, while the other suggested that the VAT treatment would be consistent with the strict law that a LLP is a body corporate (and therefore eligible for VAT grouping with companies).

Taxation 21 July 2011

2.3.9 Education notice

HMRC have issued a new version of Notice 701/30 *Education and vocational training*. It explains the application of the exemption in general, including the difference between business and non-business activities, and also deals with a number of specific issues such as the treatment of school photographs. It appears merely to consolidate the previous version with some updates, rather than reflecting specific recent changes in policy.

Notice 701/30

HMRC have also updated their online manual on *VAT on Education* to cover what it regards as the "four key questions" on education, vocational training and research:

- Is the education a supply for VAT purposes?
- If it is a supply, is that supply a business activity?
- Is the person providing the education entitled to exempt those supplies?
- Are the supplies covered by the exemption?

http://www.hmrc.gov.uk/manuals/vatf vatedumanual/index.htm

2.3.10 Welfare notice

HMRC have issued a new version of Notice 701/2 *Welfare*. It has been restructured and updated to improve readability and reflect the withdrawal of Extra Statutory Concession 3.37 VAT: Exemption for supplies of welfare services by private welfare agencies pending registration. It also includes a section on supplies of staff and provides clarification of the evidence required to demonstrate charitable status.

Notice 701/2

2.3.11 Green fees dispute

HMRC announced that they are seeking leave to appeal the decision of the First-Tier Tribunal in *Bridport and West Dorset Golf Club* (TC01214). They continue to believe that the UK law, which imposes restrictions on the exemption where a club has a membership scheme, is within the permitted range of the EU law.

The announcement robustly declares: "*Decisions of the First-Tier Tribunal are binding only on the parties to the decision. Consequently, we do not propose to pay other claims already submitted and we are not inviting new claims in the wake of this decision. Any claims that are submitted will be rejected.*"

R & C Brief 30/11

2.3.12 Sports notice

HMRC have issued a new version of Notice 701/45 *Sport*. It replaces the April 2002 version and also RCBs 37/10 and 15/10. The preamble suggests that it is essential to read also Notice 701/5 *Clubs and associations* and the relevant section of Notice 742 *Land and property*.

The notice does not contain a brief summary of "what's changed". However, it does contain the following useful explanation of when the exemption might be lost because the organisation is subject to "commercial influence":

From 1 January 2000 the exemption for sporting services which was available to all non-profit-making bodies was restricted to supplies by eligible bodies. The term eligible body is explained in section 4, but, in summary, an eligible body must:

- *be non-profit-making;*
- *have in its constitution restrictions on the distribution of profits; and*
- *not be subject to either commercial influence or part of a wider commercial undertaking.*

Commercial influence is explained in section 5 but you are likely to be subject to the commercial influence test if, within the three years preceding the relevant sports supply, you:

(a) paid a salary or bonus calculated by reference to profits or gross income to anyone who was an officer or a shadow officer of the club; or was connected with such an officer; or

(b) purchased certain goods or services (called "relevant supplies") from anyone; who was:

- *an officer or shadow officer of the club;*
- *acting as an intermediary between the club and the officer; or*
- *connected with any such person.*

Notice 701/45

2.3.13 Culture notice

HMRC have issued a new version of Notice 701/47 *Culture*. It updates and replaces the December 2003 version. The main changes are stated to be improvements in clarity and the removal of references to the change of policy in June 2004 following the *London Zoo* decision as the transitional arrangements are no longer relevant.

Notice 701/47

2.3.14 Cost sharing exemption

The Chartered Institute of Taxation has responded to a comment by a HMRC official on the implementation of the cost-sharing exemption, reported on the "civil society" website (reference below). The senior policy advisor suggested that outsourcing of "back office functions" such as payroll would not qualify for the exemption, which would be restricted to activities "directly necessary" for the purposes of the exempt bodies which form a cost-sharing group.

The CIOT response is that such an attempt to restrict the scope of the exemption is contrary to EU law. The CIOT takes the view that all that is required for the exemption to apply is:

- those sharing costs must be members of a cost sharing group (CSG) and must use the services provided by the CSG for their exempt or non-taxable activities;
- the goods and services provided must be charged at the cost to the CSG of procuring them – in other words the CSG will be a not for profit group;
- the provision of services by the CSG should not lead to distortions in competition with third party providers of other service providers.

According to Stephen Coleclough, the Vice-President of CIOT and President of the Confederation Fiscale Europeenne, "It is difficult to envisage any services that a business might outsource to a CSG that will not be directly necessary to the business of the group's members. Even costs such as for accounting are directly necessary given that the business has to recover its costs from members."

CIOT Release 30 September 2011

2.3.15 Study into public sector/public interest exemptions

The European Commission has published a study researching the different public sector VAT rules operated by member states, analysing the problems which may be caused by competition between public and private sector entities. The study also compares the EU rules with those operated in significant OECD countries outside Europe.

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

2.4 Zero-rating

2.4.1 Adapted cars

A company supplied seven adapted Land Rovers or Range Rovers to handicapped people, and treated them as zero-rated under Sch.8 Group 12 Item 2A. HMRC had become aware of a team of people abusing this zero-rating relief by buying expensive cars with relatively minor amendments and then selling them after a short time. The loss to HMRC amounted to £20m – £30m and had led to arrests and publicity in 2007.

HMRC identified some "familiar names" among the seven customers, and ruled that insufficient evidence was held to justify the zero-rating. In particular, the alterations had to be permanent, substantial and specific to the disability of the customer concerned. Four of the sales were accepted as qualifying; the other three, to the known abusers, were assessed as standard rated.

The company responded that at the time of the sales it had no knowledge of the abuse of the relief and took its customers at face value in good faith. There was no objective difference between the circumstances of the sales: HMRC were only disallowing zero-rating on three because they knew something about the purchasers, which the company could not know.

The Tribunal accepted that the company could not be expected to carry out investigations to validate the good faith of customers who appeared to satisfy the criteria. The decision considers the nature of alterations that can qualify, and holds that it is not necessary for these to involve lengthy or complicated fitting: the important point is whether they are intended for permanent use by the customer.

HMRC had raised the assessments in accordance with best judgement on the basis of the information available to them, but the appeal was nevertheless allowed. The company had sufficient evidence to justify zero-rating the three sales in dispute.

First Tier Tribunal (TC01341): *Croall Bryson & Co Ltd*

2.4.2 Ships, aircraft etc.

HMRC have issued a new version of Notice 744C *Ships, aircraft and associated services*. It explains the VAT liability for ships and aircraft and associated services which are supplied in the UK. The technical content has been updated to take account of developments in policy and changes in the law since the December 2010 edition. This includes a new section on "aircraft management" as well as other points of clarification and expansion.

Notice 744C

The online manual has also been updated in relation to the treatment of aircraft management companies.

www.hmrc.gov.uk/manuals/vtransmanual/vtrans110650.htm

2.5 Lower rate

2.5.1 Updated notice

HMRC have published a revised (June 2011) version of Notice 701/18. It replaces the March 2002 edition and explains how to apply the reduced rate of VAT on sanitary protection products.

Notice 701/18

2.6 Computational matters

2.6.1 Updated notice

HMRC have published a revised (August 2011) version of Notice 727/2 *Bespoke retail schemes*. The only change appears to be a correction to the address to which comments or suggestions should be sent.

Notice 727/2

2.7 Discounts, rebates and gifts

Nothing to report.

2.8 Compound and multiple

2.8.1 Land and water

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

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

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

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

First Tier Tribunal (TC01245): *The Honourable Society of Middle Temple*

2.9 Agency

2.9.1 HMRC respond to *Reed* decision

HMRC have set out their position following the decision of the First-Tier Tribunal in the *Reed Employment* case (TC01069). The Tribunal held that in providing temporary staff to its clients Reed was supplying introductory services rather than making supplies of staff. Accordingly the company was only liable to account for VAT on the commission element of its charge and not on the overall amount paid by the client which included the wages paid to the temp and associated National Insurance contributions.

HMRC note that a First-Tier Tribunal decision is only binding on the parties concerned, and also that this decision contradicted an earlier VAT Tribunal decision (*Hays Personnel Services Ltd* VTD 14,882). HMRC therefore appear to regard the case as a rogue decision which does not affect their view of the correct treatment of employment business supplies, which is restated in the Brief:

HMRC's view of the correct VAT treatment for employment bureaux remains that set out in VAT Information Note 03/09. In essence a bureau acting as an agent only has to account for VAT on its commission whereas a bureau acting as a principal has to account for VAT on the full amount charged to clients including the temps' wages and employers' National Insurance contributions.

2.1 Principal

In the context of employment bureaux a principal is the business making the supply of staff. The staff may be employees bound to the bureau by a contract of service or a self-employed worker making supplies to the bureau under a contract for services. In either case, the workers enter into a contract with the bureau making the supply of staff, which then makes an onward supply of those staff as principal to its client. VAT is due on the total consideration received by the bureau.

2.2 Agent

If a bureau is not making a supply of staff as principal, but instead acts as an intermediary in finding work for work-seekers, or workers for its clients and:

- *those two parties enter into a direct contractual relationship with each other;*
- *the bureau (or any person with which it is connected) does not pay, or arrange to pay, the workers;*

- *then the bureau is acting as an agent. The supply is not of staff but, rather, intermediary services of finding work-seekers employment. VAT is only due on the fee the bureau charges.*

R & C Brief 32/2011

2.9.2 Agent or principal?

The taxpayer has succeeded in an appeal to the Upper Tribunal against the decision in TC00431, *Secret Hotels2 Ltd (formerly Med Hotels Ltd).*

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

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

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

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

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

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

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

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

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

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

I would summarise my conclusions as follows:

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

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

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

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

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

vi) The identification of the true rights and obligations of the parties will be the same, whether the question arises in the context of VAT or in the context of an action for breach of contract; and is the same whether the question arises in a domestic or a European context ... ;

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

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

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

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

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

The judge considered that the clear and unambiguous terms of the contract between the appellant and the holidaymakers were that the hotel supplied them with accommodation. Similarly, the clear and unambiguous terms of the contract between the hotels and the appellant were that the appellant had authority to act as agent in booking contracts between holidaymakers and the hotels. There was nothing in the background to suggest that these

were not the actual supplies that were being made. Accordingly, the appeal was allowed.

Upper Tribunal: *Secret Hotels2 Ltd (formerly Med Hotels Ltd) v HMRC*

2.10 Second hand goods

Nothing to report.

2.11 Charities and clubs

Nothing to report.

2.12 Other supply problems

2.12.1 Salary sacrifice arrangements

HMRC have at last responded to the CJEU judgment in *AstraZeneca* (C-40/09), in which it was held that vouchers provided to employees in exchange for a reduction in salary were supplied for consideration. The previous policy is described as follows:

For VAT purposes 'salary sacrifice' has a very narrow and specific meaning. It describes an arrangement such as in the Co-operative Insurance Society case [1992] (VTD 109) where an employee opts to receive services and forgoes part of their salary in return. The employee enters into a new employment contract or has their existing contract amended to reflect the new arrangement which they are tied into.

In relation to such schemes HMRC have, to date, accepted that the reduction in the salary did not constitute consideration for the benefits received and output tax was not due. Employers were able to recover the related VAT as input tax, subject to the normal rules.

In cases where the employee has been provided with the use of a good (for example a home computer) and opts to purchase it at the end of the scheme it has always been HMRC's view that VAT is due (where applicable) at that stage.

The new policy will apply the principles of the *AstraZeneca* case to any situation in which an employee is supplied with goods or services in exchange for a reduction in salary. It is recognised that this may cause problems with existing arrangements, so the new policy will not be implemented until 1 January 2012.

The value of the consideration will normally be the amount of salary forgone. The Brief states "*Where this is less than the true value (for example where employers supply the benefits at below what it cost to buy them in), the value should be based on the cost to the employer,*" but does

not give any technical justification for using this. As this is a barter arrangement, consideration is primarily set at the subjective value to the person who is receiving it (which would justify the use of "cost" by the employer, as that is what the employer is prepared to spend in order to provide the goods or services); however, that is usually overridden by an explicit or implied agreement of value between the parties, and the salary sacrifice arrangement appears to meet that condition.

HMRC do not believe that the direct tax consequences of any salary sacrifice arrangements are affected. The case was about VAT and has no wider application. HMRC also point out that the provision of goods or services for a deduction from salary, shown on the payroll, has always been regarded as a supply for consideration and is therefore not affected by this change in policy.

Particular comments are made in relation to the application of the new policy to:

- cycle to work schemes (which have become common in order to exploit a direct tax exemption for bicycles loaned to employees for commuting);
- face value vouchers, where the policy has not changed because it was upheld in *AstraZeneca*;
- childcare vouchers, which are exempt from VAT and therefore may lead to an input tax restriction for the employer;
- food and catering, which is not VATable if there is no consideration, but if provided under a salary sacrifice arrangement will become chargeable from 1 January 2012;
- cars, which are not covered by the new policy because the employer will generally not be able to recover input tax on the purchase. The onward supply of the car is technically therefore exempt, although the Brief appears to regard it as outside the scope. Regulations which pre-date the *Italian Republic* case excluded employee cars from any output tax charge even where there is an explicit deduction from salary, mainly to make sure that there was never any justification for recovering input tax.

R & C Brief 28/2011

3. LAND AND PROPERTY

3.1 Exemption

3.1.1 Land and services

A firm of solicitors rented a serviced office. The landlord regarded the whole payment under the lease as exempt, in line with HMRC's advice. The lawyers argued that, in line with the CJEU's decision in *Tellmer* (Case C-572/07), the service element should be VATable, so the firm should be able to recover input tax. HMRC have refused a claim on the principal ground that the supply is wholly exempt, and also on the subsidiary ground that the landlord has not charged any VAT nor accounted for it to HMRC. There is therefore nothing to claim.

The solicitors argue that the situation is effectively identical to *Tellmer*, in which the CJEU held that cleaning services supplied and charged to tenants by a landlord were a separate taxable supply. HMRC argue that the lease and the services in respect of which the Service Rent is charged are a single supply. This is because they form objectively a single indivisible economic supply which it would be artificial to split. Alternatively, HMRC argue that the services provided by the landlords are ancillary to the principal supply, being the leasing of land.

The Tribunal decided to refer questions to the CJEU. The chairman explains that the overall issue (single and separate supplies) is also the subject of a recent reference in *Purple Parking*, but this case raises further issues which would not be covered by the answers to that reference – in particular, the treatment of a package of services for a single charge where some might be regarded as ancillary to property and some might be regarded as separate.

The questions are:

(i) The principal question in the present case is whether the services provided by landlords under a lease agreement with their tenants ("the Services") should be regarded as an element of a single exempt supply of a lease of land, either because the Services form objectively a single indivisible economic supply together with the lease or because they are "ancillary" to the lease, which forms the principal supply ("the Principal Supply"). In determining this question and in the light of the ECJ's decision in Case C-572/07 Tellmer, how relevant is it that the Services could be (but are not in fact) supplied by persons other than the landlords, albeit under the terms of the present leases in question the tenants had no choice but to receive the services from the landlords?

(ii) In determining whether there is a single supply, is it relevant that a failure by the tenant to pay the service charge would entitle the landlord not only to refuse to provide the Services but also to terminate the lease agreement with the tenant?

(iii) If the answer to question 1 is that the possibility of third parties providing the Services direct to the tenant is relevant, is it merely a contributory factor in determining whether the Services are either a single, indivisible economic supply, which it would be artificial to split or an ancillary supply to the Principal Supply, or is it a determining factor? If it is merely a contributory factor or if it is not relevant at all, what

other factors are relevant in determining whether the Services are an ancillary supply? In particular how relevant is it whether the Services are performed in or in respect of the demised premises which are the subject matter of the letting or in other parts of the building?

(iv) If the possibility of third parties providing the Services is relevant, is more particularly what is relevant whether the Services could as a legal matter be supplied by third parties, even if this would be difficult in practice to organise or agree with the landlord, or is the practical possibility or the common practice in the provision of such services the relevant consideration?

(v) The Services in the present case represent a range of services provided in return for a single service charge. In the event that some of these services (e.g. cleaning of common parts, the provision of security services) are not part of a single indivisible economic supply or are to be regarded as ancillary to the Principal Supply, but other services are, would it be correct to apportion the total consideration between the various services in order to determine the portion of the consideration chargeable to tax and that portion not so chargeable? Alternatively would it be correct to regard the range of services provided as so closely linked to each other that they form "a single indivisible economic supply which it would be artificial to split" being of itself a single supply separate from the leasing of property?

CJEU (Reference) (Case C-392/11); First Tier Tribunal (TC01371): *Field Fisher Waterhouse LLP*

3.1.2 Land or shares?

The Dutch court has referred interesting questions about the application of the exemption for land where the value of that land is held in the form of shares. Art.5(3)(c) 6th Directive allows member states to treat shares in property-holding companies as equivalent to tangible property (i.e. to look through the means of ownership to the underlying asset), but neither the Netherlands nor the UK have implemented that provision. The issue has arisen in the UK in the case of *Joiner Cummings* (First Tier Tribunal TC00847): an estate agent provided exempt intermediary services, rather than taxable estate agency services, because the value of a £50m London property was transferred in the form of units in a unit trust (as a SDLT avoidance plan, but with an incidental VAT benefit).

Must Article 13B(d)(5) of the Sixth Directive be interpreted as also covering transactions, such as those carried out by the interested party, which in essence relate to the immovable property held by the companies concerned and its (indirect) transfer, solely on the ground that those transactions were aimed at, and resulted in, the transfer of the shares in the companies?

Is the exception to the exemption contained in the second indent of Article 13B(d)(5) of the Sixth Directive also applicable if the Member State has not availed itself of the possibility provided by Article 5(3)(c) of the Sixth Directive of considering shares or interests equivalent to shares giving the holder thereof rights of ownership or possession over immovable property to be tangible property?

If the previous question must be answered in the affirmative, must the aforementioned shares or interests equivalent to shares be understood to include shares in companies which, directly or indirectly (by means of (sub-) subsidiaries), own immovable property, regardless of whether they exploit it as such or whether they utilise it in the context of a different type of undertaking?

CJEU (Reference) (Case C-259/11): *DTZ Zadelhoff vof v Staatssecretaris van Financiën*

3.2 Option to tax

3.2.1 Disapplication

A Reader's Query in *Taxation* asked about the correct procedure for disapplying the option to tax where the director of a property broking company wanted to buy an opted pub and convert it into a residence for his own use. The answers pointed to the procedure which is set out in Notice 742A, involving the issue of a certificate from the buyer to the seller before the purchase. The answers also drew attention to the possibility of a DIY builders' claim, as long as the house was for personal use and not part of the property business.

Taxation 11 August 2011

3.3 Developers and builders

3.3.1 Extensions

A company operating a nursing home engaged a building contractor to construct new accommodation adjoining its existing premises. HMRC ruled that the work was standard rated. The builder and operator jointly appealed, arguing that zero-rating should apply: the two parts of the resulting structure were used for different purposes (nursing and residential care) and were effectively independent buildings.

The Tribunal agreed with HMRC. There was internal access between the old and new buildings throughout. There were certain common services used by both parts, such as the kitchen, the laundry, the administration and reception areas. The two could not be regarded as independent, and the construction of an extension was standard rated.

First Tier Tribunal (TC01375): *TL Smith Properties Ltd and Tregwilym Lodge Ltd*

The same issue arose in another case featuring a different style of extension – one that was not built to fit in with the existing structure. There were two lockable doors between the old and new structures, which meant that there was a degree of physical integration; the Tribunal found that the purposes for which the new structure was used were an extension of what the old had been used for beforehand, and this also suggested an

extension rather than a new, independent building. The same conclusion was reached: zero-rating was not available.

If the new structure was instead an annexe rather than an extension, the Tribunal considered that it was not capable of independent operation, and so it would still not qualify for zero-rating.

First Tier Tribunal (TC01350): *Treetops Hospice Trust*

3.3.2 Building?

A charity claimed that the historic weir it was engaged in restoring should qualify for zero-rating of works because it was a scheduled monument. After consideration of a number of precedents going back over many years, the Tribunal agreed with HMRC that it was not a "building" and could therefore not possibly qualify. Even if it did, most of the works were in the nature of repairs and maintenance rather than "approved alterations". It was not necessary to consider whether the weir was used for a relevant charitable purpose.

First Tier Tribunal (TC01310): *Calver Weir Restoration Project*

3.4 Input tax claims on land

3.4.1 House or tied accommodation?

A couple operated a number of holiday chalets. They obtained planning permission to build a house adjacent to the site, with the intention that their son would occupy it and help in the business. The planning permission placed a restriction to require occupation by a person engaged in the management of the holiday chalet business. HMRC ruled out a DIY builders' claim on the basis that Note 2(c) Group 5 Sch.8 VATA 1994 was infringed.

The Tribunal ruled that the restriction related to occupancy, but it did not prohibit the separate use or disposal of the property. It therefore qualified as a dwelling and the DIY claim succeeded. The decision considers a number of earlier cases, including *Wendels* (TC00476) with which it is consistent and *Lunn* (Upper Tribunal 2009) from which it was distinguished.

First Tier Tribunal (TC01227): *I Phillips*

3.4.2 Additional dwelling?

An individual carried out a barn conversion and made a DIY claim. HMRC refused the claim on the grounds that the barn had formed part of a previous building which had been used for residential purposes, namely as a garage.

The Tribunal recognised that there were inconsistencies in the evidence about the previous use of the building, but decided on balance that it should accept the evidence of the appellant that it had been used for agricultural storage rather than as a garage in the normal domestic sense.

The project appears to have been complicated, in that there was an earlier extension to the main house which was subsequently incorporated in the barn conversion to become a new separate dwelling. HMRC argued that the inclusion of the extension meant that the project failed as a whole, because the new dwelling incorporated something that had previously been in residential use; however, the Tribunal did not agree with this interpretation. The VAT on the conversion of the existing extension could not be claimed, but it did not undermine the validity of the whole claim. The project did include the conversion of a non-residential building into a new dwelling, and to that extent it qualified for relief.

First Tier Tribunal (TC01351): *J Wade*

3.5 Other land problems

Nothing to report.

4. INTERNATIONAL SUPPLIES

4.1 E-commerce

4.1.1 E-traders

HMRC have published the usual currency rate table for special scheme traders for the quarter ending June 2011.

Information Sheet 10/2011

They have published an Information Sheet to warn traders that the Italian VAT rate has increased from 20% to 21% on 17 September.

Information Sheet 11/2011

4.2 Where is a supply of services?

4.2.1 Staff or not?

A German company supplied the services of lorry drivers to customers who were established in Italy. It regarded this as a subject to the reverse charge on business customers under art.9(2)(e) 6th Directive – a supply of staff. The German authorities ruled that it could not be a supply of staff because the drivers were self-employed. Questions were referred to the ECJ, and the Advocate-General has given an opinion that the self-employed status of the drivers did not prevent the supply constituting a supply of staff.

CJEU (A-G) (Case C-218/10): *ADV Allround Vermittlungs AG v Finanzamt Hamburg-Bergedorf*

4.2.2 Italian numbers

HMRC have issued a press release to alert UK businesses to the fact that the Italian VAT registration system has changed on 24 February 2011 and certain numbers issued prior to that date are no longer valid. HMRC recommends that UK traders contact their Italian customers to obtain an up-to-date Italian VAT registration number and verify that number at the Europa website in order to ensure its validity.

VAT registration number validation can be undertaken by way of the Europa website at http://ec.europa.eu/taxation_customs/vies/vieshome.do.

HMRC Release 21 July 2011

4.2.3 Article and query

Neil Warren examines the treatment of “B2C” supplies of services – supplies by UK business to non-business customers who belong outside the UK.

Taxation 21 July 2011

A Reader's Query in *Taxation* concerned the possible liability of a consulting engineer to registration for VAT in other EU countries where he carried out work. The answers observe that services supplied to business customers will generally be subject to the reverse charge, so a sales list will be required but not a local registration. However, it is possible for an engineer to be involved in supplies which are closely linked to immoveable property, in which case the question of registration should be investigated with the local authorities. The UK would still not require a registration in such circumstances as long as the customer would account for VAT under the reverse charge.

Taxation 28 July 2011

4.3 International supplies of goods

4.3.1 Buying commission

HMRC have issued a paper to explain changes to the way in which buying commission may be treated for valuation of imports, which affects both the customs duty charge and the VAT.

A review has been necessary because the services of buying agents were covered by the changes in the place of supply rules introduced on 1 January 2010. Where a foreign agent charges buying commission to a UK importer, previously this has been treated as part of the cost of the goods for import valuation. Now, where the importer will account for the VAT on the commission under the reverse charge, this is treated as a cost incurred in the UK rather than abroad, and the commission is excluded from the import value.

HMRC comment that discovery of a failure to account for the buying commission will lead to different actions depending on the timing of the transaction:

- if the transaction was before 1 January 2010, the VAT due will be import VAT and will be demanded by the issue of a C18 form (which presumably may also require an adjustment to the duty);
- from 1 January 2010 onwards, the importer will be instructed to account for the VAT on the next VAT return (in Box 1).

In either case the VAT will normally be recoverable as soon as it is paid, but there may be a cash flow effect in the case of import VAT and a cost if the imported goods are used for partially exempt purposes.

Customs Information Paper (11) 59

4.3.2 Intrastat proposals

HMRC have issued proposals for changes to the Intrastat system from April 2012. The main changes are to make electronic filing mandatory, and to bring forward the deadline from the end of the month following the trade to the 21st of the month following the trade.

When Intrastat was introduced in 1993, the due date was the 10th day of the month following the month to which the trade related. Since 2004 the due date has been the last day of the month following the month to which the trade relates. The UK deadline for submission is out of line with other Member States, the majority of which set the deadline at 10 – 15 days after the month end. Although two Member States set their due date as late as 21 – 25 days after, the UK's current deadline is the latest.

www.uktradeinfo.com/index.cfm?task=userconsults&targetconsultsid=55

4.3.3 Temporary admission

HMRC have issued updated versions of Notice 200 *Temporary Admission*, as well as Notice 306 *Temporary Admission – temporarily importing non-EU containers and pallets* and Notice 308 *Temporary admission – temporarily importing non-EU means of transport*. They explain the circumstances in which relief from customs duties (including VAT) can be claimed on temporary importations of the items concerned.

Notices 200, 306, 308

4.3.4 Query

A Reader's Query in *Taxation* raised the problem of a UK trader who has sold some €50,000 of plant to non-registered Irish customers in each of the last three years. The trader had assumed (if he had thought about it at all) that the distance selling limit in Ireland was the same as in the UK (£70,000); as it is the lower limit of €35,000, he ought to have been registered there. The answers state that the trader ought to register and correct all the VAT charges.

Taxation 15 September 2011

4.3.5 Travelling to the UK

HMRC have issued an updated version of Notice 1 *Travelling to the UK*. It gives details of what goods travellers can bring with them into the UK, what limits apply, and what must be declared on entry.

Notice 1

4.4 European rules

4.4.1 German welfare

The German VAT law provides that a welfare body can enjoy VAT exemption for out-patient care services provided that "*the costs of the care have been borne in at least two thirds of cases wholly or mainly by the statutory social security or social welfare authorities in the previous calendar year*". The German courts have decided to refer questions to the CJEU on whether this is in accordance with the Directive:

Does Article 13(A)(1)(g) and/or (2)(a) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes permit the national legislature to make the exemption of out-patient care services for those who are sick or in need of care dependent on the fact that, in the case of such organisations, 'the costs of the care have been borne in at least two thirds of cases wholly or mainly by the statutory social security or social welfare authorities in the previous calendar year' (Paragraph 4(16)(e) of the Umsatzsteuergesetz 1993)?

Is it relevant to the answer to this question, having regard to the principle of the neutrality of VAT, that the national legislature treats the same services as exempt under different conditions where they are carried out by officially recognised voluntary welfare associations, and corporations, associations of persons and funds serving purposes of voluntary welfare which are affiliated as members of a welfare association (Paragraph 4(18) of the Umsatzsteuergesetz 1993)?

Imposing conditions on the application of a public interest exemption may raise similar issues to those in the golf club green fees case which HMRC wish to appeal to the Upper Tribunal. Maybe that will also reach the CJEU before it is settled.

CJEU (Reference) (Case C-174/11): *Finanzamt Steglitz v Ines Zimmermann*

4.4.2 Latvian forests

The Latvian court has referred questions on the scope of VAT and the concept of economic activity. It is not entirely clear why a private owner of a forest should be forced to supply goods to someone else to compensate for the effects of a storm, but these are the questions:

1. Is a natural person who has acquired goods (a forest) for his own needs and who makes a supply of goods to alleviate the consequences generated by force majeure (for example, a storm) a taxable person for the purposes of VAT, within the meaning of Article 9(1) of Directive 2006/112/EC [1] and Article 4(1) and (2) of the Sixth Council Directive 77/388/EEC, [2] who is required to pay VAT? In other words, does such a supply of goods constitute an economic activity within the meaning of those rules of European Union law?

2. Does a regulation, under which a fine can be imposed on a person who has not registered on the register of taxable persons for the purposes of VAT, in an amount equivalent to the tax that would normally be due for the value of the goods supplied, even though that person would not have

to pay the tax if he had registered on the register, comply with the principle of proportionality?

The question of proportionality of penalties could be of more widespread interest.

CJEU (Reference) (Case C-263/11): *Ainārs Rēdlihs v Valsts ieņēmumu dienests*

4.4.3 Travel agents

The Commission has commenced infringement proceedings against a number of member states concerning their implementation of the tour operators rules. Italy, Greece and the Czech Republic allow supplies to be dealt with through its version of TOMS even where the customer is not the traveller but another business – the UK amended its rules some time ago to correct this. The CJEU will be asked to declare that this approach is not in compliance with arts.306 – 310 of the Directive.

Similar actions have been commenced against France and Finland. The Commission has invited the CJEU to reject the French defence that the French legislation enables the objectives pursued by the special scheme, namely the simplification of travel agencies' administrative formalities and the attribution of VAT revenue to the Member State in which the end consumption of each individual service took place, to be better achieved.

CJEU (References) (Case C-236/11): *Commission v Italian Republic*; (Case C-293/11) *Commission v Hellenic Republic*; (Case C-269/11) *Commission v Czech Republic*; (Case C-296/11) *Commission v France*; (Case C-309/11) *Commission v Finland*

A different question has been raised by the Czech courts on the scope of the scheme – it seems unlikely that a coach company could fall within it in respect of the supply of coaches, but that is the question:

Does Article 306 of [the VAT Directive] refer only to supplies made by travel agents to end users of a travel service (travellers) or also to supplies made to other persons (customers)?

Should a transport company which merely provides transport of persons by providing bus transport to travel agencies (not directly to travellers) and which does not provide any other services (accommodation, information, consultancy etc.) be regarded as a travel agent for the purposes of Article 306 of [the VAT Directive]?

If the CJEU believes that a transport company can fall within TOMS, the UK will have to change its policy.

CJEU (Reference) (Case C-220/11): *Star Coaches s.r.o. v Finanční ředitelství pro hlavní město Prahu*

4.4.4 Reduced rate in Spain

As reported in the last update, the Commission is taking infringement proceedings against Spain for applying a reduced rate to general medical equipment, appliances to alleviate the physical disabilities of animals and substances used in the production of medicines. A reasoned opinion was sent in November 2010 pointing out that the Directive permits a reduced rate only for appliances which are "normally intended to alleviate or treat

disability", and which are "for the exclusive personal use of the disabled", which does not extend to general medical equipment and appliances for animals. Also, the Directive permits reliefs for medicines, but not for the ingredients used in the production of medicines.

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

CJEU (Application) (Case C-360/11): *Commission v Spain*

4.4.5 French ships

The Commission has referred France to the CJEU in respect of its exemption for services relating to the fuelling and provisioning of ships. This is required by the VAT Directive to be exempt with credit (i.e. zero-rated) where the ships are used for navigation on the high seas, but France does not include this requirement. The Commission therefore considers that the scope of the VAT relief is too wide.

The Commission issued a reasoned opinion to France in March 2010. The French tax code was amended in January 2011 to include the condition about navigation on the high seas, but an administrative interpretation published on 22 February 2011 stated that the previous rules would continue to operate in practice.

IP/11/1126

4.4.6 Polish mixed supplies

The Polish courts have referred a question that echoes a number of UK disputes – whether a charge for insurance, supplied with something else, can be treated as separate and can fall within the exemption:

(a) Must Article 2(1)(c) of [the VAT Directive] be interpreted as meaning that the service providing insurance for a leased item and the leasing service are to be treated as separate services or as one single, comprehensive, composite leasing service?

(b) If the answer to the first question is that the service providing insurance for a leased item and the leasing service are to be treated as separate services, must Article 135(1)(a) of [the VAT Directive], in conjunction with Article 28 thereof, be interpreted as meaning that the service providing insurance for a leased item is to be exempt in the case where the lessor insures that item and charges the costs of that insurance to the lessee?

The UK courts have considered this a number of times, particularly in connection with the supply of "cars and insurance". It has generally been held that the supply of insurance is absorbed within the supply of the goods and is not exempt.

CJEU (Reference) (Case C-224/11): *BGŻ Leasing Sp. z o. o. v Dyrektor Izby Skarbowej w Warszawie*

4.4.7 Portuguese farmers

The Advocate-General has agreed with the Commission that the operation of the agricultural flat rate scheme in Portugal is excessively disadvantageous to farmers – no flat rate compensation is given to balance

the input tax forgone, and transactions of farmers are exempt from VAT. Although member states are not allowed to give compensation which exceeds the input tax forgone, the Advocate-General's opinion is that member states are allowed to implement a scheme which offers no compensation at all.

CJEU (A-G) (Case C-524/10): *Commission v Portuguese Republic*

4.4.8 Demolition and destruction

The Romanian courts have referred a question that appears to be about attribution and expenditure which is effectively "wasted". It relates to the purchase of buildings which are to be demolished in order to make way for a residential development. If VAT is incurred on the purchase of the buildings, that appears to be input tax under the UK's understanding, even if the buildings themselves are not incorporated into the onward supply; the costs have to be incurred in order to make that supply. It will be surprising if the CJEU comes to a different conclusion.

In the light of Articles 167 and 168 of [the VAT Directive], can the purchase, by a commercial company liable for VAT, of a number of buildings scheduled for demolition, together with a plot of land, with a view to developing a residential complex on that land constitute a preparatory activity, that is to say, investment expenditure for the purposes of developing a residential complex, entitling that company to deduct the VAT on the purchase of the buildings?

In the light of Article 185(2) of [the VAT Directive], is the demolition of the buildings scheduled for demolition, which were purchased together with the plot of land, with a view to developing a residential complex on the land, subject to adjustment of the VAT on the purchase of the buildings?

CJEU (Reference) (Case C-257/11): *SC Gran Via Moineşti srl v Agenţia Naţionala de Administrare Fiscală (ANAF), Administraţia Finanţelor Publice Bucureşti*

Some similar issues appear to be covered by a reference from the Bulgarian courts concerning the adjustment of attribution on the destruction of assets (art.185 VAT Directive). Where the original purchase justified deduction but there is a change of circumstances, the article requires an adjustment, but allows an exception where the subject matter has been destroyed. The questions for reference appear to question whether this exception can apply if the destruction was the intention all along. As with the Romanian case, it seems likely that the VAT would be regarded as properly deductible in the UK.

How is the expression 'destruction of property' for the purposes of Article 185(2) of Directive 2006/112 to be interpreted, and are the motives for the destruction and/or the conditions under which it takes place relevant for the purposes of the adjustment to the deduction made upon acquisition of the property?

Is the demolition of capital assets, duly proved, with the sole aim of creating new, more modern capital assets with the same purpose to be regarded as a modification of the factors used to determine the amount to be deducted within the meaning of Article 185(1) of Directive 2006/112?

Is Article 185(2) of Directive 2006/112 to be interpreted as permitting the Member States to make adjustments in the case of the destruction of property where its acquisition remained totally or partially unpaid?

Is Article 185(1) and (2) of Directive 2006/112 to be interpreted as precluding a national provision like Article 79(3) of the Law on VAT and Article 80(2)(1) of the Law on VAT, which provides for an adjustment of the deduction made in cases of destruction of property upon the acquisition of which a total payment of the basic amount and the tax calculated was made, and which makes the non-adjustment of a deduction dependent on a condition other than payment?

Is Article 185(2) of Directive 2006/112 to be interpreted as ruling out the possibility of an adjustment to the deduction in the case of the demolition of existing buildings with the sole aim of creating new, more modern buildings in their place which fulfil the same purpose as the demolished buildings and [are used for transactions] which [give] entitlement to [deduction of input] VAT?

CJEU (Reference) (Case C-257/11): *SC Gran Via Moineşti srl v Agenţia Naţionala de Administrare Fiscală (ANAF), Administraţia Finanţelor Publice Bucureşti*

4.4.9 Bulgarian procedures

The Bulgarian court has referred questions about the principle of "effectiveness" which contains echoes of the *Marks & Spencer* dispute. It seems that extra conditions were imposed on the deduction of acquisition input tax; the *M&S* judgment makes it doubtful whether this could have retrospective application, or whether it could be justified at all given that the acquisition tax would have to be paid.

1. Are Articles 179(1), 180 and 273 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax and the principle of effectiveness in the field of indirect taxation, which is discussed in the judgment of the Court of Justice in Joined Cases C-95/07 and C-96/07 Ecotrade, to be interpreted as permitting an exclusion period such as that in the present case under Article 72(1) of the Law on value added tax (2008 version), which period was extended - under Section 18 of the transitional and concluding provisions of the Law amending and complementing the Law on value added tax - until the end of April 2009 only for recipients of supplies who became taxable before 1 January 2009, taking into account the circumstances of the dispute in the main proceedings, that is to say:

– the requirement under national law that a person who has made an intra-Community acquisition and who is not registered under the Law on value added tax register voluntarily as a precondition for exercising the right to deduct input VAT, even though that person does not meet the conditions for compulsory registration;

– the new rule under Article 73a of the Law on value added tax (in force since 1 January 2009) whereby the right to deduct input value added tax is to be granted irrespective of whether the time-limit under Article 72(1) of the Law on value added tax was complied with, if the tax is chargeable to the recipient of the supply, provided the supply was not concealed and is documented in the accounts;

– the subsequent amendment of Article 72(1) of the Law on value added tax (in force since 1 January 2010), whereby the right to deduct input value added tax may be exercised during the tax period in which that right arose or in one of the subsequent twelve tax periods?

2. Is the principle of tax neutrality as a fundamental principle, which is of importance for the establishment and functioning of the common system of value added tax, to be interpreted as meaning that a tax assessment practice such as that at issue in the main proceedings - which acknowledges the late charging of value added tax, levies interest as a penalty and imposes an additional penalty of denial of the right to deduct input value added tax - is permissible in the actual circumstances of the appellant's case, taking into account the fact that the transaction was not concealed, it was documented in the accounts, the tax authorities had the necessary information, no abuse occurred and the budget was not adversely affected?

CJEU (Reference) (Case C-284/11): *EMS Bulgaria TRANSPORT OOD v Direktor na Direktsia'Obzhalvane i upravlenie na izpalnenieto' pri Tsentralno Upravlenie na Natsionalnata Agentsia po Prihodite gr. Plovdiv*

The Bulgarian courts have also referred a very long list of questions about “absence of actual supply” and tax evasion – it appears to relate to a missing trader or similar fraud, and covers the liability for output tax and deductibility of input tax for the parties involved. One particular question which has implications in the UK relates to the possibility of denying input tax because of a fraud which is some way removed from the claimant in the supply chain:

8. Does it constitute a permissible measure for the purpose of ensuring the collection of tax and preventing tax evasion that the right of deduction is made dependent on the conduct of the supplier and/or his upstream suppliers?

CJEU (Reference) (Case C-285/11): *Bonik EOOD v Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto', Varna*

4.4.10 Thresholds

The EU has published an updated list of national thresholds for various special schemes and rules of VAT.

Member State	Threshold for application of the special scheme for acquisitions by taxable persons not entitled to deduct input tax and by non-taxable legal persons[1]		Threshold for application of the special scheme for distance selling [2]		Exemption for small enterprises[3]	
	National currency	Euro equivalent	National currency	Euro equivalent	National currency	Euro equivalent
Belgium	€11.200	-	€35.000	-	€5.580	-
Bulgaria	20.000 BGN	10.226	70.000 BGN	35.791	50.000 BGN	25.565
Czech Republic	326.000 CZK	13.318	1.140.000 CZK	46.570	1.000.000 CZK	40.851
Denmark	80.000 DKK	10.730	280.000 DKK	37.557	50.000 DKK	6.707

Germany	€12.500	-	€100.000	-	€17.500	-
Estonia	€10.226		€35.151		€15.978	
Ireland	€41.000	-	€35.000	-	€75.000 or €37.500	-
Greece	€10.000	-	€35.000	-	€10.000 or €5.000	-
Spain	€10.000	-	€35.000	-	None	None
France	€10.000	-	€100.000	-	€81.500 or €32.600	-
Italy	€10.000	-	€100.000	-	€30.000	-
Cyprus	€10.251	-	€35.000	-	€15.600	-
Latvia	7.000 LVL	9.932	24.000 LVL	34.052	35.000 LVL	49.659
Lithuania	35.000 LTL	10.137	125.000 LTL	36.203	100.000 LTL	28.962
Luxembourg	€10.000	-	€100.000	-	€10.000	-
Hungary	2.500.000 HUF	9.164	8.800.000 HUF	32.257	5.000.000 HUF	18.328
Malta	€10.000	-	€35.000	-	€35.000 or €24.000 or €14.000	-
Netherlands	€10.000	-	€100.000	-	None	None
Austria	€11.000	-	€35.000	-	€30.000	-
Poland	50.000 PLN	12.592	160.000 PLN	40.293	150.000 PLN	37.774
Portugal	€10.000	-	€35.000	-	€10.000 or €12.500	-
Romania	34.000 RON	8.071	118.000 RON	28.012	119.000 RON	28.249
Slovenia	€10.000	-	€35.000	-	€25.000	-
Slovakia	€13.941,45	-	€35.000	-	€49.790	-
Finland	€10.000	-	€35.000	-	€8.500	-
Sweden	90.000 SEK	10.190	320.000 SEK	36.232	None	None
United Kingdom	70.000 GBP	81.843	70.000 GBP	81.843	70 000 GBP	81.843

Notes:

1 See Article 3(2)(a) of Directive 2006/112/EC, as amended.

2 See Article 34 of Directive 2006/112/EC, as amended.

3 See Articles 284 to 287 of Directive 2006/112/EC, as amended. This scheme is reserved for taxable persons established within the territory of the country.

http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/traders/vat_community/vat_in_ec_annexi.pdf

4.5 Eighth Directive reclaims

4.5.1 E-learning course

The European Commission has published on its website an e-learning course on the VAT refund electronic procedure. The course is intended for use both by traders and tax officials.

The course aims to meet the following objectives for participants:

- Increase familiarity with the new provisions for the VAT refund to non established persons;
- Increase familiarity with the new procedures for applying for a VAT refund;
- Understanding the reasons for the implementation of the new procedures;
- Understanding what is expected of traders and tax officials respectively in relation to the new system;
- Understanding how to access the sources of information available at EU and national level.

http://ec.europa.eu/taxation_customs/common/elearning/download_en.htm

4.5.2 Whose claim?

The Swedish courts have referred a question to the CJEU on the compatibility of the Swedish rules on VAT claims by non-residents with the EU legislation. The questions are:

1. *How is the expression 'fixed establishment from which business transactions are effected' to be interpreted in an assessment on the basis of the relevant provisions of European Union law?*
2. *Is a taxable person who has the seat of his economic activity in another Member State and whose activity principally consists of the manufacture and sale of cars, who has carried out winter testing of car models at installations in Sweden, to be regarded as having had a fixed establishment in Sweden from which business transactions have been effected where that person has acquired goods and services that were received and used at testing installations in Sweden without having his own staff permanently stationed in Sweden and where the testing activity is necessary to the performance of the person's economic activity in another Member State?*
3. *Does it affect the answer to question 2 if the taxable person has a wholly-owned Swedish subsidiary, the purpose of which is almost exclusively to supply the person with various services for that testing activity?*

Presumably the dispute with the authorities concerns whether Daimler (a German company) should register for VAT in Sweden and claim input tax through a return, or whether it is entitled to claim under the 8th Directive. The Implementing Regulation gives some guidance on how to determine whether a business has a fixed establishment in another member state; it

will be interesting to see the CJEU discussing the application of these principles to specific circumstances.

It may be that Daimler has a subsidiary in Sweden which has carried out the testing and has charged VAT to its holding company (before the VAT Package, work carried out on goods would have been subject to VAT in Sweden). The Swedish authorities are then questioning whether the subsidiary is a "mere auxiliary organ" of the holding company, as in the *DFDS* case, and its existence would therefore rule out the holding company being eligible for an 8th Directive claim.

CJEU (Reference) (Case 318/11): *Daimler AG and Widex A/S v Skatteverket*

4.5.3 Time limits

The Italian courts have referred a question to the CJEU on the time limit for making 8th Directive claims:

Is the period of six months from the end of the calendar year in which value added tax became chargeable, being the time allowed for taxable persons not established in the territory of the country to submit an application for refund of that tax – as laid down in the last sentence of the first subparagraph of Article 7(1) of Eighth Council Directive 79/1072/EEC of 6 December 1979 – a mandatory time-limit, that is to say, a time-limit non-compliance with which results in forfeiture of the right to a refund?

CJEU (Reference) (Case 294/11): *Daimler AG and Widex A/S v Skatteverket*

4.5.4 Monaco

HMRC have been advised by the French Tax Administration that claims for EU VAT incurred in Monaco must still be processed manually, because the electronic refund system does not yet cover the principality. A form is provided for making a claim.

www.hmrc.gov.uk/news/imprime-3559-mc.pdf

www.hmrc.gov.uk/news/notice-imprime-3559-mc.pdf

5. INPUTS

5.1 Economic activity

5.1.1 Hunting, shooting and posting

An individual purchased a large Scottish estate in 1993. The vendor had been registered for VAT and treated the sale as a transfer of a going concern. Among other activities, the individual undertook to deliver mail for the Post Office, which considered the area too remote to carry out deliveries itself. He reclaimed input tax on expenditure in relation to the distribution of the mail and the sale of venison from deer shot on the land. HMRC disallowed this in 2008, ruling that there was no economic activity. It appears that no questions had been raised since 1993, but the submission of a large repayment return led to an enquiry.

The assessments were substantial, both for underdeclared output tax (which seems inconsistent with an assertion that there was no economic activity at all) and overclaimed input tax. Input tax was claimed in respect of expenditure on a helicopter which was used for hiring to the owner's substantial companies (based in North Wales) as well as for travelling between Wales and the Scottish estate, and for the purposes of hunting deer on the estate. It seems that HMRC believed that much of this was private use, and either warranted disallowance of the input tax or a substantial *Lennartz* charge.

The owner organised shooting parties to hunt the deer: up to 80 beasts were shot each year. No charge was made to the members of the shooting parties, but the carcasses were sold at a commercial rate to a local meat dealer. The owner emphasised that hunting deer on a Scottish estate is a "serious undertaking earnestly pursued", and that the point of the exercise was not sport but the realisation of the value in the deer herd by selling the meat. HMRC appear to have regarded the shooting activity as akin to Lord Fisher's circumstances.

There were also input tax claims in respect of the installation of a water-powered turbine to generate electricity. By the time of the hearing, HMRC had accepted that this was an economic activity.

The Tribunal considered the facts in detail, examining the way in which the estate was run and the motives behind the shooting and the operation of the helicopter. The chairman applied the *Lord Fisher* tests to the activities and concluded that they were satisfied: this was an economic activity. The details of the assessments were not discussed, and presumably any *Lennartz* adjustments were left for the parties to discuss once the basic principle had been established.

The Tribunal also concluded that the contract between the Post Office and the owner for the delivery of the mail was an individually negotiated contracted which imposed obligations on him in return for consideration. It was validly VATable, and he was entitled to deduct associated input tax.

First Tier Tribunal (TC01288): *Mark Ziani de Ferranti*

5.2 Who receives the supply?

Nothing to report.

5.3 Partial exemption

Nothing to report.

5.4 Cars

Nothing to report.

5.5 Business entertainment

Nothing to report.

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 Normal input tax conditions

HMRC decided to enquire into a repayment return submitted by a wholesaler of optical wear. It reclaimed £15,000 of input tax and declared no outputs. After some revisions and adjustments, HMRC disallowed £7,000 on the basis that the suppliers were not VAT-registered, and another £5,000 on the basis that the invoices had not been paid (so s.26A VATA 1994 would require a reversal of the input tax claim).

The trader presented a long list of grievances at the hearing, only some of which were accepted as valid grounds for appeal. In respect of the invoices from unregistered traders, the appellant claimed that VAT had been paid in good faith against invoices which stated that registration had been applied for; the Tribunal decided that it did not have jurisdiction to consider whether HMRC should have exercised a discretionary power to allow this input tax on alternative evidence, and dismissed that part of the appeal.

In respect of the invoices which HMRC considered had not been paid, the appellant had produced receipts and accounting entries which HMRC had rejected as unsatisfactory evidence – particularly as there appeared to be a connection between the trader and some of the suppliers. The Tribunal

did not find evidence of payment convincing either, and dismissed the appeal on this matter as well.

First Tier Tribunal (TC01238): *Daytona Surf Ltd*

Another company had more success with a claim for input tax of some £1.2m in respect of invoices issued by traders who had subsequently deregistered. It appears that this was related to a missing trader fraud, although it related to a recycling business rather than mobile phones.

The decision contains a useful summary of the key question of who has to prove what:

"*The burden of proof, on the balance of probabilities, shifts according to whether the supplies in question are supported by valid invoices or not. If there is a valid invoice then it is for HMRC to prove that the supplies did not take place as described on the invoice; in this case the Tribunal has an appellate jurisdiction, (i.e) its decision as to whether the supplies took place would determine the appeal. If there is no valid invoice the London Wiper must prove that the taxable supplies took place and the HMRC have acted unreasonably in refusing to accept that there was sufficient evidence to establish those supplies took place; in this case the Tribunal has a supervisory jurisdiction (i.e) it must go onto decide whether HMRC were reasonable in deciding that there was insufficient evidence to support the claim for input tax.*"

The Tribunal had to decide whether the disputed supplies had actually taken place. The appellant accepted that the invoices were not valid because the addresses were out of date, they did not carry a tax point date, and the companies concerned had been deregistered by the time the purchases were supposed to have been made. The companies were under investigation at the time by HMRC.

The Tribunal examined the evidence in detail and concluded that the goods existed and had actually been supplied and paid for. HMRC had accepted earlier invoices which were in the same format as the disputed ones, and had no satisfactory and convincing reason for rejecting this claim when earlier claims had been paid. The decision to refuse to accept the combined evidence of invoices, weighbridge certificates and other documentation was therefore unreasonable, and the appeal was allowed in accordance with the supervisory jurisdiction referred to in the passage above. HMRC were directed to review the evidence again, which presumably means that another officer could come to the same decision, but will have to produce better reasons for doing so.

First Tier Tribunal (TC01298): *London Wiper Company Ltd*

5.8.2 Mailing lists

A company purchased mailing lists which it used to make onward supplies of fundraising "direct mail packs" to charities. HMRC denied an input tax deduction on the cost, but admitted that its real objection lay in the belief that the onward supply to the charities was a separate taxable supply of services rather than part of a single zero-rated supply of printed matter.

As HMRC accepted that there was no legal basis for the denial of input tax, the Tribunal formally allowed the appeal. The appellant was invited

to make representations about a costs order, which presumably would depend on "unreasonable conduct".

First Tier Tribunal (TC01387): *Different Kettle Ltd*

5.8.3 Carousels

HMRC disallowed input tax in relation to mobile phone transactions in 03/06, 04/06 and 06/06 amounting to £15.25m. After 463 paragraphs of exhaustive examination of the transactions, due diligence procedures, customers and legal arguments about the way HMRC had presented their case, the chairman states that the Tribunal's task is "simply" to determine in respect of the disputed transactions:

(1) Was there a VAT loss?

(2) If so was it occasioned by fraud?

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

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

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

First Tier Tribunal (TC01248): *Edgeskill Ltd*

Another appellant was only arguing about £364,000, unusually starting earlier (01/06 – 05/06) and concerning CPUs rather than mobile phones. The decision follows a similar pattern of examination, and comes to the same conclusion: there was no commercial reason for the company to be approached to enter into these deals, and the only credible explanation – which should have been obvious to the parties at the time – was that it was assisting in a fraud.

First Tier Tribunal (TC01374): *Manatlantic Ltd*

Another trader also suffered defeat in relation to £614,000 of input tax, also in relation to CPUs.

First Tier Tribunal (TC01376): *Fusion Electronics Ltd*

Another case begins with the surprising statement "*This was a relatively simple MTIC appeal in which the Appellant appealed against the denial of an input refund claim of £644,043.75 in the return for its 3-month VAT period ending on 31 May 2006*". The decision still runs to 131 paragraphs, but that is perhaps "relatively simple".

The conclusion on "means of knowing" is a useful summary:

We conclude that Mr. Rasul's expectations were not only too good to be true. If they were genuine, which we do not believe, then they reflect an embarrassing naivety in relation to elementary business logic. The reality must be that if you are offered deals on a plate by a supplier, and you can

make 7% or 10% profit margins on deals in relation to stock that you never see, stock about which you know nothing, and stock in relation to which you do nothing (other than contribute to various transport, inspection and other costs) all on a nil credit risk basis, then that deal must be too good to be true, and therefore must be connected to fraud.

First Tier Tribunal (TC01367): *Business Management Concepts Ltd*

A rare success for a MTIC appellant related to £343,000 of input tax for the months to 06/06, 07/06 and 09/06. The company had a long history of trading in various goods (it was incorporated in 1959) and had been involved in trading in mobile phones, among other things, from 1997 onwards. It was not a company which had been set up for the purpose or which had come from nowhere to make a massive turnover.

The Tribunal decided that there was insufficient evidence to link two of the deals to fraud, and – although the question was finely balanced – also insufficient evidence to conclude that there was no other reasonable explanation for the transactions than fraud. The appeal was allowed.

First Tier Tribunal (TC01302): *The Hira Company Ltd*

5.8.4 Fuel advisory rates

The fuel-only advisory mileage rates have in recent times changed twice a year, but after changes in March and June, HMRC have announced another revision to operate from 1 September. As the only change appears to be a 1p reduction in the rate for one of the bands for LPG cars, it is not clear why they bothered.

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

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

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

* 1400cc up to 31 May 2011

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

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

6. ADMINISTRATION AND PENALTIES

6.1 Group registration

Nothing to report.

6.2 Other registration rules

6.2.1 Wrong direction

HMRC issued a "business splitting direction" under para.1A Sch.1 VATA 1994 in respect of:

- a bed and breakfast business run as a sole trade by a farmer's wife;
- a farming partnership carried on by the husband, the wife and their son.

The Tribunal noted that its jurisdiction was supervisory: it could only overturn the direction if it was satisfied that it had been unreasonably made. The Tribunal therefore had to examine the reasons HMRC gave for concluding that there were close financial, economic and organisational links between the businesses:

(1) The farm pays for electricity used by the farm and the B&B

(2) The farm pays for domestic fuel used by the farm and the B&B

(3) The farm pays the rates bill

(4) The single telephone line used by the farm and the B&B is paid for by the farm

(5) The farm pays for the insurance

(6) There are no cross-charges between the two businesses for rent or a share of utility or other bills

(7) The B&B operates from the farmhouse using three bedrooms as guest accommodation

(8) The farmhouse kitchen is shared by the farm and the B&B which is used to cook and serve breakfasts for the guests. It is also used for the domestic use of the appellants

(9) The B&B operation is too small to be viable without use of the farmhouse. The B&B does not have premises of its own and is dependent on the use of the farmhouse. If it had to rent a farmhouse in its own right, then the business would not be viable.

(10) Advertising on the internet for the B&B show the name "Parsonage Farm Bed and Breakfast". The accommodation binds itself to the farm and depends upon the farm for its appeal.

The appellants argued that para.1A has to be considered before the linkage between the businesses. If the operations have not been "artificially separated", it does not matter whether there are financial, economic and organisational ties between them – a direction cannot be sustained. The Tribunal did not accept this, interpreting the words "in

determining whether ... any separation ... is artificial, regard shall be had ...” as indicating that the linkage is part of the decision on artificial separation, not a subsequent step.

The issue therefore depended on whether the two businesses were independent operations dealing with each other at arm’s length. Crucially, the officer’s visit notes listed the factors he had considered when inspecting the operations, and the majority of factors was either against a direction or neutral. This list will be of interest to other similar businesses which are at risk of a similar visit:

	Factor	Weight given by Mr Taylor
i	B&B run from farmhouse by Mrs Forster with 3 bedrooms as guest rooms	In favour of direction – premises used both for farm and B&B
ii	Mrs Forster has own records, bank account, and annual accounts, and considers the B&B to be her own separate business which she has operated since the 1970s	Against direction
iii	Mrs Forster takes bookings, cooks the breakfasts, and cleans the rooms herself with the help of a part-time cleaner that is paid for by the B&B	Against direction
iv	In the case of absence or illness, bookings are cancelled	Against direction
v	Mr Forster plays no part in the B&B	Against direction
vi	The current turnover of the B&B business is about Â£8000 which Mrs Forster does not intend to expand as she is 67 yrs old	Neutral
vii	There has been no DEFRA grant	Neutral
viii	The only refurbishment costs have been a new carpet which was bought by the B&B	Against direction
ix	The kitchen is shared for domestic use and for cooking and serving breakfasts for the guests	In favour of direction- because of shared use of kitchen
x	Direct costs of B&B such as furnishings, part-time cleaner, food and cleaning materials are all paid for by the B&B	Against direction
xi	Mrs Forster is responsible for any profits or losses of the B&B and declares the income on her own tax return	Against direction
xii	The farm pays for rates, domestic fuel, electricity, insurance and phone	In favour of direction
xiii	There are no cross-charges from the farm to the B&B for rent or a share of the utility bills	In favour of direction

xiv	John has nothing to do with the B&B which he understands is run by his mother	Neutral

The failure to recharge the costs of operating the business could be damaging, but the appellant argued that these costs were reflected in a disallowance of private expenditure in the partnership accounts. This disallowance was charged to Mr Forster's drawings account rather than Mrs Forster's, but that was not relevant: it was Mr Forster, not the firm, who was supporting the bed and breakfast operation.

The Tribunal also considered that it was very important that the bed and breakfast operation had been started in 1975 when Mr Forster's parents had been the main partners in the farming business. This was not taken into account by the officer. Insufficient weight had been given to the fact that Mrs Forster ran the business herself, separately from the farm, keeping her own accounts and records. There were insufficient links to justify the direction, and it had not been reasonably made.

First Tier Tribunal (TC01319): *Forster and others*

6.2.2 Compulsory registration

An individual commenced to trade as a retailer from October 1997. She submitted income tax returns that showed turnover above the registration threshold. When HMRC finally picked this up in 2009, they issued a backdated notice of compulsory registration with effect from January 2002, assessments to collect the unpaid VAT (£21,000), and a belated notification penalty. The VAT was calculated using the FRS percentage. Following correspondence, the assessment was reduced to £9,365, and the penalty to 15% of that.

It appeared that the trader was confused about the difference between profits subject to income tax and turnover which might trigger a liability to VAT. She argued that her profit had been very low, which was irrelevant. It was difficult for her to establish any figures to displace those used by HMRC because she had retired and destroyed her records. Because she had not submitted a VAT return, she was not entitled to dispute the amount of the assessment; and the Tribunal agreed with HMRC that the self-assessment returns showed that she should have been registered for VAT from 1 January 2002.

The Tribunal cancelled the penalty – presumably, but not explicitly, as an act of mitigation under s.70 VATA 1994. The delay in contacting the trader until 3 years after she had closed her business was unreasonable and unjustified.

First Tier Tribunal (TC01314): *Susan Evans*

6.2.3 Exception from registration

In June 2009 a trader was issued with a notice of compulsory registration to take effect from 1 December 2007. He appealed, arguing that he should be eligible for exception from registration on the basis that his taxable turnover for the year following registration would not exceed the deregistration threshold.

The trader had gone into semi-retirement in June 2007, retaining only a small part of the family business to keep him occupied – the renting of

dehumidifiers. His attempt to retire coincided with catastrophic local flooding, and his expected turnover of £30,000 – £40,000 turned out to be over £300,000 for the year to 31 March 2008. His accountants had asked for exception from registration in August 2007, but after seeing the annual accounts they wrote to HMRC again for a further ruling. HMRC ruled that he was liable for registration under the "forward look", which does not have an exception.

The Tribunal examined the precedent cases on exception from registration, in particular *Gray v HMRC*, and also the correspondence which showed the basis on which HMRC had taken their decision. It could not be said that the decision had been unreasonably made, so the appeal could not succeed.

First Tier Tribunal (TC01292): *Roy Victor Evans t/a Britannia Services*

6.2.4 Voluntary registration

Two individuals incorporated a UK company which was intended to purchase second-hand cars in Spain and sell them to customers in other EU countries (although not the UK). The company applied for VAT registration in the UK, which HMRC refused, arguing that it did not intend to carry on a business here.

The purpose of the UK registration appears to have been to take advantage of triangulation. If a Spanish company had been used, the Spanish sellers of the cars (e.g. leasing companies) would have had to charge Spanish VAT, which would have had to be recovered later. To improve cash flow, the traders preferred to make a zero-rated despatch possible.

HMRC argued that there was no objective evidence of an intention to trade at all. The director, who was a retired accountant (described as a man of total integrity by the Tribunal), explained that it was difficult to start to trade – or even to take preliminary steps – without the VAT registration that was the whole basis of the business.

The Tribunal sympathised with HMRC's concerns about MTIC fraud, but concluded that they were misplaced here. It was satisfied with the director's evidence of an intention to trade, and the business was therefore entitled to registration under Sch.1 para.10(2) VATA 1994.

First Tier Tribunal (TC01315): *Car Factors Ltd*

6.2.5 Cancellation of registration

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

The Tribunal considered that the direction to cancel the registration was not valid. Sch.1 para.13 VATA 1994 requires a cancellation to be from the time when the trader ceased to be registrable, or such later time as is agreed between HMRC and the trader. As no later date had been agreed, the direction to cancel could only be backdated to the time that HMRC concluded the trade had ceased. If a current date was used, it had to be

shown that the trader was not currently entitled or required to be registered; the Tribunal was satisfied that the current building project amounted to economic activity, and the direction to cancel the registration was therefore invalid.

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

First Tier Tribunal (TC01320): *Gardner & Co*

Another company was deregistered by HMRC after the director cancelled an initial meeting to inspect the company's records. Answers to enquiries by telephone had been vague and evasive, and the director did not turn up to the hearing. The Tribunal accepted that HMRC had good reasons for grave misgivings about the company, and was entitled to cancel its registration from the outset.

First Tier Tribunal (TC01289): *System Fabricators Ltd*

6.2.6 Campaign to find the unregistered

The campaign to find unregistered traders, announced on 20 May, was strengthened by an offer of reduced penalties if traders notified HMRC of their liability to register by 30 September. The offer was phrased as follows:

"*If they make a full disclosure, most face a low penalty rate of 10 per cent on VAT that has been paid late. They will also be invited to disclose any other tax arrears. Where they have to pay a penalty on undeclared tax other than VAT, this will be lower than the customary penalty of up to 100 per cent charged to those who fall outside the opportunity.*"

HMRC said they would send out 40,000 letters to invite people to come forward – presumably to those who they thought might have something to confess – with the implication that higher penalties would be due if the offer was not taken up in good time. The announcement states that voluntary disclosures following earlier campaigns have yielded £500m, with another £100m coming from follow-up activity afterwards.

NAT 60/11; www.hmrc.gov.uk/ris/hmrc-campaigns.htm

A follow-up press-release reminded business to come forward by the deadline to enjoy the offer of reduced penalties, and added that "Target sectors include: construction, business services, hair and beauty, hotels and catering, retail distribution, recreational services, motor vehicle distribution and repair, sanitary and domestic services, agriculture and horticulture, property and road haulage".

NAT 70/11

Meanwhile, the "plumbers' safe tax plan" expired on 31 August – plumbers had to register with HMRC by that date to benefit from the offer of lower penalties for all taxes.

NAT 65/11; www.hmrc.gov.uk/plumberstaxsafeplan

HMRC do not appear to have waited for the end of August before moving against those plumbers who have not taken advantage of the plan. Five have been arrested and around 600 are under civil investigation for failing to pay the right amount of tax. Some of those involved owe up to £150,000.

NAT 68/11

6.2.7 Updated VAT 1 notes

The online notes which help with the completion of the registration form have been updated.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ShowContent&id=HMCE_PROD1_026388&propertyType=document

6.3 Payments and returns

6.3.1 FRS notice

HMRC have issued a new version of Notice 733 *Flat rate scheme for small businesses*. The main change of substance is to recognise that bank interest no longer needs to be included in FRS turnover as consideration for an exempt supply, in recognition of the FTT decision in *FanField Ltd/Thexton Training Ltd* (TC00919).

The new wording does not seek to make the distinction drawn by Sir Stephen Oliver between bank interest that could represent economic activity (an extension of a core activity) and bank interest that is a "mere satellite activity". It therefore appears that no FRS business needs to include any bank interest on the VAT return, whatever the circumstances. The Notice does not have the force of law, but it is an explicit statement and a trader can surely rely on it.

Notice 733

There is an explanation in VAT Notes:

In the Tribunal cases of Thexton Training Limited and Fanfield Limited, the ruling was that where the receipt of bank interest is derived from the taxable activity of a business:

- *such interest is a relevant supply for the purposes of the FRS*

Conversely, where the receipt of bank interest is not a direct result of the taxable activity of a business:

- *such interest falls outside the scope of VAT and is not a relevant supply*

This gives rise to the potentially confusing situation where FRS users will need to determine whether or not to include bank interest in their flat rate turnover.

Therefore HMRC has decided that, for simplification purposes, all FRS users can exclude interest from their flat rate turnover.

VAT Notes 3/2011

6.3.2 FRS query

A Reader's Query in *Taxation* asked whether a FRS trader could recover input tax where two computers were purchased for more than £2,000 in total, but one was subsequently returned because it was faulty. The answers disagreed over whether an adjustment needed to be made.

Taxation 7 July 2011

6.3.3 Digital by default

HMRC have issued a consultation to discuss the move to requiring all traders to file their returns and make most other communications with HMRC online, including registration for all major taxes. There are two documents, one concentrating on moving VAT services online and the other consulting about HMRC services in general.

Businesses with a turnover below £100,000 will be required to file electronically for return periods starting on or after 1 April 2012, but they will not suffer penalties for any return period ending up to 31 March 2013. There are exemptions for two categories: VAT registered businesses that are subject to an insolvency procedure or that are run by people who are practising members of a religious group whose beliefs are incompatible with the use of computers.

Registration, deregistration and variations of registration will also move online.

http://tinyurl.com/3hxd72b; Tax information and impact note 8 August 2011; consultations on www.hmrc.gov.uk

This is discussed in an article in *Taxation*.

Taxation 25 August 2011

6.4 Repayment claims

6.4.1 Timing of claim

A motor dealer made a *Fleming* claim on 13 March 2009 in respect of overpaid output tax of £51,000 on demonstrator and courtesy cars for the period 1985 to 1996. After an exchange of correspondence between the parties, the claim was settled, plus £60,000 of statutory interest, notified to the appellant by HMRC in a letter of 29 April 2009.

At the last minute (30 March 2009), the company accountant wrote to HMRC to add a further claim for £20,000 in respect of another company which had been separately VAT-registered within the group but which had not existed for some time. As with most such "Italian Republic" claims, it was made on an estimated basis which had been agreed between the industry and HMRC.

The Tribunal held that a claim for a separate VAT registration was possible in principle, but it would be a separate claim rather than an amendment of the existing one. In that case, more details would have been required to make the claim valid within the time limit – in particular, the obsolete VAT number was needed, and this was not available to the accountant on 30 March 2009. The additional claim was out of time.

First Tier Tribunal (TC01261): *Wilsons of Rathkenny Ltd*

6.4.2 Accounting problem

A company discovered a problem with its accounting software: invoices which were received in the last quarter of its accounting period but not paid until the following quarter were not picked up for input tax claims. It therefore consistently overpaid VAT for the first quarter of each period. This was not picked up by the company's accountants or by HMRC visiting officers. The company claimed repayments going back to 03/00, and HMRC applied the cap to the first 6 periods concerned.

The Tribunal agreed with HMRC that it had no discretion to alter the cap and it applied as stated. The appeal was dismissed.

It is interesting that the claim was received by HMRC on 4 May 2010 in an undated letter; HMRC allowed the claim in respect of 03/06. The cap for an input tax claim runs from the due date for filing the return concerned, so HMRC were generous in assuming that the claim had been "made" by 30 April 2010.

First Tier Tribunal (TC01386): *GF Mercer Ltd*

6.4.3 Bingo calculations

In 2007 HMRC issued Business Brief 07/07 to announce a change in their policy on how bingo clubs should calculate the VAT due (from "game by game" basis to "session" basis). A club decided that it had overpaid VAT from 1996 onwards and submitted a claim in December 2009. This would ordinarily be capped, but the club issued an internal credit note and claimed that the adjustment was within reg.38 SI 1995/2518, which does not have a time limit.

The company's argument was that the new policy changed the apportionment between the VATable and exempt proportions of payments by bingo players – the participation fee and the stake money. The consideration for the VATable element had reduced, so the VAT should also reduce. The Tribunal considered this in detail, examining a number of precedent cases such as *Glawe Spiel*, and concluded that the company was right. The appeal was allowed.

First Tier Tribunal (TC01389): *Carlton Clubs plc*

6.4.4 Unjust enrichment considered by CJEU

The CJEU has considered the concept of unjust enrichment in a case which concerned a levy which was found to be unlawful. The principles may be relevant to VAT disputes as well.

Denmark levied a tax which was held to be contrary to art.33 6th Directive. A number of companies claimed compensation for the illegally collected tax. The Danish authorities argued that the introduction of the illegal levy had led to the abolition of some other social security contributions that the companies would otherwise have paid, so they would be "unjustly enriched" by a repayment of the levy.

The court commented that unjust enrichment only applies where a wrongly collected tax has been directly passed on to the purchaser. Even then, the trader may argue that it has suffered because of a fall in the volume of sales, so the repayment is not a windfall. In this case, the levy had been built into the selling price of goods, but that did not mean it had been directly passed on; and the cancellation of other taxes was too loosely connected to negate a right of repayment. The reduction in another tax could not be regarded as making the rightful repayment of the levy "unjust".

CJEU (Case 398/09): *Lady & Kid A/S, Direct Nyt ApS, A/S Harald Nyborg Isenkram- og Sportsforretning and KID-Holding A/S v Skatteministeriet*

6.4.5 Different limitation periods

The Advocate-General has considered the problems for the general VAT principles of effectiveness, non-discrimination and tax neutrality if there is a significant difference between the time limits within which a customer can claim back overpaid VAT from a supplier (in the UK, generally six years) and a supplier can claim back the same overpayment from the authorities (in the UK, four years). The Italian law has a similar discrepancy in the time limits and provides no mechanism for resolving the unfairness that might arise if a customer obtained a court order requiring reimbursement from a supplier who would then be out of pocket.

The Advocate General considered that such a situation can comply with EU law provided that the national law is applied in accordance with the principles of legal certainty, the protection of legitimate expectations, and the respect for property rights. It is not clear what this means in practice, given that the supplier would be unable to protect himself.

CJEU (A-G) (Case C-427/10): *Banca Antoniana Popolare Veneta SPA v Ministero dell'Economia e delle Finanze*

6.5 Timing issues

6.5.1 Deposits

A Readers' Query in *Taxation* raises the treatment of deposits for the supply of goods, received while a trader is registered, where the goods are delivered after deregistration. The query suggests that the case of *B J Rice & Associates* is authority for the proposition that the receipt of a deposit can only determine when, but not whether, a transaction is taxable, so these deposits should be reversed on deregistration. Both respondents question whether *Rice* is applicable; it seems very likely that HMRC would distinguish it on the grounds that it concerns services not goods, and registration rather than deregistration. Such a contention would therefore be likely to require an argument before the Tribunal.

Taxation 29 September 2011

6.6 Records

6.6.1 Corrections notice

HMRC have issued a new version of Notice 700/45 *How to correct VAT errors and make adjustments or claims*. It replaces the July 2010 version, but does not have a "what's changed?" summary.

Notice 700/45

6.6.2 Change of policy on liability

HMRC have announced the withdrawal of the policy announced in Business Brief 28/04 with effect from 1 August 2011. This stated that taxpayers would not usually be required to register in respect of previous supplies they had treated as exempt based on HMRC's interpretation of the law at the time of supply.

For example, if a court rules that supplies previously regarded by HMRC as exempt were, and had always been, liable to VAT, HMRC would not under the previous policy require businesses affected by such rulings to register for VAT in relation to taxable supplies they made prior to the court decision.

The withdrawal of this policy is related to the withdrawal of ESC 3.5 (the "Sheldon concession") with effect from 1 April 2009. The Brief is not entirely clear on the consequences; the implication appears to be that traders will still be able to rely on guidance given on liability by HMRC, but in the circumstances envisaged by the post-April 2009 policy rather than ESC 3.5 which applied when BB 28/04 was issued.

R & C Brief 24/2011

6.7 Assessments

6.7.1 Campaign on fast food

Separate from the campaign to find unregistered traders, HMRC have announced the launch of another “taskforce” to tackle VAT abuse in London’s fast food outlets. The target is any business which deliberately understates its sales to evade tax. It is not clear what is particularly new about this approach, which is familiar from years of Tribunal cases about underdeclarations by takeaway outlets, but this is part of the Government’s commitment to spend £900m on tax enforcement in the hope of raising £7bn.

NAT 61/11

6.7.2 Suppression

In TC00244, there was a dispute about the significance of the officers’ test meals in calculating underdeclared income of a restaurant. HMRC could not produce the receipts or expense claims to support the meals that they claimed their officers had eaten. The trader’s representative regarded this as “sinister”. He also raised a number of other arguments in defence, and introduced a professional statistician as an expert witness to attack HMRC’s use of just 2 dates as the basis for their extrapolation. However, none of the restaurant’s management or staff gave evidence.

The First-Tier Tribunal examined the various arguments and dismissed them all. As the burden of proof was on the appellant to show that the assessment was not to the best of the officers’ judgement, an absence of any evidence from the staff – once there was an indication of suppression – made it difficult to support any other figure than that which HMRC had produced. The basis of that figure was logical and had not been directly undermined by alternative suggestions. The appeal was dismissed.

The taxpayer appealed to the Upper Tribunal, contending that the FTT had erred in law in “ignoring” the expert evidence of the statistician. The judge dismissed the appeal, holding that the evidence had not been ignored – it had been considered and rejected. The FTT was entitled to come to the conclusion that the assessment had been raised to best judgement, even on limited evidence and extrapolation, where there was an initial finding that the trader’s records were unreliable.

Upper Tribunal: *Queenspice Ltd v HMRC*

6.8 Penalties and appeals

6.8.1 Default surcharges

There has been a deluge of appeals about default surcharge, probably reflecting the difficult economic conditions faced by traders. Bear in mind that a trader who has agreed a time to pay arrangement is not subject to default surcharges; HMRC can rightly say that they will help those who plan ahead. In the majority of cases, HMRC win these appeals – although not in every one.

Unsuccessful appeals

A trader argued that the surcharge liability notice was unclear – he had rung the National Advice Service to try to clarify what it was about, but was still confused. He thought that "default" had the meaning of "default setting on a computer".

He was also in the unfortunate position of incurring his first actual surcharge at the 10% level, because earlier surcharges had been below £400. The Tribunal adjourned to await an appeal in the *Enersys* case before considering whether the surcharge was disproportionate. When HMRC did not pursue that appeal, the Tribunal reconvened and went through the tests of disproportionality that had been set out in *Kaisen Search Ltd*:

- The gravity of the default, in particular to what extent the taxpayer was at fault;
- How long the VAT was outstanding;
- The amount of the surcharge relative to the wealth of the defaulter.

None of these criteria suggested that the penalty was unfair. The Tribunal also considered whether the fact that the turnover for the quarter in question was higher than normal, resulting in a higher penalty, made the penalty unduly harsh. It concluded that it did not, and the surcharge was confirmed.

First Tier Tribunal (TC01254): *Neshama Music Ltd*

A trader suffered a surcharge of £3,000 at the 5% rate after two late payments and one late return. There were a number of factors which might have contributed to a reasonable excuse (change of address leading to SLNs going astray, difficulties with online payments) or the defence of posting the return on time knocking out one of the earlier defaults. However, insufficient evidence of any of these matters was placed before the Tribunal, which could therefore not find any excuse. The surcharge was also not considered disproportionate, being some 1% of turnover.

First Tier Tribunal (TC01266): *Impossible TV Ltd*

Another trader suffered his first default surcharge (£676) at the 10% rate for the usual reason, that previous surcharges were too small to be collected. His excuse amounted to a belief that the due date for submission of EC Sales Lists was also the due date for payment of VAT; even if that was accepted, his payment arrived a day after that, and the surcharge was confirmed.

First Tier Tribunal (TC01274): *W Oswald*

A trader suffered a 5% surcharge amounting to £1,400. The excuses offered included a "surprise" holiday for the bookkeeper, confusion between the due dates for VAT and PAYE, and non-receipt of the notification of earlier defaults. The chairman did not accept that the directors could have been unaware of their defaults, as there was evidence of negotiation of payment terms; and the bookkeeper was in the office on the day the cheque should have been sent – the surprise holiday came later. The appeal was dismissed.

First Tier Tribunal (TC01273): *Grant Vehicle Repairs Ltd*

A trader's appeal against a surcharge was dismissed in his absence. He successfully applied to have that decision set aside, and was granted two postponements of further hearing dates. When he failed to turn up to the next hearing, the Tribunal decided to hear the case in his absence again.

The chairman noted that the appellant had incurred more than 50 surcharges between 1992 and 2007. In connection with the current appeal against surcharges for three periods, the trader had offered only one thing that could possibly constitute an excuse: financial difficulties created by HMRC putting the tenant of a rental property into liquidation. The Tribunal could find no connection between this event and the defaults. Without evidence of cause, the appeal could not succeed.

First Tier Tribunal (TC01241): *Graham Roth t/a Phillips Roth & Co*

An employment agency, specialising in unskilled farm labourers, defaulted five times. It appealed against the surcharges and accompanying extension notices for the third, fourth and fifth of these. The company had assumed throughout that BACS transfers would reach HMRC immediately, and had ignored warnings about the need to make sure the money arrived by Friday where the due date was on a weekend. The Tribunal dismissed the appeal.

First Tier Tribunal (TC01239): *CV Staff Services Ltd*

A trader argued that it had been unable to pay its VAT on time because of a delay in receiving money from Essex County Council, whose accounts department closed for six weeks in the summer. The Tribunal found that the invoice to the council was raised after the quarter concerned – the business should have put aside money from other customers to pay the VAT as it fell due, and should not have relied on the proceeds of a later sale. Even if the shortage of funds for this reason could have been a reasonable excuse, the trader had left it very late to send out the invoice; it should have been realised that a time to pay agreement was needed. The appeal was dismissed.

First Tier Tribunal (TC01369): *Fury Design Consultants*

A trader had been warned several times about the transmission times for bank transfers, so the Tribunal had little sympathy with his attempt to pay by electronic transfer on Sunday 6 February – the payment arrived on 9 February and a 15% surcharge was imposed. Previous surcharges had been waived; in the circumstances, a penalty of £1,000 was not considered "plainly unfair" or disproportionate. His appeal was dismissed.

First Tier Tribunal (TC01370): *Pound Road Stores Ltd*

A subsidiary of a German company fell into the surcharge regime and suffered a surcharge when it submitted a return and applied to pay the tax by direct debit. Normally 10 days are allowed for payment by DD, but the return was submitted too late for HMRC to process the application in time. As a result, the payment arrived late and a surcharge at 5% (later reduced to 2% after an earlier surcharge was "forgiven") was levied. The company appealed against the charge (£8,700 at 2%).

The excuse offered was mainly the difficulty of understanding the payment instructions and default surcharge warnings for someone who was not a native English speaker. The senior management wanted to comply but they had been confused.

The Tribunal did not accept that this could be a reasonable excuse. The company was aware that there was a problem, but failed to consult its UK accountants to help resolve it. The appeal was dismissed.

First Tier Tribunal (TC01356): *Feldbinder (UK) Ltd*

A company mistakenly believed that it had a "time to pay" arrangement in place. There was no other reason for the payment to be late, and a 5% surcharge of £1,490 was confirmed.

First Tier Tribunal (TC01348): *Amber Valley Developments Ltd*

A company appealed against successive default surcharges for six periods. It appeared that the main excuse offered was a misunderstanding by the director about the due date for making electronic payments. He also argued that the surcharges (all at 15%) were an "excessive interest charge". The Tribunal did not consider any of this to be a reasonable excuse, and did not think that the "disproportionate" defence applied.

First Tier Tribunal (TC01349): *Intabase Solutions Ltd*

A large company was 11 days late paying a payment on account, and was charged a 2% surcharge of £50,000.

It appeared that an earlier payment was 4 days late because of staff absence due to sickness, so the company entered the surcharge regime from 1 October 2009. As part of an internal investigation into why this had happened, the VAT manager noted that the POA were higher than they needed to be and applied for them to be reduced. This was done, but for some reason the new schedule of POA that should have applied from the end of May 2010 was not picked up by the finance department. The failure to pay any VAT was only noticed after preparation of the management accounts in early June, and so the payment of some £2.5m was 11 days late.

The VAT manager suggested that the conclusion had to be the same as the judge reached in *Enersys*: "no court or tribunal, with the power outlined by Judge Bishopp, would impose a £50,000 penalty on the Appellant in this case". The chairman distinguished the present situation on the grounds that the delay was longer. While the penalty might be very harsh for an inadvertent error of this type, it was not so plainly unfair where the delay was 11 days rather than a single day.

First Tier Tribunal (TC01302): *Saint-Gobain Building Distribution Ltd*

Another taxpayer appeared to have misunderstood the required payment date for electronic transfers, but the issue of earlier surcharges and notices should have drawn his attention to the problem. Although the company was not represented and had not raised the argument, the Tribunal considered the "disproportional" point anyway, and decided that the surcharge at 5% was not unduly harsh.

It was noted that an earlier surcharge of £409.70 should have been levied at 2% rather than 5% (and therefore not levied at all); HMRC had raised the percentage when only the return had been late, not the payment. HMRC's representative undertook to make sure that the surcharge (which had been paid) would be refunded to the taxpayer.

First Tier Tribunal (TC01316): *Preferred Refrigeration Ltd*

Another appellant had a surcharge reduced from 5% to 2% on review, but the Tribunal could find no excuse for the default and did not consider the penalty of £699 unduly harsh. The company had paid its VAT liability of £34,967.10 in four instalments on 8, 9, 13 and 15 September, mainly because the bank would not process electronic payments of more than £10,000 on any day.

The Tribunal noted that it had not occurred to the director to make a payment by CHAPS, which would have resulted in the payment being on time. He had also preferred to pay his suppliers before HMRC. There was no reasonable excuse.

The director referred to the ECJ decision in *Louloudakis* (C-262/99) as well as *Enersys*. That was about a customs duty penalty, but the Tribunal agreed it was relevant: "*it seems to us that its relevance is that it makes plain that the test to be applied is whether a particular penalty provision goes beyond what is necessary, and that in determining whether a particular penalty is necessary to achieve an objective the gravity of the default is a relevant consideration to be weighed against the object of the measure.*" Taking that into account, and working through the steps applied in *Enersys*, the Tribunal decided that the penalty "bore heavily" on the appellant but was not wholly unfair.

First Tier Tribunal (TC01300): *Blue Forest (UK) Ltd*

Successful appeals

The first trader since *Enersys* to succeed with the "disproportionate" argument may force HMRC to address the issue again. Their failure to appeal *Enersys* to the Upper Tribunal may have been based on the belief that the circumstances were so particular that the decision would not be repeated; the argument has been put forward in many of the appeals about surcharges since, but has not up to now been accepted.

The company had been brought within the surcharge regime by two occasions on which it filed its VAT returns and subsequently made small adjustments to the figures, disclosed to HMRC, which resulted in additional payments (£476 added to £125,000 for 05/08; £331 added to £108,000 for 11/08). These were logged as defaults because not all the VAT due had been paid; this led to the issue of a SLN and the raising of the percentage from 2% to 5%, but no surcharge on such small amounts. These appeared to have arisen from an unsatisfactory accounting system which had subsequently been replaced.

The company was then a day late paying £85,000 for 07/09, and was charged a surcharge at 5% of £4,260. Judge Redston was careful to explain why she chose to follow *Enersys* and not the other decisions:

In coming to our conclusion we noted in particular the lack of correlation between the single day of delay and the quantum of the penalty; the relationship between that quantum and the Company's profits; the sudden jump in surcharge from zero to over £4,000 and the Company's generally good compliance record both before and since this default period. We also considered it relevant that, in the first two default periods, over 99.5% of the amounts due had been paid on time.

The appeal was allowed on the basis of disproportionality and the surcharge was cancelled in its entirety.

First Tier Tribunal (TC01341): *Total Technology (Engineering) Ltd*

An appeal against an income tax surcharge is not directly relevant to VAT, but the argument that the taxpayer used to succeed might be carried across to other taxes. Income tax surcharges are due if the balancing payment for a tax year is not paid 28 days after the due date (31 January following the tax year) and a further surcharge is levied on any outstanding amount after 31 July following.

A trader succeeded in convincing the Tribunal that the *Steptoe* argument should be applied to his income tax payments. He had not received full payment from a company which had employed him, and this had caused such financial difficulties that he was unable to pay his tax. The Tribunal considered that this was a finely balanced question, but decided that these were circumstances beyond his control. It may have helped his case that HMRC did not bother to send a representative to the hearing, relying only on a written statement of case which pointed out that the onus was on the appellant to demonstrate a reasonable excuse. At the first hearing, the appellant told his story, but did not produce evidence that the Tribunal could rely on; he was then given an opportunity to return for a second hearing with the evidence, which the Tribunal found convincing.

First Tier Tribunal (TC01220): *Gary Knapper*

Another income tax surcharge was struck out on the basis that the taxpayer had reasonably assumed that his tax affairs were in order. He had told his accountants that he was receiving self-employed income in April 2007. The accountants informed HMRC in April 2008, but received no reply. When they finally submitted returns on his behalf for the tax years 2006/07 to 2009/10 in April 2010, HMRC imposed surcharges for 2007/08 and 2008/09. The taxpayer appealed, arguing that he had provided details to his accountants within the relevant time limits and he had reasonably assumed that his accountants would have dealt with the information in a timely manner.

"Reliance on another" is precluded from being a reasonable excuse for VAT purposes by s.71 VATA 1994, but there is no similar provision for income tax. The chairman followed an income tax precedent set by the Special Commissioners, *Rowland* (SCD 536), and found that the reliance on the accountants was a reasonable excuse.

First Tier Tribunal (TC01380): *S Rich*

A company changed its name in November 2008 and its address in August 2009. In spite of this, HMRC sent surcharge notices using the old name to the old address. The director of the company was in any case suffering from stress and was being assisted by the directors of a supplier, who had a floating charge over the assets of the company. The first they knew of a problem about surcharges was the arrival of bailiffs (at the new address) to levy distress on the assets for non-payment of the surcharges.

The Tribunal found that the company had tried to notify HMRC of its changed name and address and HMRC had failed to alter its records. The surcharge notices were therefore not validly issued to the taxpayer and the appeal against the surcharges was allowed.

First Tier Tribunal (TC01339): *DWS Environmental Ltd*

A company was partially successful with a surcharge appeal on similar grounds – it had moved, and HMRC appeared not to have amended their records in good time. One surcharge (levied before the change of address) was confirmed, as there was no reasonable excuse; the other surcharges were quashed, because the Tribunal was satisfied on the basis of the evidence that the company had not received the surcharge liability notices. It was strengthened in this conclusion by the fact that the office manager, who gave evidence under cross-examination, responded immediately to the last such notice to be issued – that was the reaction the Tribunal would have expected her to have had if she had received any of the others.

First Tier Tribunal (TC01296): *Mass Information Systems Ltd*

A business succeeded in persuading the Tribunal that its shortage of funds fell within the *Steptoe* principle and could therefore constitute a reasonable excuse. A combination of defaulting debtors and a bank unwilling to extend facilities constituted factors beyond the trader's control which led to the shortage. The appeal was allowed.

First Tier Tribunal (TC01279): *JMS Aggregate Supplies*

Another business was mainly successful with the same argument – it had a single customer on whom it was dependent and on whom it could not exert any pressure to pay bills quicker. HMRC accepted that two of five periods were covered by a reasonable excuse; the Tribunal accepted the same for another two, and confirmed the surcharge for just one period. In that period, the lateness appeared to be related to an illness of the company secretary rather than the shortage of funds; this illness was potentially serious but had been going on for some time, and did not have the unforeseen and uncontrollable nature of a reasonable excuse.

First Tier Tribunal (TC01385): *Paul Hoskins Ltd*

6.8.2 Appealing out of time

A sole trader received assessments in August 2000 in respect of accounting periods in 1997 and 1998. HMRC disallowed some £34,000 of input tax on the basis that the transactions were associated with fraud. The trader did not appeal at the time, and HMRC issued a statutory demand followed up with a bankruptcy petition. The trader was made bankrupt in February 2001.

The trader's agent asked for a review in May 2001. Even though this was out of time, HMRC agreed, and reduced the assessments by about half. However, they maintained that £17,000 of the input tax was not deductible. The trustee in bankruptcy settled this debt.

The trader's agent took up the case again in 2007, apparently having read of the decision in *Bond House/Optigen*. This suggested that the reasons given by HMRC for disallowing the input tax would not have been accepted by the CJEU, so the assessments were not valid. An appeal was finally lodged in March 2009.

The trader's representative put forward a number of reasons for the Tribunal to allow the appeal to proceed in spite of the admittedly inordinate delay of eight and a half years from the time limit in September 2000. The Tribunal considered that there were several different delays at different times, and the appeal appeared to have been entered into as a hopeful "afterthought" after reading about the CJEU decisions. The application to appeal out of time was dismissed.

First Tier Tribunal (TC01222): *DP Hyde t/a Pentagon Software*

A trader submitted VAT returns for three quarters in 2000 showing a substantial VAT liability. In 2010 he tried to adjust the returns to reduce that liability, and appealed against HMRC's decision to refuse an adjustment. HMRC successfully applied for the appeal to be summarily struck out on the grounds that it had no chance of succeeding. Whatever the substantive arguments about the true liabilities for those periods, reg.34 imposed a time limit for correcting them (at the time, three years) which had been exceeded by a lengthy period.

The trader was awarded "wasted costs" associated with attending an earlier Tribunal hearing when HMRC failed to turn up to support their own strike-out application, but did not as a result win his appeal.

First Tier Tribunal (TC01221): *Enviroengineering Ltd*

In December 2006, a company which operated gaming machines claimed a repayment of output tax following the *Linneweber* decision. HMRC refused the claim in January 2007, but the company did not appeal until July 2009, when it asked for the claim to be reconsidered following the *Rank* decision in the High Court. HMRC refused: this eventually led to a formal appeal in October 2010. The company applied to be allowed to appeal out of time.

HMRC's decision letter of 2007 did not refer to any time limit for making an appeal. The company claimed that it had understood its claim to be awaiting the outcome of the *Rank* litigation, and it had not understood the need to make a formal appeal. There had been some correspondence in 2009, including an e-mail from HMRC that the company had "missed", leading to further delay. It argued that, in the light of misunderstandings, it should be allowed to proceed.

The Tribunal decided that the failure to appeal had been deliberate both in early 2007 and in mid-2009. The application to proceed with the late 2010 appeal was dismissed.

First Tier Tribunal (TC01223): *Black Pearl Entertainments Ltd*

In a MTIC dispute, a company applied for leave to appeal out of time against a decision made in relation to input tax on one specific deal in its 04/06 return period. The company claimed that it had not received the decision letter, and only became aware that a decision had been taken while dealing with correspondence about another matter (the disallowance of input tax on another 16 deals in the same period).

The Tribunal weighed the various issues and dismissed the application. The only evidence to support the contention that the decision letter had not been received was a witness statement from a director who did not attend the hearing. This was not sufficiently clear about some of the details, and the Tribunal therefore did not accept that there was sufficient justification for the delay. It is not clear whether the application would have had more success if the director had attended and given evidence in person, or why he did not do so (to back up the opportunity to appeal about over £160,000 of input tax).

The remaining deals will go to a substantive appeal in due course.

First Tier Tribunal (TC01382): *Data Select Ltd*

6.8.3 Misdeclaration notice

HMRC have issued a new version of Notice 700/42 *Misdeclaration penalty and repeated misdeclaration*. It refers to the new system of penalties for errors that has applied since 1 April 2009, to make it clear that it only applies in relation to errors found which fall before that date.

Notice 700/42

6.8.4 Legitimate expectations

An article in *Taxation* discusses the use of the "legitimate expectations" argument in appeals, quoting a number of precedent cases in which it has succeeded or failed. The recent case of *Noor* was one in which the trader succeeded – the Advice Line had given the trader the impression that pre-registration VAT would be recoverable based on the EDR chosen, and the FTT held that HMRC had to honour that expectation.

Taxation 21 July 2011

6.8.5 Costs

In an income tax case, HMRC withdrew an assessment shortly before a hearing was due to take place. The appellants applied for costs, and these were awarded by the FTT on the basis that HMRC had acted "unreasonably in bringing, defending or conducting the proceedings". The taxpayers had prepared returns in accordance with HMRC guidance in respect of deceased Lloyd's names, and HMRC had not raised an enquiry within the appropriate statutory "window". They later tried to assess for more tax under the "discovery" provisions, but dropped the assessment and apologised for doing so at such a late stage. HMRC did not attend the costs hearing, and the judge said that he was as a result forced to rely almost entirely on the taxpayer's representative's account of what happened – but this seemed entirely credible, and it suggested that HMRC ought to pay the costs.

First Tier Tribunal (TC01318): *Atkins' Executors*

6.8.6 Information order

In another income tax case, HMRC issued a notice requiring the production of information under Sch.36 FA 2008. The case is mainly interesting because two such notices were objected to by the taxpayer's accountants and were withdrawn following the HMRC independent review procedure – the reviewing officer agreed that the notices did not meet all the conditions of the legislation. However, the third notice satisfied the Tribunal: it asked for statutory records which the trader is required to keep (and there is no right of appeal against a notice demanding production of the statutory records) and other information that was reasonably required for the purposes of the enquiry.

First Tier Tribunal (TC01312): *Wai Yan Chan*

6.8.7 Joining appeals

Two companies which were connected but not under common ownership had disputes with HMRC about carousel transactions. HMRC applied to have the appeals joined together because there was a substantial overlap in the evidence. The companies objected, presenting a long list of reasons why this would be prejudicial to their interests and also not helpful to the Tribunal (highlighting the separateness of the two cases). Judge Mosedale ruled that the appeals should be joined for the reasons put forward by HMRC; the taxpayer's representative announced that this decision would be appealed. Presumably the Upper Tribunal will have to consider whether to hear or to allow this appeal in due course before the substantive issues (which relate to about £2m in input tax for each company) can be examined.

First Tier Tribunal (TC01276): *First Talk Mobile Ltd*

6.9 Other administration issues

6.9.1 Mirrlees report

The Institute for Fiscal Studies commissioned a report by Sir James Mirrlees called "Tax by Design". It included the politically unlikely recommendation that VAT should be extended to almost all spending to remove inconsistencies. It also proposed an equivalent tax on financial services.

Other recommendations include the integration of income tax and NIC, total exemption from tax of standard bank and building society accounts, and taxation of dividends and capital gains at marginal income tax rates (less an allowance for corporation tax already paid).

www.ifs.org.uk/publications/5346

6.9.2 Annual reports

The annual report of the National Audit Office on HMRC's accounts has been published. It shows an increase in revenues from 2009/10 to 2010/11 of £33.1bn (7.6%). This includes a £13.2bn (17%) increase in VAT. This partly reflects an improving economic situation, but in relation to VAT also arises from the increases in rate on 1 January 2010 and 4 January 2011.

Comments were made by the Auditor and Comptroller General about a number of major challenges facing HMRC – settling tax disputes with large businesses, stabilising the administration of PAYE and reducing the cost of error and fraud in the tax credits system – but none of these relate specifically to VAT.

Press Notice 39/11;
http://www.nao.org.uk/publications/1012/hmrc_accounts_2010-11.aspx

The annual report of the HMRC Adjudicator has been published. It contains a number of interesting statistics and case studies about complaints made against the Department, but none of the details relate to VAT. It is not clear whether this means that the VAT part of HMRC has had a good year, or the cases did not make such interesting reading.

http://nds.coi.gov.uk/ImageLibrary/detail.aspx?MediaDetailsID=3985

6.9.3 Tax consultations

HMRC have published two new consultation documents:

- Civil Investigation of Fraud – Contractual Disclosure Facility – a discussion document which explores one option for toughening and tightening HMRC's approach to civil investigation of fraud through the concept of a contractual disclosure facility.
- Modernising Customs and Excise Law – a consultation on modernising the provisions of the Customs and Excise Management Act (CEMA) 1979 and other customs and excise law with a view to simplifying the legislation, closing the tax gap, removing burdens on business and strengthening the UK's borders.

HMRC have also published a discussion document about dealing with dishonest conduct by tax agents. This follows on from earlier consultations and draft legislation that was issued in February 2010. It summarises the changes made to the proposals after earlier consultations. A separate document summarises the responses to the consultations.

The Treasury's "tax consultation tracker" records the following consultations relevant to VAT as open at present:

VAT cost-sharing exemption	Consultation will continue on the options for implementing the VAT cost sharing exemption into UK legislation	Informal consultation Formal consultation	Ongoing Open for comment 28 June – 30 September
VAT grouping extra statutory concession	Consultation on how best to legislate for ESC 3.2.2 to ensure its effect is maintained. ESC 3.2.2 allows the value of an anti-avoidance tax charge required within UK VAT groups to be capped at the value of services purchased by an overseas VAT group member and recharged to the UK.	Formal consultation	Open for comment 10 May – 3 August
Machine games duty	Consultation on the design characteristics of Machine games duty.	Formal consultation	Open for comment 24 May – 26 July
Tackling VAT evasion on road vehicles brought into the UK	Consultation on a new on-line vehicle notification system to be introduced to combat VAT fraud on road vehicles brought into the UK for permanent use on UK roads. This is a joint HMRC-DVLA initiative	Formal consultation	Open for comment 31 May – 31 August
Digital by default	Consultation on how the Government will mandate use of the new online Registration Wizard for the main business taxes.	Formal consultation	Open for comment 8 August – 31 October
Simplification of regulatory penalties	Consultation on the range of penalties that HMRC can impose for failure to comply with regulatory obligations across the tax and duty regimes.	Formal consultation	Open for comment 17 June – 9 September
Working with Tax Agents: Dishonest conduct	Consultation on proposals allowing HMRC, with appropriate safeguards, to obtain the working papers of dishonest tax agents, penalise them and publish their details on the HMRC website	Informal consultation	Open for comment 14 July - 16 September

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

6.9.4 Arguing with HMRC

HMRC have published a new draft of their internal guidance to officers on the Litigation and Settlements Strategy (LSS). The introduction states that the LSS encourages HMRC staff to:

- *Minimise the scope for disputes and seek non-confrontational solutions;*
- *Base case selection and handling on what best closes the tax gap;*
- *Resolve tax disputes consistently with HMRC's considered view of the law;*
- *Subject to that, handle and resolve disputes cost effectively – based on the wider impact or value of cases across the tax system and across HMRC's customer base;*
- *Ensure that the revenue flows potentially involved make any dispute worthwhile;*
- *(in strong cases) settle for the full amount HMRC believes the Tribunal or Courts would determine, or otherwise litigate;*
- *(in 'all or nothing' cases) not split the difference;*
- *(in weak or non-worthwhile cases) concede rather than pursue.*

It is a useful document to consult for anyone who is contemplating entering into a potentially protracted argument with HMRC. It shows when they should fold and when they should dig in.

http://www.hmrc.gov.uk/practitioners/lss-draft-guidance.pdf

HMRC have also issued for public comment draft practical guidance for HMRC staff on the use of alternative dispute resolution in large or complex cases. This explains the subject matter as follows:

Traditionally tax disputes are settled either by litigation or, in the majority of cases, by out of court agreement following discussions between the two parties. The essence of ADR is that a third party is brought in with the agreement of both parties, either to determine the dispute (arbitration) or to facilitate bilateral agreement (as an expert, or through mediation).

Various forms of ADR are used in commercial disputes and by a number of overseas tax authorities. In HMRC, and in this guidance, when we talk about ADR we are generally talking about mediation rather than arbitration. HMRC sees little benefit in using arbitration for tax disputes since there is already clear jurisdiction and a publicly available process in the form of the Tribunal Service and the Courts.

http://www.hmrc.gov.uk/practitioners/adr-draft-guidance.pdf

6.9.5 Another compliance check factsheet

HMRC have issued a version of their background information factsheet on compliance checks which is specifically aimed at large businesses. This specific focus is explained as follows:

Extensive consultation with our Large Business customers identified four key themes that they told us would help build a more transparent and trusting relationship with HMRC:

- *a proportionate use of resources in addressing tax risks*
- *speedier resolution of issues*
- *greater and earlier certainty*
- *effective consultation and dialogue.*

To deliver these themes, our preferred approach is to:

- *be open and transparent in our interactions with you*
- *expect that you will interact openly and transparently with us*
- *work together with you to explore tax risks we, or you, identify*
- *explore those risks with you by dialogue, rather than using formal powers in the first instance.*

The document goes on to discuss HMRC's use of information powers, what the approach will mean in practice for large businesses, and the disclosure of information to HMRC.

A "large" business for this purpose is one defined as such by the European Union – one having more than 250 employees, or turnover exceeding €50 million and balance sheet asset value exceeding €43 million.

CC/FS1(LB)

6.9.6 Security

The principal partner in a firm of solicitors established a company to supply services to the firm – staff, office equipment, computers etc. The company pays for these items and periodically recharges them to the firm. A predecessor company which had served the same purpose went into liquidation in 2010 owing over £300,000 in VAT. Not surprisingly, HMRC issued a notice requiring a deposit of security on this new company; also unsurprisingly, an appeal against the notice failed. The solicitor argued that the previous company had been forced into liquidation by the intransigence of HMRC when he could have rescued it, but the Tribunal confirmed that its jurisdiction over security requirements is limited, and it could not be said that the notice was unreasonably issued.

First Tier Tribunal (TC01313): *Wilsons Solicitors (1991) Ltd*

6.9.7 Civil disorder

HMRC announced a helpline (0845 366 1207) for businesses and individuals adversely affected by the recent civil disorder.

The dedicated helpline is available to provide comprehensive advice and deal sympathetically with problems currently faced by businesses and individuals. In particular, HMRC will:

- agree payment schedules with those who are unable to pay their tax bills due to short-term financial difficulties; and
- discuss practical solutions where businesses and individuals cannot meet their other obligations to HMRC – for instance, their records have been lost or destroyed in the disturbances.

In these circumstances, and whenever possible, HMRC will review any penalties imposed and withhold additional surcharges that would normally be triggered by missed deadlines.

NAT 76/11

6.9.8 Civil investigation of fraud

HMRC have published an updated Code of Practice 9 which sets out their practice in cases of suspected serious tax fraud from 1 August 2011. In its introduction, it explains:

HMRC will investigate any situation where they suspect serious tax fraud. The investigation will be undertaken with or without your voluntary co-operation. If you do co-operate, the investigation will proceed more quickly, efficiently and advantageously for both parties than if you refuse to co-operate. This Code of Practice is designed to help you make an informed decision on co-operation by telling you how HMRC carry out such investigations and how, through full co-operation and disclosure of irregularities, you may achieve a significant reduction in any penalty found to be due and avoid other unwelcome consequences, for example insolvency and the publication of your name.

The document sets out a number of important policies, including the likelihood of a criminal prosecution, and includes in an appendix the "four questions" which will be put to a trader who is under suspicion of VAT fraud:

Question 1

Have any transactions been omitted from, or incorrectly recorded, in the books and records of any business with which you are or have been concerned, whether as director or managing officer, sole trader or partner?

Question 2

Are the books and records you are required to keep by HMRC for any business with which you are or have been concerned, whether as director or managing officer, sole trader or partner, correct and complete to the best of your knowledge and belief?

Question 3

Are all the VAT returns of any business with which you are or have been concerned, whether as director or managing officer, sole trader or partner correct and complete to the best of your knowledge and belief?

Question 4

Were you aware that any of the VAT returns were incorrect or incomplete at the time they were submitted?

False statements may result in a criminal investigation with a view to prosecution.

COP 9

6.9.9 Fraud procedures

HMRC have issued a discussion document proposing a facility where the Department would offer those suspected of tax fraud the opportunity to enter into contracts to disclose the frauds in return for certainty that HMRC would not carry out criminal investigations. HMRC would be able to terminate the contracts and short circuit the process for taxpayers who refused to co-operate, and taxpayers would be able to make spontaneous offers to HMRC to enter contracts to disclose. Comments are invited by 20 September 2011.

The proposal is summarised under the following policy objective:

1.13 The aim of changing our operational approach in cases where we suspect fraud but consider that the best approach would be a civil rather than a criminal investigation would be to:

1. Encourage those who have committed tax fraud to make a full disclosure of irregularities by giving a clear message that full disclosure will not result in prosecution; and

2. Deter non disclosure or partial disclosure by improving the ability to prosecute for fraud following non disclosure or partial disclosures.

1.14 The proposed contract will also have a preset time for making the outline disclosure which will speed up the working of the case for HMRC and the taxpayer.

1.15 Those who want the contract and co-operate within its terms will be given better certainty. At present HMRC is bound by the Charter but we will also be bound by the contract up to the point of disclosure and will be expected to work within an agreed framework. Finally taxpayers who disclose and co-operate with the contract will see reduced penalties as they will be entitled to penalty reductions for disclosure and co-operation.

http://tinyurl.com/3wftndw

HMRC have updated their online manual on *VAT Fraud* to include new sections dealing with irrecoverable acquisition tax and with box breaking (the purchase of handsets which are locked into a particular network and which are then adapted so they can be used on other networks).

http://www.hmrc.gov.uk/manuals/vatfmanual/vatf44000.htm

6.9.10 End of the Scott Undertaking

Following the collapse of the Matrix Churchill case on illegal export of weapons in 1992, Sir Richard Scott led an inquiry into what went wrong. One of the conclusions was that covert inquiries by HM Customs & Excise, under the disguise of a VAT control visit, amounted to unlawful trespassing and therefore undermined the prosecution. Following this

finding, HMRC (as they now are) agreed not to undertake covert operations of this type.

Since then other legislation has been introduced to provide protection for people subject to prosecution (in particular the Police Act 1997 and the Regulation of Investigatory Powers Act 2000). The government has decided that the "Scott Undertaking" was preventing the use of valid investigative techniques that would comply with the newer laws. It has therefore been withdrawn with effect from 5 September 2011.

http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110905/wmstext/110905m0001.htm

6.9.11 Joint and several liability

HMRC have issued a new online manual on *Joint and several liability*. covers HMRC's ability to recover one trader's deliberately unpaid output tax from another trader, but only when that other trader is in the same supply chain and subject to certain conditions. It stems from measures introduced in the April 2003 Budget to combat VAT fraud, and relates to Notice 726.

www.hmrc.gov.uk/manuals/jslmanual/jsl1000.htm

6.9.12 Tax avoidance schemes

HMRC have issued a consolidated version of their guidance on the disclosure of tax avoidance schemes (DOTAS) legislation. The parts that specify the form and manner for providing specified information have the force of law. HMRC warn that the remainder is not a substitute for the relevant legislation. Whilst taxpayers can rely on it as an accurate explanation of how HMRC will apply the legislation, it does not cover every possible issue that may arise.

The guidance summarises what has changed and gives a long list of the primary, secondary and tertiary legislation which applies to this convoluted area of law.

http://www.hmrc.gov.uk/aiu/guidance.htm

6.9.13 Director's liability

A company claimed input tax which it had paid on purchases of liquor and tobacco. HMRC refused the claims on the basis that the suppliers were missing traders. The losses were enough to force the company into liquidation. The liquidators claimed against one of the directors, arguing that he had caused the company to enter into the fraudulent trades and was therefore responsible for the company's loss. The High Court agreed that the trades were not genuine and the director was responsible for the losses.

High Court: *Payless Cash and Carry Ltd (in liquidation) v Patel and others*